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UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

MSC ACCOUNTANCY & FINANCIAL MANAGEMENT

SEMESTER TWO EXAMINATION 2018/19

ADVANCED AUDIT AND ASSURANCE

MODULE NO: ACC7507

Date: Friday 24 May 2019 **Time: 10.00 – 1.00**

INSTRUCTIONS TO CANDIDATES:

There are THREE questions on this paper.

SECTION A consists of ONE question which is COMPULSORY

SECTION B consists of TWO questions, both are COMPULSORY

This is a closed book exam.

You must hand in the exam paper with your answer booklet.

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 2 Examinations 2018-19
ACC7507 Advanced Audit & Assurance

SECTION A

Question 1

You are a manager in Fawad & Co, an audit and accountancy firm with 22 offices. Your firm has been recently appointed as auditor of William Co, a listed company which provides home emergency cover and domestic repairs to households.

You have received an email from the audit engagement partner, Malik Sadiq:

I have been preparing the current file for the audit of William Co. I've left the files in the office. I'm out of the office for the next few days and I'd like you to complete some work that is outstanding. I would appreciate it if you could prepare briefing notes in time for my return next week.

(a) There are a number of new members in our department and I would like to provide them with some initial training. I have asked them to provide me with a list of questions that I will answer in a team briefing next week. One of the new recruits has asked me to explain why we need to perform a risk assessment. They have started their exam training and so they should know that the auditor needs to identify and evaluate the risk of material misstatement in the financial statements and design and implement appropriate responses to the risks identified. However, they may not have been told about the importance of business risk to the auditor. Please explain why the auditor needs to obtain an understanding of business risk. **(4 marks)**

(b) Evaluate the business risks facing William Co. **(10 marks)**

(c) (i) Identify and explain the audit risks in relation to the audit of the financial statements of William Co for the year ended 31 October 2017. **(10 marks)**

(ii) Recommend the additional information which would be relevant in the evaluation of audit risk. **(5 marks)**

(d) Recommend the principal audit procedures that should be performed on:

(i) the condition attached to the grant received by William Co **(4 marks)**

(ii) the land held for sale by William Co. **(5 marks)**

(e) Discuss the ethical issues relevant to Fawad & Co, and recommend any actions which should be taken by our firm. **(8 marks)**

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Notes from meeting held 15 October 2017:

On 15 September 2017, William Co received notice from a government body that it is under investigation, for alleged mis-selling. If it is found guilty, significant financial penalties will be imposed. The company is vigorously defending its case. William Co's share price dropped by 50% after admitting it was being investigated.

A number of buyout groups have approached the board of William Co with an offer to purchase the entire share capital of the company. The Chief Executive of William Co, Carl Smith owns 15% of the company. The offers have been rejected as they were not believed to be in the shareholders' best interests. The share price has recovered slightly since the attempted takeovers became public knowledge.

In June 2017, the government paid a grant to William Co, to assist with costs associated with the installation of devices in customer boilers to improve their energy efficiency. William Co is required to install 100,000 of these devices by 30 November 2017 at no charge to eligible customers.

Although profits have improved over the last two years, William Co is planning to downsize its business, creating a smaller more focused and sustainable business from which to grow. The directors plan to downsize the business by about 20%. William cut 200 jobs last year, and said it would cut further jobs in line with the fall in the number of customers. All 200 employees who lost their jobs last year have received the redundancy payments to which they are entitled.

As part of this downsizing, William Co has sold a number of plots of land. Significant losses were made on the sale of these plots of land which were originally acquired for development potential. Some plots of land have not yet been sold, although William Co intends to sell off more of the land acquired that has not yet been developed.

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Additional services

The directors of William Co are aware that as a listed company they must comply with corporate governance regulations including having an audit committee which comprises at least three independent non-executive directors. At present the audit committee has three directors, one of which is the finance director and two of whom are retired executive directors of the company who retired two years ago. The directors have asked our firm to help recruit independent non-executives to the board who will also sit on the audit committee. The directors would also like our firm to perform a valuation service in respect of the plots of land which are to be sold.

Required:

Respond to the partner's email. (46 marks)

Professional marks will be awarded for the structure and presentation of the briefing notes and for the clarity of explanations. (4 marks)

(Total: 50 marks)

END OF QUESTION 1

END OF SECTION A

Questions continue over the page

SECTION B (All questions compulsory)

Question 2

You are the manager responsible for the audit of Garry. Garry sells furniture and home furnishings through retail stores and home catalogues (i.e. mail order). The draft financial statements for the year ended 31 March 2017 show revenue of £72.4 million (2016: £68.9 million), profit before taxation of £7.3 million (2016:£6.7 million) and total assets of £18.6 million (2016: £17.5 million).

The audit is nearly complete and you are performing the final review ahead of signing the auditor's report. During your review you identify the following issues.

There is no signed written representation on the audit file. The audit senior in charge of the audit has documented on file that as there are no specific matters to include in the representation, it is not worth bothering the client to obtain one to put on file.

Due to various difficulties encountered during the audit, work towards the end of the audit had to be rushed to get finished. The audit senior instructed the audit juniors to scale down sample sizes that had been decided at the planning stage to save time on sections where the prior year file showed no problems had arisen.

