ACCA FINAL ASSESSMENT

Advanced Audit & Assurance

December 2011

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Kaplan Publishing/Kaplan Financial

Paper P7 (INT/UK)

KAPLAN PUBLISHING

BOTH questions are compulsory and MUST be attempted

1 You are a senior manager at Wayne & Co, a firm of chartered certified accountants. The firm has recently been appointed as auditor of Stagecoach Inc, a manufacturer of components for long distance haulage vehicles, coaches and buses and you are to take the role of audit manager.

You are currently planning the audit of the financial statements for the year ended 31 August 2010. The draft financial statements show revenue of $62.5 million (2009 – $51.5 million), profit before tax of $2.8 million (2009 – $2.6 million) and total assets of $48 million (2009 – $45 million).

Stagecoach have a number of clients, however 60% of all sales revenue comes from four large multinational companies. These companies tend to place infrequent but significant orders. Due to one instance where a customer pulled out of a large order halfway through production Stagecoach requests 35% part payment upon order as deposit. The remaining 65% falls due for payment 60 days after acknowledgement of receipt of the goods by the customer. This happens when the components have passed through customer's quality control procedures, which on average takes a fortnight.

Following enquiries of the financial controller, Mr John Ford, you discover that one of the four key customers, Yellow Ribbon Travel, are withholding the $0.6mn second payment due on completion of an order. Apparently their quality controls have concluded that the goods received are not satisfactory and they are waiting for Stagecoach to take corrective action before they release any payment.

The year-end finished goods inventory count was held over the weekend of the 15–16 August 2010 and then a 'roll-forward' to 31 August 2010 was performed. Finished goods are valued at $0.8mn at the year-end. Work in progress is valued at $1.3 million at the same date. The production manager has to estimate the stage of completion of all work in progress at the year-end

During the year Stagecoach switched the supply of one of their key components to a company called Rio Grande, in Mexico. At the year-end there is a trade payable of $0.9mn million owing to Rio Grande recorded within current liabilities.

The company operates a defined benefit pension scheme. The year-end pension assets and liabilities are valued by the company's actuaries, O'Hara LLP. According to Mr Ford all relevant pension costs and interest adjustments have been accounted for within expenses. This includes a $200,000 actuarial gain, which has been recognised in full during the year.

All components are supplied carrying a three year warranty. The provision is recognised on the balance sheet at $1.7 million (2009 – $1.8 million). The MD, Henry Thursday, estimates the cost of repairing/replacing defective components reported by customers, and his estimate forms the basis of the provision.

Another major customer, Quiet Coach Tours, communicated with Stagecoach in July 2010, via its lawyers, claiming damages due to an accident. One of their drivers lost control of a coach during an old age pensioners' trip to Weston-Super-Mere. A number of tourists were injured, including one lady who broke her hip. Quiet Coach Tours are claiming costs for all the refunds they made, the damages they will have to pay out to the injured parties and for loss of reputation and business as a result of the accident.

Henry Thursday has told you that the claim has little chance of succeeding because Quiet Coach Tours cannot currently prove that the accident was due to a faulty component supplied by Stagecoach. They are therefore ignoring the claim. Consequent to the accident Quiet Coach Tours have not placed any further orders.

During discussions with Henry Thursday, who also happens to be a 51% shareholder in Stagecoach, you realise that his wife, Mrs Jane Thursday, is the majority shareholder of a company called Apache Commercial Properties, which leases a head office to Stagecoach.

Required:

(a) Using the information provided, identify and explain the principal audit risks, and any other matters to be considered when planning the final audit for Stagecoach Co for the year ended 31 August 2010.

Note: your answer should be presented in the format of briefing notes to be used at a planning meeting.

Requirement (a) includes 2 professional marks. (15 marks)

(b) Describe the principal procedures to be performed during the audit in respect of the actuarial gain included in expenses for the year ended 31 August 2010. (6 marks)

(c) Explain the purpose of the changes to International Standards of Auditing following the implementation of the IAASB's 'Clarity Project.' Your answer should provide examples of the key changes made to auditing standards. (7 marks)

(d) Discuss what practical impact the 'Clarity Project' will have on firms of chartered certified accountants. (4 marks)

(Total: 32 marks)

2 You are a senior manager at Borthwick LLP, a firm of chartered certified accountants. You have been approached by Phil Vickery, the finance director of a company called Stayburys, with regard to providing advice on a potential acquisition of a target company called Nutto.

Stayburys, a limited liability company, is a major food retailer. Further to the recent success of its national supermarkets in the UK it has extended its operations throughout Europe and, most recently, Asia. It is now experiencing rapid growth in both markets.

You recently attended a meeting with Mr Vickery during which you ascertained the following information.

Nutto provides training in management, communications and marketing to a wide range of corporate clients, including multi-nationals. The 'Nutto' name is well regarded in its areas of expertise. Nutto is currently wholly-owned by The Barrier Corporation, an international publisher of management texts, whose shares are quoted on a recognised stock exchange. Nutto has a national and an international presence in the training market.

The National business comprises ten training centres. The audited financial statements of this geographic segment show revenues of $20 million and profit before taxation of $2.7 million for the year to 31 December 2010. Most of the National business' premises are owned but some are held on a long lease basis. Trainers in the National business are all employed on a full-time basis.

