

Fundamentals Level – Skills Module

# Audit and Assurance (International)

Wednesday 9 December 2009

**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.**

The Association of Chartered Certified Accountants

Paper F8 (INT)

**ACCA**

**ALL FIVE questions are compulsory and MUST be attempted**

- 1 (a) Explain the importance of audit planning and state TWO matters that would be included in an audit plan.** (6 marks)

Redburn Co, a publisher and producer of books of poetry, has been a client of your firm of Chartered Certified Accountants for a number of years. The manager in overall charge of the audit has been discussing the audit plan with the audit team, of which you are a member, prior to commencement of the work. The audit manager has informed the team, among other things, that there has been a growing interest in poetry generally and that the company has acquired a reputation for publishing poets who are still relatively unknown.

During your audit you determine:

- (i) Contracts with the poets state that they are given a royalty of 10% on sales. Free copies of the books are provided to the poets and to some organisations such as copyright libraries and to others, such as reviewers and university lecturers. No royalties are given on these free copies.
- (ii) The computerised customer master file contains a code indicating whether a despatch is to earn a royalty for the author. This code is shown on the sales invoice and despatch note when they are prepared.
- (iii) A computerised royalties file is held, all entries therein bearing the invoice number and date.
- (iv) The company keeps detailed statistics of sales made, including trends of monthly sales by type of customer, and of colleges where its books are recommended as part of course material, based on reports from sales staff.
- (v) Bookshops have the right to return books which are not selling well, but about 10% of these are slightly damaged when returned. The company keeps similar records of returns as it does for sales.

**Required:**

- (b) Describe TWO procedures used to ensure that the sales statistics kept by the company may be relied upon.** (4 marks)
- (c) Describe THREE substantive tests you should perform to ensure that the royalties charge is accurate and complete, stating the objective of each test.** (6 marks)
- (d)** A material figure in the statement of financial position of Redburn Co is the amount attributed to inventory of books.

**Required:**

**State TWO inherent risks that may affect the inventory figure and suggest ONE control to mitigate each risk.** (4 marks)

- (e)** The management of Redburn Co have told you that inventory is correctly valued at the lower of cost and net realisable value. **You have already satisfied yourself that cost is correctly determined.**

**Required:**

- (i) Define net realisable value;** (2 marks)
- (ii) State and explain the purpose of FOUR procedures that you should use to ensure that net realisable value of the inventory is at or above cost.** (8 marks)

**(30 marks)**

2 (a) ISA 500 *Audit Evidence* requires audit evidence to be reliable.

**Required:**

**List FOUR factors that influence the reliability of audit evidence.**

(4 marks)

(b) ISA 260 (Revised and Redrafted) *Communication with Those Charged with Governance* deals with the auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements.

**Required:**

(i) **Describe TWO specific responsibilities of those charged with governance;**

(2 marks)

(ii) **Explain FOUR examples of matters that might be communicated to them by the auditor.**

(4 marks)

**(10 marks)**

- 3 ISA 315 (Redrafted) *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment* requires auditors to obtain an understanding of the entity and its environment, including its internal control.

**Required:**

- (a) Explain why obtaining an understanding of the entity and its environment is important for the auditor.**

(4 marks)

Letham Co is a large engineering company with ten manufacturing units throughout the country in which it is located. The manufacturing process is capital intensive and the company holds a wide variety of plant and equipment.

The finance director is responsible for the preparation of a detailed non-current assets budget annually, which is based on a five-year budget approved by the whole board of directors after consultation with the audit committee. This annual budget, which is also approved by the full board, is held on computer file and is the authority for the issue of a purchase order.

When the item of plant and equipment is delivered to the company, a pre-numbered goods received note (GRN) is prepared, a copy of which is sent to the accounting department, and used to update the non-current assets budget to reflect the movement. The equipment is carefully inspected by production personnel and tested for proper operation. An operational certificate is prepared by the production department and this is used by the accounting department, together with the GRN, to check against the purchase invoice when it is received.

