

AUDIT AND ASSURANCE / FINANCIAL REPORTING

AAT Fast-Track examination

6 June 2008

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

Both 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.

Proforma booklets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

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.

SECTION A (Compulsory – answer both questions)

1

The firm of Walker, Wilding and Harrison are about to admit a new partner, Mrs. Lloyd. Mrs Lloyd will be handling a portfolio of public sector clients with responsibility for both internal and external audit.

You are a newly-qualified member of staff in the firm and have been asked to assist in preparing publicity material which will both announce Mrs. Lloyd's new status at the firm and explain the range of services it offers to the public sector. You need to decide how best to explain value for money and risk assessment to potential clients. You also want to explain how internal audit work is done and have examples of how internal audit can assess operational systems.

Most of your work is done, but information gathering in certain specific areas is still required.

• **Requirement for question 1**

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|---|---|
| (a) Compare the terms Economy, Efficiency and Effectiveness and give examples of each from a system with which you are familiar. | 6 |
| (b) Discuss the resources (human and other) required for an effective internal audit service. | 8 |
| (c) Discuss some of the risk factors which should be taken into account in undertaking an operational audit of a grants payment system. | 9 |
| (d) Discuss briefly the four elements of Control Risk Self Assessment (CRSA). | 4 |
| (e) Identify the three categories of business risk. | 3 |

(30)

2

The following balances have been extracted from the accounts of Spartacus plc as at 31 May 2008, the end of the company's most recent financial year:

	<i>Note</i>	£000
Share capital	1	900
Share premium account		250
Deferred tax		35
Retained earnings, 1 June 2007		603
Revaluation reserve, 1 June 2007		95
10% Debenture		500
Sales		5,684
Inventory, 1 June 2007	2	355
Purchases		4,263
Distribution costs		625
Administrative expenses		892
Other operating income		341
Dividends paid		135
Corporation tax	3	40
Interest payable		50
Investment income		27
Non-current asset investments		42
Properties, at cost:		
Land		300
Buildings		400
Equipment, at cost	4	984
Accumulated depreciation:		
Buildings	5	88
Equipment	5	295
Investment property, fair value at 31 May 2007	6	300
Proceeds of sale of non-current assets		44
Trade receivables		711
Trade payables		355
Cash at bank and in hand		143
Allowance for doubtful debts, 1 June 2007	7	23

The following additional information is available:

- 1) The share capital of Spartacus plc consists of ordinary shares of £1.
- 2) It has just been discovered that inventory as at 1 June 2007 was understated by £17,000 because of an error. Inventory as at 31 May 2008 was valued at £391,000.

- 3) The balance on corporation tax account is a debit balance representing the difference between corporation tax provided in the 2006/2007 accounts and the amount paid in full settlement during the 2007/2008 financial year. The corporation tax charge for the year ended 31 May 2008 has been estimated at £40,000. The balance on deferred tax account is to be increased by £11,000.
- 4) During the financial year ended 31 May 2008 production equipment which cost £123,000 and had been depreciated by £98,000 was sold for £44,000. The proceeds were credited to proceeds of sale of assets account and debited to bank but no other entries have been made.
- 5) Depreciation for the year ended 31 May 2008 needs to be provided as follows:

Land: nil
Buildings: 2% on cost
Equipment: 20% on reducing balance

Depreciation should be allocated 70% to cost of sales, 15% to administrative expenses and 15% to distribution costs.
- 6) The fair value of the investment property was £350,000 as at 31 May 2008.
- 7) The allowance for doubtful debts is to be increased by £56,000.

• **Requirement for question 2**

Prepare Spartacus plc's income statement for the year ended 31 May 2008 and its balance sheet as at 31 May 2008 in a form suitable for publication.

Note

- Additional notes and disclosures are not required.
- Disclosure of earnings per share is not required.
- All figures should be rounded to the nearest £000.

(35)

SECTION B (Answer one from two questions)

3

- (a) Xyron plc entered into a finance lease on 1 June 2007 to acquire a non-current asset with a fair value of £101,492. The lease involves paying five annual rental payments of £25,640 starting on 1 June 2007. The rate of interest implicit in the lease is 13.26%. The asset is depreciated equally over its economic life of five years with no residual value.

• **Requirement for question 3 (a)**

Show how the above transactions would be reported in the income statement and balance sheet of Xyron plc for the years ended 31 May 2008 and 2009.

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- (b) The following information has been taken from the financial statements of Ybriz plc for the financial year ended 31 May 2008:

	As at 1 June 2007 £	As at 31 May 2008 £
Inventory	122,650	109,875
Trade receivables	229,870	236,870
Prepaid operating expenses	44,600	19,744
Trade payables	185,640	269,840
Accrued operating expenses	19,850	21,630

Sales revenue for the year ended 31 May 2008 totalled £10,805,060. Cost of sales for the year was £7,586,410. Operating expenses for the year were £1,897,300. Operating expenses included depreciation of £389,550 and discounts allowed of £31,200.

• **Requirement for question 3 (b)**

Calculate Ybriz plc's cash flow from operations using the direct method. Ignore VAT.

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- (c) Summarise the conditions necessary for the recognition and derecognition of an asset.

4

(35)

4

A friend of yours works for a company which has just taken over another company, Loxlee Ltd. Your friend has been supplied with the following performance indicators for Loxlee Ltd for its most recent three financial years. Your friend will shortly be meeting with his boss who wants an analysis of the past performance and future prospects for Loxlee Ltd. Your friend has asked you for help.

		Financial year		
		2005	2006	2007
1	Profit after tax to total assets	13.0%	15.4%	20.4%
2	Profit before tax to sales revenue	12.0%	12.3%	15.1%
3	Turnover to total assets (times)	1.54	1.78	1.93
4	Gross profit to sales revenue	20.0%	20.0%	22.9%
5	Administrative expenses to sales revenue	6.0%	5.3%	4.9%
6	Distribution costs to sales revenue	2.0%	2.3%	2.9%
7	Profit after tax to sales revenue	8.4%	8.7%	10.6%
8	Sales revenue to non-current assets (times)	2.00	2.40	2.80
9	Sales revenue to current assets (times)	6.76	6.82	6.25
10	Current ratio (to 1)	1.23	1.26	1.22
11	Quick/acid test ratio (to 1)	0.90	0.91	0.91
12	Inventory to cost of sales	4.0%	4.0%	4.0%
13	Trade receivables to sales revenue	8.0%	8.3%	11.4%
14	Cash to sales revenue	2.8%	2.3%	0.6%

• **Requirement for question 4**

Prepare notes for your meeting with your friend which:

- Provide a detailed analysis of the past performance of Loxlee Ltd, identifying areas of strength and weakness, in so far as the information permits.
- Make detailed recommendations as to how the performance of Loxlee Ltd could be improved in the future.

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(35)