AUDIT AND ASSURANCE/FINANCIAL REPORTING

AAT Fast-Track examination

7 June 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** question in **Section A** and **two** questions in **Section B**. The marks available for each question are shown in italics in the right hand margin.*

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

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.

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

AT THE HEART OF
YOUR CAREER

SECTION A – (Compulsory)

1

You are the internal audit manager of a central government department, which has a large fleet of vehicles.

The department's external auditors', the National Audit Office (NAO) are known to be about to review vehicle provision as part of a value for money study across government departments.

The chair of your department's Audit Committee, a Mrs Watt, has written to you as follows:

"I am concerned that the NAO will consider our vehicle management arrangements too weak. I am not sure if you have looked at them, but if so, it would be interesting to know what you found. Is there any chance that if you did a thorough review, we need not have the one from the NAO?

"Could you also please tell me exactly what your role in respect of VFM audit is anyway? How does it differ from what management and the external auditors do in respect of VFM? Could you please give me a bit of background on the issues of control risk and integrated control systems"?

- **Requirement for Question 1**

(a) (i) Describe in outline the respective roles played by an organisation's external auditors and its management in respect of its financial statements. *6*

(ii) Explain the roles played by external and internal auditors in different parts of the public sector in respect of value for money. *5*

(b) Explain the key risks involved in running a vehicle fleet and the controls you would expect to see in place to address those risks. *12*

(c) Briefly state what you understand by the initials "COSO" and describe the five components of an integrated control system according to COSO. *7*

(30)

Section B - (Answer two question form this section)

2

The following list of balances comes from the records of Wharf plc as at 31 May 2006, the end of its most recent financial year:

	Notes	£000
Sales	1	4,080
Cost of sales		3,020
Stock, at 31 May 2006	2	200
Administrative expenses		350
Distribution costs		330
Dividends paid		224
Other operating income		90
Under-provision for corporation tax for 2004/2005		20
Fixed asset investments	3	180
Investment income		30
Interest payable		43
Freehold properties, at cost		
Land	4	300
Buildings	4	400
Equipment, at cost	4	650
Accumulated depreciation, at 1 June 2005		
Buildings		60
Equipment		350
Trade debtors		510
Trade creditors		200
Allowance for doubtful debts, 1 June 2005	5	26
Cash at bank and in hand		74
Bank loans		
Due for repayment 1 April 2007		60
Due for repayment 1 June 2008		70
11% Debentures, repayable 31 May 2009		180
Issued share capital	6	350
Share premium account		50
Revaluation reserve		140
Profit and loss account, at 1 June 2005		615

The following additional information is available:

1 Sales include items sold on a sale or return basis to a customer for £100,000. These goods were invoiced to the customer at a mark-up of 25%. The customer returned these items on 5 June 2006.

2 Included in the stock as at 31 May 2006 are some items valued at their cost of £19,000. The directors now feel that these items were obsolete as at 31 May 2006 and had a net realisable value of £10,000.

3 Fixed asset investments include equity investments which originally cost £90,000 and which have a carrying value of £110,000. The directors have decided to reduce the carrying value of these investments to £83,000 because of a permanent diminution in their recoverable amount during the year ended 31 May 2006. None of the holdings of equity shares gives rise to a participating interest.

4 Wharf plc's depreciation policies are:
- Land: no depreciation charged
- Buildings: 2.5% per year using the straight line method
- Equipment: 30% per year using the diminishing balance method

Depreciation is charged for a full year in the year of acquisition. No fixed assets were sold during the year ended 31 May 2006.

Depreciation is to be allocated 60% to cost of sales, 20% to administrative expenses and 20% to distribution costs.

5 The allowance for doubtful debts is to remain unchanged.

6 The issued share capital of Wharf plc consists of ordinary shares of 25 pence each. Wharf plc used the balance on the share premium account to make a 1 for 7 bonus issue of shares on 31 May 2006. This has not yet been recorded in the accounts. The bonus shares will rank for all dividends payable after 31 May 2006.

7 Corporation tax payable for the year ended 31 May 2006 is estimated at £110,000.

8 The directors will be proposing a final ordinary dividend of 10 pence per share for the year ended 31 May 2006.

- **Requirement for question 2**

Prepare Wharf plc's profit and loss account for the year ended 31 May 2006 and its balance sheet as at 31 May 2006 in so far as the above information permits.