Required:

(a) Explain the quality control and other professional issues raised by the audit assistant's comments, discussing any implications for the completion of the audit and explain the potential consequences to the audit firm of conducting an audit that does not comply with professional standards **(8 marks)**

(b) You are the also the audit manager for the audit of Mary Co, a company that sells sports equipment. The draft financial statements for the year ended 31 March 2017 show revenue of £21.1 million (2016: £20.9 million), profit before taxation of £0.9 million (2016: £1.1 million) and total assets of £15.4 million (2016: £11.7 million).

You are currently reviewing two matters that have been left for your attention on Mary's audit file for the year ended 31 March 2017:

Question 2 continued over the page

Question 2 continued

Revaluation of properties
Mary's management board decided to revalue properties for the year ended 31 March 2017 that had previously been measured at depreciated cost. At the yearend three properties had been revalued resulting in a revaluation surplus of £1 million. Another nine properties have since been revalued by £2.7 million. The remaining three properties are expected to be revalued later in 2017.

Warranty provision
On 1 April 2016 Mary introduced a 10-year warranty on sales of its entire range of golf equipment. Sales of golf equipment for the year ended 31 March 2017 totalled £9.1 million. The notes to the financial statements disclose the following: 'Since 1 April 2016, the company's range of golf equipment is guaranteed to be free from defects in materials and workmanship under normal use within a 10-year guarantee period. A warranty provision has not been recognised as the amount of the obligation cannot be measured with sufficient reliability.'

Required:

Identify and comment on the implications of these two matters for your auditor's report on the financial statements of Mary Co for the year ended 31 March 2017. (14 marks)

(c) The going concern section of the file includes a note stating:

'Mary Co has prepared forecasts covering the period to 30 September 2017. The directors are currently developing a new strategy for the company that will be launched in September 2017 and will include forecasts and projections for 1 October 2017 to 30 September 2018. Until the strategy is finalised, the directors do not want to prepare forecasts beyond 30 September 2017.'

Required:

Explain the implications for the auditor's report if the directors refuse to prepare forecasts beyond 30 September 2017. (3 marks)

Total 25 marks

END OF QUESTION 2

Question 3

You are a manager in Farah & Co responsible for assurance engagements including social and environmental reporting and due diligence reviews.

(a) **Science Co**

Science Co is a pharmaceutical research company. Science Co receives funding from governmental health departments, as well as several large charitable donations. This funding represents on average 25% of the company's research and development annual expenditure. The amount of funding received is dependent on three key performance indicator (KPI) targets being met annually. All three of the targets must be met in order to secure the government funding.

Extracts from Science Co's operating and financial review are as follows:

KPI target	***Draft KPI 2017***	***Actual KPI 2016***
Pharmaceutical products donated free of charge to health care charities:		
1% revenue	**0.8% revenue**	**1.2% revenue**
Donations to, and cost of involvement with, local community charities:		
0.5% revenue	**0.6% revenue**	**0.8% revenue**
Accidents in the work place:		
Less than 5 serious accidents	**4 serious accidents**	**2 serious accidents**

Question 3 continued over the page

Question 3 continued

Your firm is engaged to provide an assurance opinion on the KPIs disclosed in the operating and financial review.

Required:

(i) Discuss why it may not be possible to provide a high level of assurance over the stated key performance indicators. **(4 marks)**

(ii) Describe the procedures to verify the number of serious accidents in 2017. **(4 marks)**

(iii) Recommend SEVEN additional KPIs which could be used to monitor Science Co's social and environmental performance, and outline the nature of evidence that should be available to provide assurance on the accuracy of the KPIs recommended. **(7 marks)**

(b) **Parveen Co**

Parveen Co, is a national hotel group with substantial cash resources. Its accounting functions are well managed and the group accounting policies are rigorously applied.

Parveen has been seeking to acquire a construction company for some time in order to expand into the building and refurbishment of hotels and related leisure facilities (e.g. swimming pools, squash courts and restaurants).

Parveen's management has recently identified Ryan Construction Co as a potential target and has urgently requested that you undertake a limited due diligence review lasting two days next week.

Further to their preliminary talks with Ryan's management, Parveen has provided you with the following brief on Ryan Construction Co:

The chief executive, managing director and finance director are all family members and major shareholders. The company name has an established reputation for quality constructions.

Due to a recession in the building trade the company has been operating at its overdraft limit for the last 18 months and has been close to breaching debt covenants on several occasions.

Question 3 continued over the page

Question 3 continued

Ryan's accounting policies are generally less prudent than those of Parveen (e.g. assets are depreciated over longer estimated useful lives). Contract revenue is recognised on the percentage of completion method, measured by reference to costs incurred to date. Provisions are made for loss-making contracts.

Ryan has recently received a claim that a site on which it built a housing development several years ago was not properly drained and is now subsiding. Residents are demanding rectification and claiming damages. Ryan has referred the matter to its lawyers and denied all liability as the site preparation was subcontracted to Sardar Services Co. No provisions have been made in respect of the claims, nor has any disclosure been made in their financial statements.

Required:

State, with reasons, the additional information that should be made available for your review of Ryan Construction Co. (10 marks)

(Total: 25 marks)

END OF QUESTIONS

END OF EXAMINATION