

Strategic Professional – Options

Advanced Audit and Assurance – International (AAA – INT)

September/December 2019 –
Sample Questions



Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

AAA – INT

Think Ahead

ACCA

The Association of
Chartered Certified
Accountants

Section A – This ONE question is compulsory and MUST be attempted

- 1** It is 1 July 20X5. You are a manager in the audit department of Squire & Co, a firm of Chartered Certified Accountants, responsible for the audit of the Ryder Group (the Group), which has a financial year ending 30 September 20X5. The Group, a listed entity, operates in the hospitality sector, running restaurants, coffee shops and hotels.

Squire & Co audits the Group consolidated financial statements, and the individual financial statements of each Group company. All companies in the Group use IFRS® Standards as their financial reporting framework.

You are provided with the following exhibits:

1. An email which you have received from Mo Iqbal, the Group audit engagement partner.
2. Background information about the Group's current structure and business activities.
3. Notes taken at a recent meeting between Mo Iqbal and the Group finance director.
4. Selected financial projections to 30 September 20X5 and comparative financial information.
5. Notes taken by Mo Iqbal during a phone call with a representative of the audit committee.

Required:

Respond to the instructions in the email from the audit engagement partner.

(46 marks)

Note: The split of the mark allocation is shown in the partner's email (Exhibit 1).

Professional marks will be awarded for the presentation and logical flow of the briefing notes and the clarity of the explanations provided.

(4 marks)

(50 marks)

Exhibit 1 – Email from audit engagement partner

To: Audit manager

From: Mo Iqbal, Group audit engagement partner

Subject: Ryder Group audit planning

Date: 1 July 20X5

Hello

You need to start planning the Ryder Group (the Group) audit, and to help with this I have provided you with some relevant information. I met with the Group finance director yesterday to discuss a number of matters including some recent business developments. I also spoke with a representative from the Group audit committee regarding several issues.

Using all the information provided, I require you to prepare briefing notes for my own use, in which you:

- (a)** Evaluate the significant audit risks to be considered in planning the Group audit for the financial year ending 30 September 20X5. Given the planned Group restructuring, **you should** evaluate audit risks relating to disclosure issues at this stage in the audit planning. (24 marks)
- (b)** Identify the additional information which should be requested from management in order to effectively audit the disposal of Primal Burgers Co, and explain why this information is required. (4 marks)
- (c)** Design the principal audit procedures to be performed in respect of:
 - (i)** The classification of the \$48 million investment in Peppers Co, and
 - (ii)** The government grant of \$20 million received in January 20X5. (8 marks)
- (d)** Using the notes from the audit committee phone call in Exhibit 5, discuss any ethical issues relevant to the Group audit, and recommend appropriate actions to be taken by our firm. (10 marks)

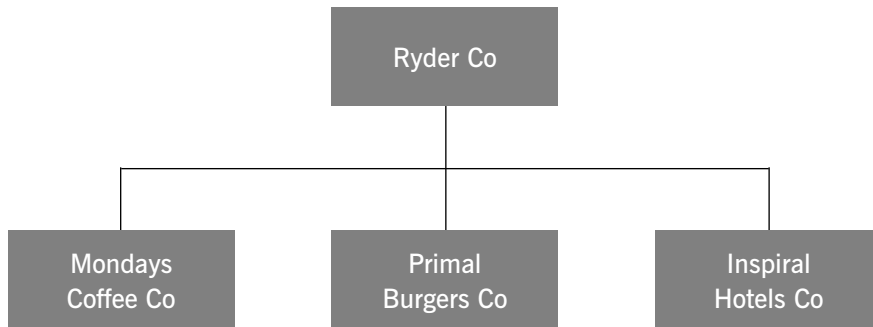
Thank you.

Exhibit 2 – Background information about the Group

The Ryder Group is one of the country’s leading hospitality providers. Over the last 15 years, the Group has grown steadily and has a range of successful hospitality brands, each brand being operated by a separate, wholly owned, subsidiary of the Group.

The Group is planning some restructuring, which is discussed in the notes from the client meeting (Exhibit 3). The Group structure shown below is the Group’s existing structure, before any restructuring takes place.

