AUDIT AND ASSURANCE/FINANCIAL REPORTING

AAT Fast-Track examination

6 June 2007

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

Instructions to candidates
*There are **four** questions on this question paper*
*Answer **three** questions in total*
Two** compulsory questions from **Section A ***One** of the two questions from **Section B***
The questions in Section A carry, in total, 65 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.

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.

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.

FINAL DRAFT 24/07/2007 12:16

AT THE HEART OF YOUR CAREER

SECTION A (Compulsory – answer both questions)

1

You have recently been appointed as the training manager with an internal audit consortium. The consortium has a number of NHS and Higher Education clients. It is trying to break into new markets as well as to expand the range of services it supplies to its existing clients. You have been asked to provide training materials for all of its staff.

The Director of the consortium has asked to meet you to discuss a number of specific ideas he has for the consortium and the consequent training needs. All you have been given so far is a bullet point summary of the issues he wishes to raise as follows:-

- External audit in the Public Sector
- Operational Audit
- Control and Risk Management

In order to prepare for the meeting you decide to prepare a series of more detailed notes to illustrate the type of material you would be covering in the training sessions on these topics.

- **Requirement for question 1**

(a) Explain in outline the financial and value for money roles of the Audit Commission and the National Audit Office. *10*

(b) As an illustration of how audit might become involved in an operational system, detail the main risks and controls which audit might review in a print unit. *10*

(c) Explain the main recommendations of the Turnbull report and the steps being taken to translate its recommendations to the public sector. *10*

(30)

2

The most recent financial year of Molitor plc ended on 31 May 2007 and the following is the company's trial balance as at that date.

	Notes	Dr	Cr
		£m	**£m**
Revenue			246
Purchases		155	
Inventory as at 1 June 2006	*1*	37	
Operating expenses		49	
Dividends paid		13	
Other operating income			13
Under-provision for corporation tax for 2005/2006	*4*	8	
Non-current investments		21	
Investment income			5
Net finance charge		3	
Property, at cost			
Land		11	
Buildings		24	
Equipment, at cost		38	
Investment property, at valuation	*6*	12	
Accumulated depreciation, 1 June 2006			
Buildings	*2*		7
Equipment	*2*		18
Trade receivables		25	
Trade payables			16
Allowance for doubtful debts, 1 June 2006	*3*		5
Cash and cash equivalents		24	
9% Loan notes			18
Issued share capital (ordinary shares of £1 each)	*5*		48
Share premium account			9
Revaluation reserve			9
Deferred taxation	*4*		12
Retained earnings, 1 June 2006			14
		420	420

The following additional information is available:

(1) Closing inventory was valued at £38m. However it was not possible to value the inventory until 5 June 2007. The following transactions took place between 31 May 2007 and 5 June 2007:

	£m
Purchases	14
Sales	10
Returns outwards	3

The sales were made at an average mark-up of 25%.

(2) Depreciation for the year ended 31 May 2007 has not yet been provided for. Depreciation policies are:

Land	nil	
Buildings	5%	straight line method
Equipment	30%	reducing balance method

Depreciation is provided for on a full year basis.

Depreciation is to be allocated as follows:

Cost of sales	70%
Administrative expenses	25%
Distribution costs	5%

(3) The allowance for doubtful debts is to be reduced by £2m.

(4) A transfer of £8m is to be made to deferred taxation account. The corporation tax on profits for the year ended 31 May 2007 has been estimated at £14m.

(5) During the year ended 31 May 2007 the share premium account was used to make a bonus issue of 1 ordinary share for every 5 ordinary shares in issue. This was recorded correctly in the accounts.

(6) The value of the investment property was £9m as at 1 June 2006.

