AUDIT AND ASSURANCE/FINANCIAL REPORTING

AAT Fast-track examination

11 December 2006

From 10.00am to 12.00noon
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

*Answer **three** questions in total:*
One** compulsory question from **Section A
Two** of the three questions from **Section B

The question in Section A carries, in total, 30 marks
The questions in Section B each carry a total of 35 marks

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

A Proforma booklet, graph paper and cash analysis paper are available from the invigilator.

Candidates may use the proforma sheets provided and submit them as part of their answer.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

AT THE HEART OF
YOUR CAREER

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SECTION A – (Compulsory)

1 The firm of accountants for which you work, Walker, Harrison and Wilding, have recently taken on a new manager, Mrs Lloyd.

Mrs Lloyd has previously worked as a financial controller within a large company, but now wishes to pursue her career in a professional firm. Walker, Harrison and Wilding specialise mainly in public sector auditing and so Mrs Lloyd must be trained in this area.

You are a CIPFA-qualified member of staff and have been asked by one of the firm's partners to provide a training package for Mrs Lloyd, which incorporates key messages about public sector auditing as well as providing some insight into internal auditing and risk management. You need to begin by composing the answers to some specific questions put to you by the partner overseeing Mrs Lloyd's introduction to the firm.

- **Requirement for question 1**

(a) Explain briefly which organisations provide external audit of the financial statements for each of the following parts of the public sector and explain who controls their appointment as external auditors

(i) Local Authorities and the NHS in England
(ii) Universities in the United Kingdom
(iii) Central Government Departments *6*

(b) Explain in outline the key human resources issues for an organisation establishing an internal audit unit. *6*

(c) Detail what controls you would expect to see over the tendering process when contracts are let by a public service body. *9*

(d) Identify and briefly describe the six approaches to Control (Risk) Self Assessment (CRSA), which internal audit or management might employ. Explain the factors which influence the success of a CRSA process. *9*

(30)

Section B – (Answer two question from this section)

2 The following balances have been extracted from the accounts of Karactus plc as at 31 October 2006, the end of its most recent financial year:

	Notes	£m
Sales		266
Purchases		188
Stock, 1 November 2005	*1*	21
Administrative expenses		17
Distribution costs		14
Dividends paid		10
Other operating income		11
Corporation tax	*6*	6
Fixed asset investments		24
Investment income		8
Interest payable		2
Freehold properties, at cost	*2*	
Land		4
Buildings		40
Equipment, at cost	*2, 3*	53
Investment property, at valuation	*2*	22
Accumulated depreciation		
Buildings	*4*	13
Equipment	*4*	18
Proceeds of sale of assets	*3*	7
Trade debtors		33
Trade creditors		16
Allowance for doubtful debts, 1 November 2005	*5*	3
Cash at bank and in hand		23
7.5% Debenture		15
Issued share capital	*7*	40
Share premium account	*7*	6
Revaluation reserve		10
Deferred taxation		9
Profit and loss account, 1 November 2005		35

The following additional information is available:

1 It has recently been discovered that stock as at 1 November 2005 was overstated by £3m because of an error. Stock as at 31 October 2006 was valued at £23m.

2 The costs or valuations of tangible fixed assets as at 1 November 2005 were:

	£m
Land, at cost	1
Buildings, at cost	32
Equipment, at cost	44
Investment property, at valuation	18

3 During the financial year ended 31 October 2006 equipment with a carrying value of £3m (original cost £15m) was sold for £7m. The proceeds were credited to proceeds of sale of assets account and debited to bank but no other entries have been made.

4 Depreciation for the year ended 31 October 2006 has been calculated as follows:

	£m
Land	nil
Buildings	4
Equipment	8

Depreciation should be allocated 50% to cost of sales, 25% to administrative expenses and 25% to distribution costs.

5 The allowance for doubtful debts is to be increased by £2m.

6 The balance on the corporation tax account represents an underprovision for corporation tax for the financial year ended 31 October 2005. The corporation tax charge for the year ended 31 October 2006 has been estimated at £11m. The balance on the deferred tax account is to be increased by £5m.

7 The share capital of Karactus plc consists of ordinary shares of 50 pence. During the year ended 31 October 2006 Karactus plc used the share premium account to make a 1 for 4 bonus issue of shares. This was correctly recorded in the amounts.

- **Requirement for question 2**

(a) Prepare, in tabular format, the disclosure note showing movements in tangible fixed assets for the year ended 31 October 2006. *8*

(b) Prepare Karactus plc's profit and loss account for the year ended 31 October 2006 in a form suitable for publication.