Note
- Additional notes and disclosures are not required.
- Disclosure of earnings per share is not required.
- Round all figures to the nearest £000.

(35)

3

The following is an extract from the draft cash flow statement of Biggles plc for the year ended 31 May 2006:

	£
Returns on investment and servicing of finance	
Interest element of finance lease rental payments	4,500
Financing	
Capital element of finance lease payments	11,750

These figures relate to a fixed asset acquired under a finance lease on 1 June 2005. The lease requires Biggles plc to make 5 equal annual instalments in advance at the start of each year of the lease. Interest is being apportioned using the rule of 78.

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

(a) Calculate the equivalent figures which will be reported in the cash flow statement for the year ending 31 May 2007. *5*

FRS 12 defines a provision as 'a liability of uncertain timing or amount'. The following items have not yet been taken into account when preparing the draft financial statements of Biggles plc for the financial year ended 31 May 2006:

(i) Cooperage Ltd, a company which supplies Biggles plc, has gone into liquidation owing £340,000 on a loan which has been guaranteed by Biggles plc. Cooperage Ltd will not have sufficient funds to repay the loan.

(ii) Biggles plc has purchased a helicopter for use by the company's directors and senior management. The company is required by law to overhaul the helicopter every three years. The managing director has estimated that the overhaul will cost £450,000 and wishes to build up a provision at the rate of £150,000 a year.

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

(b) (i) According to FRS 12, what three conditions should be met for a provision to be recognised in the financial statements? *6*

(ii) Explain, giving your reasons, how each of the two items above should be dealt with in the company's accounts. *6*

During its financial year ended 31 May 2006 Biggles plc started a long-term contract – the Leith contract.

The following information for the year ended 31 May 2006 relates to the Leith contract:

	£000
Contract price	125
Value of work invoiced to contractee	48
Payments received from contractee	44
Work certified as complete	56
Costs to date	39
Estimated further costs to complete	44

Biggles plc uses a revenue approach to calculate the percentage of work completed to date. Revenue is to be based on 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 paid and no provision is to be made for doubtful debts.

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

(i) Calculate the estimated total profit or loss on the contract. *4*

(ii) Calculate the attributable profit or loss on the contract. *4*

(iii) Calculate the figures which would be shown in Biggles plc's profit and loss account for the year ended 31 May 2006 for:
- turnover
- cost of sales, and
- profit or loss

for the contract. *4*

(iv) Calculate the figures which would be shown in Biggles plc's balance sheet as at 31 May 2006 for:
- work in progress,
- amounts recoverable on contracts, and
- trade debtors

for the contract. *6*

(35)

4

You have applied for a managerial position in Mariner plc and have been invited to attend an interview. Prior to the interview you have been asked to prepare a report, about two pages long, on how the performance of Mariner plc compares with other companies in the same industry.

You obtain the most recent financial statements of Mariner plc and three of its competitors. Using these you have calculated the following ratio values:

			Company		
		Mariner	**X**	**Y**	**Z**
1	Net profit to total assets	26.5%	12.2%	13.4%	20.7%
2	Net profit to turnover	18.2%	9.8%	11.9%	14.2%
3	Turnover to total assets (times)	1.46	1.25	1.13	1.46
4	Gross profit to turnover	31.8%	19.0%	22.7%	24.0%
5	Administrative expenses to turnover	8.2%	7.8%	8.6%	8.3%
6	Distribution costs to turnover	5.5%	1.5%	2.2%	1.5%
7	Turnover to fixed assets (times)	2.00	1.65	1.46	1.79
8	Turnover to current assets (times)	5.37	5.13	5.00	7.85
9	Current ratio	1.37	1.25	1.37	0.93
10	Acid test ratio	0.83	0.81	1.07	0.71
11	Stock to sales	7.3%	6.8%	4.3%	2.9%
12	Debtors to sales	10.5%	9.3%	7.6%	4.9%
13	Cash to sales	0.9%	3.4%	8.1%	4.9%

- **Requirement for question 4**

Prepare a report which analyses the performance of Mariner plc. Your report should

- Compare Mariner plc's profitability, assets utilisation and liquidity with the other companies. *18*
- Make clear recommendations on how the performance of Mariner plc could be improved. *4*
- Indicate any limitations of your analysis. *8*

(Presentation 5)

(35)