Existing Group structure:



Information about each of the Group companies is given below:

Ryder Co is the parent company of the group, a listed company, which does not trade, and holds the shares in each subsidiary company.

Mondays Coffee Co operates one of the leading coffee shop chains in the country under the ‘Mondays Coffee’ brand. It enjoys a strong market share and operates more than 1,200 coffee shops across the country.

Primal Burgers Co operates over 150 fast food restaurants. In recent years, revenue from Primal Burgers Co has declined, but it still provides approximately 30% of Group revenue.

Inspiral Hotels Co is a successful hotel business, with over 75 hotels across the country. The Group acquired Inspiral Hotels Co three years ago, as part of a growth strategy based on diversification.

Exhibit 3 – Notes from client meeting

Group restructuring

The Group is restructuring, as part of a strategy for continued growth in revenue and profitability. As part of this strategy, the Group is investing \$48 million in a newly formed company, Peppers Co, representing 50% of the share capital of the company. The remaining 50% shareholding is owned by Smiths Co, a property development company. The contract behind this investment states that the Group and Smiths Co will work together to develop six new hotels, all based at the country's major airports. The investment in Peppers Co is likely to take place in August 20X5.

Partly to provide some of the finance needed for the restructuring, and partly because of its declining revenue, the Group is planning to dispose of Primal Burgers Co. The board approved this disposal in March 20X5. Vendor's due diligence has been carried out by Usami & Co, a firm of Chartered Certified Accountants. Usami & Co conducted an independent review of the company's financial position and future prospects and produced a report on their findings, which is made available to potential buyers. At today's date, several potential buyers have expressed an interest and the Group expects that the disposal will take place just after the financial year end.

Due to the success of the Inspiral Hotels brand, the Group plans to expand its hotel offering, and a target company for acquisition has been identified. The Group aims to acquire Valentine Co, which operates the successful Valentine Hotel chain. Negotiations are underway, and it is likely that the acquisition will go ahead in the first quarter of the next financial year. The purchase price has yet to be agreed, but is likely to be around \$100 million. Due diligence performed on Valentine Co indicates that the fair value of its identifiable net assets is \$85 million.

Mondays Coffee drive-through

The Group has previously trialled 20 drive-through coffee shops situated on busy roads, which offer customers the convenience of purchasing coffee without leaving their cars. This year the Group opened 50 new drive-through coffee shops, open 24 hours a day, seven days a week, which have proven to be extremely popular with customers. The associated capital expenditure recognised in property, plant and equipment was \$43 million, which, according to the Group finance director, includes the cost of constructing the coffee shops amounting to \$28 million, and the cost of acquiring three-year licences to allow 24-hour trading, at a cost of \$15 million. The Group's accounting policy is to depreciate property over 20 years, and a full year's worth of depreciation will be charged in the year to 30 September 20X5 in respect of the \$43 million capitalised.

According to the Group finance director, the new drive-through coffee shops are projected to account for almost all of the increase in revenue generated from the Mondays Coffee brand in the year. His comment is based on data produced from the management information system which separately records revenue generated from the drive-through coffee shops so that management can assess its performance and determine the return on the \$43 million of capital expenditure.

Government grant

The government provides grants to organisations which commit to investing in properties to reduce carbon emissions and energy consumption. Grants are also available to organisations to promote the benefits of recycling to their customers.

In January 20X5, Ryder Co received a grant of \$20 million. The only condition attached to the grant is that half of the amount must be used to upgrade existing assets to make them more environmentally friendly. None of the amount received has yet been spent, but it is planned that it will be used to finance capital expenditure across the Group's property portfolio. The other half of the grant will be used to fund an advertising campaign.

According to the Group finance director, the full \$20 million is included within operating profit in the projected Group statement of profit or loss for the year (Exhibit 4).

Exhibit 4 – Selected financial projections

Subsidiary	Projected to	Projected to	Actual to	Actual to
	30 September 20X5	30 September 20X5	30 September 20X4	30 September 20X4
	\$ million	\$ million	\$ million	\$ million
	Revenue	Assets	Revenue	Assets
Mondays Coffee Co	155	200	110	160
Primal Burgers Co	99	110	103	113
Inspiral Hotels Co	66	140	62	125
Total	320	450	275	398

The table above is based on management information which forms the basis of the segmental reporting disclosed in the notes to the financial statements.

