

ACCA FINAL ASSESSMENT

Audit & Assurance

December 2011

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

All FIVE questions are compulsory and MUST 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.

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Paper F8 INT/UK

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ALL FIVE questions are compulsory and MUST be attempted

- 1 You are responsible for the audit of the property, plant and equipment of Bevs, a company engaged in the manufacture and supply of soft drinks and other beverages to the retail, catering and leisure industries. The accountant has provided you with the following schedule summarising the movements in tangible non-current assets during the year ended 31 October 2010.

	<i>Freehold land and buildings</i>	<i>Plant and equipment</i>	<i>Asset in course of construction</i>	<i>Total</i>
	\$000	\$000	\$000	\$000
Cost				
At 1 Nov 2009	3,733	7,282	–	11,015
Additions	384	1,412	2,040	3,836
Disposals	–	(144)	–	(144)
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 Oct 2010	4,117	8,550	2,040	14,707
Depreciation				
At 1 Nov 2009	1,019	3,289	–	4,308
Charge for year	77	870	–	947
Disposals	–	(102)	–	(102)
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 Oct 2010	1,096	4,057	–	5,153
Net Book Value				
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 Oct 2010	3,021	4,493	2,040	9,554

From your discussions with the finance director, you ascertain that a capital expenditure budget is prepared annually. Departmental managers can authorise capital expenditure up to \$5,000, as long as it is within their budget.

Board approval is required for amounts above the \$5,000 threshold. However, the managing director, who is also the major shareholder in the company, does not always adhere to this policy. He often commits the company to acquiring assets without considering how they are to be financed, leaving the finance director to arrange the borrowings.

Capital expenditure proposal forms are required to be completed but this is not always done, particularly when items are required in an emergency, and there is no formal policy in respect of obtaining quotes for major items of expenditure.

There is a property, plant and equipment register which is reconciled to the nominal ledger on a monthly basis. No other checking procedures involving the non-current asset register are undertaken.

In July 2010, the company commenced construction of a new packing line. The line is due to be completed in January 2011. Costs recorded in the property, plant and equipment register include materials, own and sub-contract labour, and overheads.

Required:

- (a) (i) List the significant deficiencies in the tangible non-current asset control system of Bevs; (4 marks)
- (ii) For each deficiency explain why it is a deficiency and state how it can be overcome. (8 marks)
- (b) List SIX substantive audit procedures that an auditor would normally carry out on the tangible non-current asset system of Bevs, explaining the reason for each procedure. (12 marks)
- (c) (i) State the aim of a test of control and of a substantive procedure;
- (ii) In respect of the non-current asset system of Bevs, state FOUR tests of control that an auditor would normally perform. (6 marks)

(Total: 30 marks)

- 2 (a) ISA 210 *Agreeing the Terms of Audit Engagements* provides guidance for auditors when accepting and continuing audit engagements.

Required:

Identify and explain the purpose of the typical contents of an audit engagement letter, as indicated by ISA 210. (5 marks)

- (b) ISA 260 *Communication with Those Charged with Governance* establishes the typical matters to be communicated with the highest levels of management.

Required:

Identify and explain the typical 'matters to be communicated' as disclosed in ISA 260. (5 marks)

(Total: 10 marks)

- 3 You have been presented with the following draft financial information about Hivex, a very successful company that develops and licenses specialist computer software and hardware. Its non-current assets mainly consist of property, computer hardware and investments, and there have been additions to these during the year. The company is experiencing increasing competition from rival companies, most of which specialise in hardware or software, but not both. There is pressure to advertise and to cut prices.

You are the audit manager. You are planning the audit and you are conducting a preliminary analytical review and associated risk analysis for this client for the year ended 30 September 2010. You have been provided with a summarised draft statement of comprehensive income and statement of financial position extracts, which have been produced very quickly to facilitate the review. You have been informed that the company accounts for research and development costs in accordance with IAS 38 *Intangible Assets*.