The International business has seven training centres across Europe and Asia. For these segments, revenue amounted to $9.4 million and profit before tax $3.3 million for the year to 31 December 2010. Most of the International business' premises are held on operating leases. International trade receivables at 31 December 2010 amounted to $3.6 million. Although the international centres employ some full-time trainers, the majority of trainers provide their services as freelance consultants.

Required:

(a) Define 'due diligence' and describe the purpose of a due diligence review. (2 marks)

(b) Discuss the difference between an assignment to provide due diligence services and a statutory year-end audit. (5 marks)

(c) Identify and explain the matters you should consider before accepting an engagement to conduct a due diligence review of Nutto.

The mark allocation includes 2 professional marks for presentation, flow and clarity of your answer. **(15 marks)**

(d) Illustrate how the following might be used in the due diligence review of Nutto:

(i) Enquiry; and (5 marks)

(ii) Analytical procedures. (5 marks)

(Total: 32 marks)

Section B – TWO questions ONLY to be attempted

3 (a) Compare and contrast the responsibilities of management, and of auditors, in relation to accounting estimates. You should include a description of the procedures used in the assessment of estimates where relevant. **(5 marks)**

(b) You are the manager responsible for the audit of Grendel, a long-established private company. Grendel sells furniture and home furnishings through retail stores and home catalogues (i.e. mail order). The draft accounts for the year ended 30 September 2010 show turnover of $72.4 million (2009 – $68.9 million), profit before taxation of $7.3 million (2009 – $6.7 million) and total assets of $18.6 million (2009 – $17.5 million).

You are currently reviewing the audit working papers for the audit of the year-ended 30 September 2010 and have identified the following issues:

In September 2010 the management board announced plans to cease offering 'home delivery' services from the end of the month. These sales amounted to $1.6 million for the year to 30 September 2010 (2009 – $1.8 million). Since the announcements all activity related to the delivery service has stopped. Delivery vehicles have been classified as non-current assets held for sale as at 30 September 2010 and measured at fair value less costs to sell, which amounted to $1 million (carrying amount, $0.5 million). **(7 marks)**

In November 2010 Grendel announced the recall and discontinuation of a range of soft furnishing products. The recall was prompted by the high level of customer returns due to claims of poor quality. For the year to 30 September 2010, the product range represented $8.1 million of revenue (2009 – $10.6 million) and $1.5 million loss before tax (2009 – $0.7 million profit before tax). The results of the discontinued operation are disclosed separately on the face of the statement of comprehensive income. **(6 marks)**

Required:

For each of the above issues:

(i) comment on the matters you should consider; and

(ii) state the audit evidence that you should expect to find,

in undertaking your review of the audit working papers and financial statements of Grendel.

Note: the mark allocation is shown against each of the issues.

(Total: 18 marks)

4 You are a senior audit manager at Hetfield LLP, a firm of chartered certified accountants. During a recent independence review of your key audit clients you identified the following situations:

(i) During the year ended 30 November 2010 your firm commenced a five-year contract to provide internal audit services to Damage Inc. Over the course of the year the internal audit team carried out a risk assessment exercise and an evaluation of the internal control systems supported by tests of control. **(6 marks)**

(ii) Lars Trujillo, the managing director and sole shareholder of Hammett, a private company, received an offer from Ulrich Enterprises, also an audit client, for the entire share capital of Hammett.

Mr Trujillo has agreed in principle to sell his shares to Ulrich Enterprises. The purchase consideration is likely to consist of an initial cash payment based on the net assets of Hammett, as at 28 February 2011, and a deferred cash payment, which is contingent on the operating profit growing by an average of 5% over the next two years.

Mr Trujillo and the management of Ulrich Enterprises have requested, independently from each other, that your firm:

- Acts as advisers in respect of the negotiations; and
- That you provide an assurance report on the calculation of the amount of the net assets at 28 February 2011. **(6 marks)**

Required:

(a) Assess the ethical and professional issues raised and recommend any actions necessary in response to the above matters.

NB: the mark allocation for each section is noted above **(12 marks)**

(b) Discuss the role and function of an audit committee. **(6 marks)**

(Total: 18 marks)

5 (a) Compare and contrast the responsibilities of management, and of auditors, in relation to the assessment of events after the reporting period (subsequent events). You should include a description of appropriate procedures, where relevant. **(7 marks)**

(b) You are a manager at Brown LLP. You are currently reviewing the working files for two audits, both with 31 July 2010 year-ends. In particular you have identified the following issues:

Balls Inc

The Chairman's report of Balls Inc states that investment property rental forms a major part of revenue. However, a note to the financial statements shows that property rental represents only 1·6% of total revenue for the year. The audit senior is satisfied that the revenue figures are correct. The audit senior has noted that an unmodified audit report should be given as the audit opinion does not extend to the other reports. **(5 marks)**

Miliband Co

Procedures on the audit of Miliband Co identified a transfer of cash from Harman Co on 30 October 2010. The audit senior documented a discussion with the FD of Miliband, who explained that Harman commenced trading on 4 August 2010, after being set up as a wholly-owned subsidiary of Miliband. The audit senior has noted that, although no other evidence has been obtained, an unmodified opinion is appropriate because the matter does not impact on the current year's financial statements. **(6 marks)**

Required:

Critically evaluate the suitability of the audit senior's proposals for the auditors' reports.

Note: the mark allocation is shown against each of the issues.

(Total: 18 marks)