Other financial information for the Group as a whole is given below:

	Projected to	Actual to
	30 September 20X5	30 September 20X4
	\$ million	\$ million
Operating profit	76	72
Profit before tax	20	18
Total assets	475	450

Exhibit 5 – Notes from audit committee call

The Group currently has three non-executive directors, who form the Group audit committee. Until January 20X5, there was a fourth non-executive director who was also the financial reporting expert of the Group audit committee. The Group is looking to find a replacement, but is finding it difficult to recruit for this position, and has requested that a senior partner from Squire & Co become a member of the Group audit committee while a replacement is being sought.

In addition, the Group audit committee is looking to appoint a firm of professional accountants to perform corporate finance work in relation to the planned Group restructuring. The audit committee understands that Squire & Co cannot provide this non-audit service as it would create a significant threat to auditor objectivity. However, the audit committee has asked if our firm can recommend another firm to perform the work.

Following the call, the managing partner of Squire & Co has suggested that the firm recommend Ranger Associates, an unconnected firm, to carry out the work. If Ranger Associates is appointed, Squire & Co will charge Ranger Associates a referral fee equivalent to 10% of the fee for the corporate finance engagement.

In addition, the audit committee has asked Squire & Co to work with the Group internal audit team to design internal controls over the part of the accounting system which deals with revenue, and also evaluate the operating effectiveness of the internal controls.

Section B – BOTH questions are compulsory and MUST be attempted

- 2 (a)** It is 1 July 20X5. You are a manager in the audit department of Peart & Co, a firm of Chartered Certified Accountants, responsible for the audit of Lifeson Co for the year ended 31 March 20X5. Lifeson Co is an unlisted retail company which is a new audit client of your firm this year. The company's draft financial statements recognise profit before tax of \$2.15 million (20X4 – \$1.95 million) and total assets of \$13.8 million (20X4 – \$12.7million).

The audit is nearly complete and you are reviewing the audit working papers. The audit supervisor has brought the following matters to your attention:

(i) Sale and leaseback transaction

On 31 March 20X5, Lifeson Co sold a property to a leasing company, Clive Co, for its fair value at this date. The property is situated in a sought after area with a high demand for rental properties for retail purposes. Clive Co has assessed the remaining life of the property to be in excess of 50 years, and under the terms of the sales agreement, Lifeson Co will lease the property back from Clive Co for a period of ten years. Lifeson Co has treated the transaction as a sale and leaseback transaction in accordance with IFRS[®] 16 *Leases*, and derecognised the property in its financial statements and recorded a sale in accordance with IFRS 15 *Revenue from Contracts with Customers*. (8 marks)

(ii) Investment property

Lifeson Co owns a building which it has used as a warehouse to store inventory. On 1 April 20X4 the building, which had not suffered any historic impairments, had a carrying amount based on depreciated historic cost of \$323,000 and a fair value of \$348,000. On this date, Lifeson Co vacated the building and moved the inventory to new larger premises. Management decided to keep the building in order to rent it out as a storage facility to local businesses and to benefit from any increases in property valuations. On 31 March 20X5, the building had not been let and it had a fair value, according to an external valuer, of \$353,000. The draft financial statements for the current year recognise the building as an investment property at a carrying amount of \$353,000 and include a fair value gain of \$30,000 in profit before tax for the year. Since reclassification as an investment property, depreciation has not been charged in relation to the building. (6 marks)

(iii) Shopping mall

Lifeson Co purchased a shopping mall on 1 April 20X3 for \$9.5 million. At the date of purchase, the mall was estimated to have a remaining useful life of 20 years and a nil residual value. On 31 March 20X4 following an impairment review, the property was written down to its recoverable amount based on value in use of \$8.25 million and an impairment loss of \$775,000 was recognised in the statement of profit or loss for the year ended 31 March 20X4.