Statement of Comprehensive Income

	<i>Year ended</i>	
	<i>30 September</i>	
	<i>2010</i>	<i>2009</i>
	\$000	\$000
<i>Revenue</i>	15,206	13,524
Cost of sales	3,009	3,007
	_____	_____
<i>Gross profit</i>	12,197	10,517
Distribution costs	3,006	1,996
Administrative expenses	994	1,768
Selling expenses	3,002	274
	_____	_____
<i>Profit from operations</i>	5,195	6,479
Net interest receivable	995	395
	_____	_____
Profit before tax	6,190	6,874
Corporation tax	3,104	1,452
	_____	_____
<i>Net profit</i>	3,086	5,422
Dividends paid	1,469	1,439
	_____	_____
<i>Retained profits</i>	1,617	3,983
	_____	_____

Statement of Financial Position Extracts

	\$000	\$000
Property, plant and equipment assets	2,500	1,900
Intangible assets	1,100	650
Cash assets	1,375	850
Receivables	2,500	1,480
Payables	1,000	500
8% Loan – repayable June 2011	2,250	2,250

Required:

- (a) State what is meant by the term 'materiality' and discuss how this affects an audit of historical financial information. In relation to Hivex, identify and explain an appropriate measure for materiality that could be used during the audit. (5 marks)
- (b) Identify and explain the areas of Hivex's audit that are subject to increased or significant audit risk. For each risk identified recommend an audit procedure to be performed in response to the risk. (15 marks)

(Total: 20 marks)

- 4 (a)** Explain what is meant by the term ‘value for money’ indicators and discuss how these can be used in the audit of a not-for-profit organisation. **(6 marks)**

You are an audit senior at Midway & Co. You have been asked to assist with the planning of the year-end audit of Homes4All, a charity whose main aim is to find homes for disadvantaged minors.

Homes4All has a detailed constitution which explains exactly how the charity’s income can be spent. It also provides guidance on how expenses can be incurred, including a maximum of 5% of income for the year on staff salaries and wages and a further 5% maximum to be spent on other administration costs.

Income is derived wholly from voluntary donations, the sources of which include:

- Cash collected during fundraising events;
- Cash collected by volunteers on public streets asking for donations;
- Cheques sent to the charity’s head office,
- Direct debits from members of the public who wish to make regular contributions; and
- Lump sum donations from individuals, often as part of their last will and testament. These donations often have specific clauses, such as: the initial amount donated cannot be spent but must be invested and the interest income is to be spent; others have clauses prioritising who the money should be spent on (young mothers, orphans etc).

The rules regarding the taxation of charities in the country Homes4All is based in are complicated. Only certain expenditure is allowable for tax deduction purposes and donations of capital are treated as income in certain circumstances.

Required:

- (b) Identify the inherent risks facing Homes4All and explain the effect of each of these risks on the audit approach. (10 marks)**

- (c) Discuss where the control deficiencies at Homes4All are likely to be. (4 marks)**

(Total: 20 marks)

- 5 (a)** Discuss the difference between reasonable and limited assurance? **(5 marks)**

Described below are situations which have arisen in three audits. The year-end in each case is 31 March 2010.

Mercury

On 21 March 2010, the tax authorities commenced a major enquiry into all aspects of the tax affairs of the company. Until the enquiry is completed it is not possible to estimate, with any reasonable degree of certainty, the ultimate liability which may fall upon the company. Consequently, no liability in respect of this matter has been included in the financial statements. The directors have included a note to the accounts explaining the situation.

Pluto

Included in the statement of financial position at 31 March 2010 are non-current assets at cost of \$2.5 million which have been constructed by the company during the year. The costs include own labour capitalised of \$180,000. The labour costs are based on the directors' estimates of time spent by employees on the construction work, which are unsupported by time records. There are no satisfactory audit procedures to confirm that labour costs have been appropriately capitalised.

The pre-tax profit of Pluto for the year ended 31 March 2010 is \$650,000.

Neptune

In January 2010, the company received a government cash grant of \$1.6 million in respect of assistance with the acquisition of tangible non-current assets which have estimated useful economic lives of between five and ten years. The \$1.6 million has been credited directly to the income statement for the year ended 31 March 2010. The directors insist on continuing with this treatment despite having been informed that this is not in accordance with the relevant accounting standard, which requires such grants to be credited to the income statement over the useful economic lives of the assets to which the grant relates.

The pre-tax profit of Neptune for the year ended 31 March 2010 is \$950,000.

Required:

- (b) In respect of each of the situations outlined above, discuss whether or not you would modify your audit report. Explain the reasons for your conclusion, and state the effect on your audit report.**

NB: the marks are split evenly between the three requirements. (15 marks)

(Total: 20 marks)