- **Requirement for question 2**

(a) Prepare a calculation of the value of inventory as at 31 May 2007. *3*

(b) Prepare a calculation of Molitor plc's gross profit for the year ended 31 May 2007.
Note: a full income statement is not required. *3*

(c) Prepare Molitor plc's balance sheet as at 31 May 2007.
Note: Retained earnings should be entered as a balancing figure. *18*

(d) Prepare the statement of changes in equity for the year ended 31 May 2007. *11*

(35)

Section B (Answer one of two questions)

3

(a) Edesch plc

Edesch plc has just completed negotiations to purchase a franchised business as a going concern. Edesch plc will purchase the property, plant and equipment, inventory and the franchise at the following agreed values:

	£
Property (10 year lease)	285,000
Franchise (10 years remaining)	188,000
Plant and equipment (10 years remaining economic life)	400,000
Inventory	12,000

The purchase consideration is £985,000.

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

(i) Calculate the amount of goodwill arising on this transaction. *2*

(ii) How should the franchise and goodwill be reported in the financial statements of Edesch plc? *6*

(iii) Would it be possible to subsequently revalue the franchise and goodwill in the accounts? Give your reasons. *6*

(iv) How would the treatment of goodwill in the accounts be different if goodwill had been negative? *3*

(b) Preece plc

Preece plc is using a machine which was purchased for £155,890 on 1 April 2001. The machine was estimated to have an economic life of 10 years with no residual value, and there has been no reason to change these estimates. The company uses the straight line method of depreciation.

It is estimated that the machine could have been sold for £93,500 on 31 March 2007, although the managing director of Preece plc feels it would be possible to sell the machine more quickly to one of the company's suppliers for £85,000. On 31 March 2007 the cost of replacing the machine with a similar new one was estimated to be £295,400. The new machine would have an identical economic life of 10 years but is considered to be 25% more productive than the machine currently owned by Preece plc.

The index of retail prices was 173 as at 1 April 2001, 193 as at 15 March 2007, and 195 as at 15 April 2007. The most recent financial year of Preece plc ended on 31 March 2007.

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

(a) Calculate values for the machine as at 31 March 2007 using:

(i) historical cost accounting
(ii) current purchasing power accounting
(iii) replacement cost accounting
(iv) net realisable value accounting *11*

(b) Define ‘fair value’ and identify which of the above valuations is closest to fair value. *3*

(c) Tribbin plc

Tribbin plc runs a chain of 69 hotels. New legislation is now in force which requires the installation of new safety equipment in all hotel bedrooms by 31 May 2007. The legislation provides for fines if the requirements of the new legislation are not met.

Tribbin plc has ignored the new legislation and has taken no steps to install the new safety equipment.

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

Explain how, if at all, this matter should be dealt with in the financial statements of Tribbin plc for the financial year ended 31 May 2007. *4*

(35)

4

(a) The following is a summary of the calculation of Calida plc's taxable profit for its financial year ended 31 May 2007:

	£
Net profit before tax reported in income statement	31,566,800
Permanent differences	533,700
Timing differences	(2,668,500)
Taxable profit	29,432,000

£2,081,430 of the timing differences is expected to reverse within the foreseeable future. The rate of corporation tax is 30% and there was a credit balance on the deferred taxation account of £974,300 as at 1 June 2006.

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

(i) Distinguish between permanent differences and temporary differences in the context of deferred tax giving an example of each. *4*

(ii) Prepare an extract from the income statement of Calida plc for the year ended 31 May 2007 showing:

- profit before tax
- income tax expense, and
- profit for the year

Your answer should show an appropriate analysis of the figure reported for income tax expense reported in accordance with IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes*. *5*

(iii) Prepare extracts from the balance sheet of Calida plc as at 31 May 2007 showing how the taxation balances would be reported. Include the appropriate headings. *4*

(b) The following ratios are sometimes used by investors:

(i) Dividend yield
(ii) Dividend cover
(iii) PE ratio

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

For *each* ratio
(i) Define how the ratio is calculated
(ii) Describe what the ratio measures
(iii) Describe how an investor should interpret the ratio *14*

(c) The following information is available about a quoted company:

Market capitalisation (£m)	507.61
Shares in issue (m)	1,460.76
Dividend yield (%)	5.04
PE ratio	49.64
Dividend cover (times)	0.4

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

  Use the above information to estimate the following:

  (i) The market price per share *2*

  (ii) Earnings per share *3*

  (iii) The dividend paid per share *3*

(35)