Note
- Include a figure for earnings per share calculated and disclosed in accordance with FRS 22 (a supportive disclosure note is required).
- Additional notes and disclosures are not required.
- All figures, other than earnings per share, should be rounded to the nearest £m.
- You are **not** required to prepare a balance sheet.

20

(c) Prepare, in tabular format, a suitable disclosure note showing movements in share capital and reserves for the year ended 31 October 2006.

7

(35)

3

(a) Keeno plc is working on a long term contract. Work on the contract commenced during the financial year ended 31 October 2005. The following information is available as at 31 October 2006:

	£000
Contract value	980
Value of work invoiced	420
Payments received	400
Costs to date	750
Estimated future costs to complete	350
Certified value of work completed	580

In its profit and loss account for the year ended 31 October 2005 Keeno plc recognised turnover of £100,000 and a profit of £40,000 on this contract.

Keeno plc uses a revenue approach to calculate the percentage of work completed to date. Revenue is to be based on the work certified in accordance with independent surveyors' certificates.

Cost of sales is to be calculated as the difference between turnover and attributable profit. All invoices issued to the contractee are expected to be collected and no allowance is necessary for doubtful debts.

- **Requirement for question 3 (a)**

Calculate the figures for this contract that will be reported in Keeno plc's financial statements for the year ended 31 October 2006 for:

(i) Turnover
(ii) Cost of sales
(iii) Profit or loss
(iv) Work in progress
(v) Amounts recoverable on contracts
(vi) Trade debtors *12*

(b) The following information has been taken from the accounts of Joz plc:

	As at 1 November 2005	As at 31 October 2006
	£	£
Stock	66,400	70,400
Debtors	240,600	221,000
Prepaid expenses	32,800	8,500
Trade creditors	186,530	246,000
Accrued wages and salaries	21,300	34,600

	£
Sales for the year ended 31 October 2006	16,750,000
Cost of sales for the year ended 31 October 2006	13,400,000
Operating expenses for the year ended 31 October 2006	2,160,768

Operating expenses include discounts allowed of £20,400, wages and salaries of £955,000 and depreciation of £484,668.

- **Requirement for question 3 (b)**

Calculate Joz plc's cash flow from operations using the direct method. Ignore VAT. *14*

(c) The following ratios have been calculated from the financial statements of Lynox plc:

	Year ended 31 October 2005	Year ended 31 October 2006
(i) Gross profit %	50%	38%
(ii) Net profit %	10%	4%
(iii) Stock turnover rate (times per year)	8.3	5.6

- **Requirement for question 3 (c)**

For each ratio describe two ways in which Lynox plc could improve the ratio for the year ending 31 October 2007. *9*

(35)

4

(a) Easton plc operates through three divisions:

- Hi-Fi
- Musical instruments
- Furniture

The following information about the turnover, results and net assets of the three divisions and Easton plc's head office is available for the financial year ended 31 October 2006:

	£m
Hi-Fi Division	
UK sales	214
Export sales to Asia	368
Export sales to Africa	105
	687
Musical instruments	
Sales to Hi-Fi division	28
Export sales to Africa	207
	235
Furniture	
Sales to Hi-Fi division	49
Export sales to Africa	161
	210

	Head office	*Hi-Fi Division*	*Musical instruments*	*Furniture*
		£m	£m	£m
Operating profit/(loss) before tax		155	22	(16)
Re-allocated costs:				
Head Office		44	26	19
Interest costs		5	6	2
	£m			
Fixed assets	51	198	38	106
Net current assets	46	105	43	96
Long-term liabilities	25	20	9	120
Provisions for liabilities	2	22	11	8

- **Requirement for question 4 (a)**

Prepare a segmental report in accordance with SSAP 25 for inclusion in the published financial statements of Easton plc for the financial year ended 31 October 2006. *29*

(b) Weston plc purchased a DVD duplicating and printing machine costing £15,000. Delivery and installation cost a further £1,000. The expected economic life of the machine was 5 years with no residual value when the machine was purchased on 1 November 2003. Weston plc has been depreciating the machine using the straight line method.

It now appears that the estimated life of the machine was optimistic and, because of technological developments, the economic life has been revised to 2 years as from 1 November 2005. It is also now expected that the machine will have a residual value of £1,500 on 31 October 2007.

- **Requirement for question 4 (b)**

Explain how this asset should be reported in Weston plc's financial statements for the year ended 31 October 2006 illustrating your answer with appropriate figures. *6*

(35)