At the same time as the purchase invoice enters the purchasing system, a computerised non-current assets register is updated. Access to the non-current assets register is restricted to personnel in the accounting department. On a rolling basis throughout the year the non-current assets register is compared to plant and equipment on site by accounting department personnel, using identification numbers in the register and permanently marked onto each item in the factory.

The internal audit department also tests on a sample basis the operation of the system from budget preparation to entry in the non-current assets register. Internal audit staff also compare a sample of entries in the non-current assets register with equipment on the shop floor.

**Required:**

- (b) Identify SIX STRENGTHS in Letham's control environment in respect of non-current assets and explain why they may reduce control risk.**

(12 marks)

- (c) As part of your work as external auditor you are reviewing the non-current assets audit programme of the internal auditors and notice that the basis of their testing is a representative sample of purchase invoices. They use this to test entries in the non-current assets register and the updating movements on the annual budget.**

**Required:**

- (i) Explain why this is not a good test for completeness;**  
**(ii) State a more appropriate test to prove completeness of the non-current assets records, including the non-current assets register.**

(4 marks)

**(20 marks)**

**4 (a) Explain the difference between the interim audit and the final audit.**

(4 marks)

You are the senior in charge of the audit of Brampton Co for the year ending 31 January 2010 and are currently planning the year-end audit. Brampton specialises in the production of high quality bread of various kinds.

During the interim audit you noted that, in the present economic down-turn, the company has suffered as its costs are increasing and its prices have been higher than its competitors because of lower production runs. One indicator of the problems facing the company is that it has consistently used a bank overdraft facility to finance its activities.

At the time of the interim audit you had discussed with company management what actions were being taken to improve the liquidity of the company and you were informed that the company plans to expand its facilities for producing white bread as this line had maintained its market share. The company has asked its bank for a loan to finance the expansion and also to maintain its working capital generally.

To support its request for a loan, the company has prepared a cash flow forecast for the two years from the end of the reporting period and the internal audit department has reported on the forecast to the board of directors. However, the bank has said it would like a report from the external auditors to confirm the accuracy of the forecast. Following this request the company has asked you to examine the cash flow forecast and then to report to the bank.

**Required:**

**(b) Explain whether you would be able to rely on the work of the internal auditors.**

(6 marks)

**(c) Describe THREE procedures you would adopt in your examination of the cash flow forecast.**

(6 marks)

**(d) Explain the kind of assurance you could give in the context of the request by the bank.**

(4 marks)

**(20 marks)**

- 5 (a) Identify and explain FOUR assertions relevant to accounts payable at the year-end date.** (6 marks)

You are the audit senior responsible for the audit of Have A Bite Co, a company that runs a chain of fast food restaurants. You are aware that a major risk of their sector is that poor food quality might result in damage claims by customers.

You had satisfied yourself at the interim audit that the company's control risk as regards purchases of food and its preparation in the kitchen was low. However, during your final audit it comes to your attention that one month before the year-end, a customer has sued the company for personal injury caused by food poisoning, claiming an amount of \$200,000 in compensation. This amount is material to the stated profit of the company, but management believes that it has good defences against the claim.

**Required:**

- (b) (i) State TWO controls that the company should have in place to reduce the risk associated with purchases of food and its preparation in the kitchen; and**  
**(ii) State TWO audit procedures you should carry out during controls testing to satisfy yourself that control risk in this area is low.** (4 marks)
- (c) In respect of the potential claim state THREE items of evidence you should obtain and explain how they might enable you to form a conclusion on the likelihood of the claim being successful.** (6 marks)

Following your audit you have concluded that there is a possibility, but not a probability, that the claim will be successful. However, management have decided not to make a provision or disclosure in the financial statements in respect of this matter.

**Required:**

- (d) Describe how the matter should be reported in the financial statements and explain the effect on your audit report.** (4 marks)

**(20 marks)**

**End of Question Paper**