Lifeson Co conducted a further impairment review as at 31 March 20X5 which indicated that the property's recoverable amount, based on value in use, was now \$8.85 million. As a result, Lifeson Co has recognised an impairment reversal of \$1.034 million in its profit before tax for the current year. The impairment reversal of \$1.034 million has been calculated as its new recoverable amount of \$8.85 million less its carrying amount of \$7.816 million. The audit supervisor has prepared the following working paper which summarises the accounting transactions in relation to the shopping mall:

Summary of transactions

Date		\$ million	Accounting treatment by management
1 April 20X3	Cost of asset	9·500	
	Depreciation (9·5m/20 years)	(0·475)	Depreciation charge for the year to 31 March 20X4
	Impairment	(0·775)	Impairment loss charged to profit for the year to 31 March 20X4
31 March 20X4	Year end carrying amount	8·250	
	Depreciation (8·25m/19 years)	(0·434)	Depreciation charge for the year to 31 March 20X5
	Reversal of impairment	1·034	Reversal of impairment credited to profit for the year to 31 March 20X5
31 March 20X5	Year end carrying amount	<u>8·850</u>	

(6 marks)

Required:

Comment on the matters to be considered and explain the audit evidence you would expect to find during your review of the audit working papers in respect of the issues described above.

Note: The split of the mark allocation is shown against each of the issues above.

- (b) It is now 1 September 20X5 and the auditor's report on Lifeson Co's financial statements for the year ended 31 March 20X5 is due to be issued in the next few days.

Following discussions with management, you are satisfied that the sale and leaseback transaction has been treated correctly and that you have gathered sufficient and appropriate audit evidence to support this treatment.

However, management has indicated that they are not willing to make any further adjustments to the financial statements in relation to the investment property or shopping mall and you are now considering the form and content of the auditor's report in relation to these matters.

Required:

Discuss the implications for the auditor's report on the basis that no further adjustments have been made to the financial statements in relation to the investment property or shopping mall.

(5 marks)

(25 marks)

- 3 (a) You are a manager in the forensic department of your firm, Kaffe & Co. You have received a request from Beyer Co about an inventory fraud which was brought to the attention of the company's audit committee by a whistle-blower. Beyer Co is not currently a client of your firm.

Beyer Co manufactures and sells parts used in the automotive industry to both car manufacturers and to garages specialising in the repair and servicing of cars. The audit committee would like Kaffe & Co to perform a forensic investigation to quantify the loss suffered as a result of the inventory fraud, and to recommend improvements in the company's internal controls to avoid similar issues in the future. In addition, the audit committee has mentioned that although the quantification of the loss is to form the basis of an insurance claim, the matter has been reported to the police who will be investigating the matter further.

Required:

Evaluate the matters which should be considered before your firm accepts the invitation to perform a forensic investigation for Beyer Co. (8 marks)

- (b) Having accepted the engagement, the operations director provides you with the following summary of the allegations of the whistle-blower:

'The warehouse manager has been working with one of the sales representatives to dispatch goods to a fictitious customer which the warehouse manager has created on the dispatch system. The sales orders are input by the sales representative into the dispatch system which is not directly linked to the invoicing and accounting system. After the goods dispatch note is issued by the warehouse manager and the goods leave the warehouse for delivery to the fictitious customer, the sales representative cancels the original order. The warehouse manager reverses the dispatch immediately so that the daily report on inventory movement used to generate invoices in the sales system does not reflect movement of the goods. The sales representative takes delivery of the goods at the address of the fictitious customer and then sells the parts on the internet, splitting the proceeds with the warehouse manager. The warehouse manager supervises and participates in all inventory counts and this way ensures he is able to adjust the records of inventory to disguise the missing items.'

The operations director has informed you that no authorisation is required for either the cancellation of orders or the reversal of dispatch notes.

Required:

- (i) **Recommend the procedures which should be performed in order to quantify the inventory loss; and** (6 marks)
- (ii) **Evaluate the deficiencies in Beyer Co's internal control system, and explain how they contributed to the fraud, together with recommendations to prevent such a fraud reoccurring.** (6 marks)

- (c) The audit committee members have expressed their dissatisfaction that the company's auditor did not identify the fraud.

Required:

Explain the difficulties arising for management and for the auditor with respect to discovering fraud. (5 marks)

(25 marks)

End of Question Paper