

UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

**MSC ACCOUNTANCY AND FINANCIAL
MANAGEMENT**

SEMESTER ONE EXAMINATION 2021/22

ADVANCED AUDIT AND ASSURANCE

MODULE NO: ACC7507

Date: Thursday 13th January 2022

Time: 14:00 – 17:00

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.

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SECTION A: COMPULSORY question

Question 1

You are an audit manager in Allen & Co, a firm of Chartered Certified Accountants, and the partners are concerned that the firm's quality control procedures may not be satisfactory, as they have never been reviewed since they were first implemented five years ago. In addition, although staff can read the policies and procedures in the staff manual, there are currently no other ways in which the information is communicated to them.

Allen & Co is responsible for the audit of Olympus Co, a listed company with a 30 September accounting year end.

You have been provided with the following exhibits:

Exhibit 1 – Email from the audit engagement partner

Exhibit 2 – Background information on Olympus Co

Exhibit 3 – Financial extracts for the year ending 30 September 2021

Required:

Respond to the email from the audit engagement partner. (46 marks)

Note: The split of marks is shown within the partner's email.

Professional marks will be awarded for the presentation, clarity of explanations and logical flow of the answer. (4 marks)

(Total: 50 marks)

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Question 1 Continued....

Exhibit 1 – Email from the audit engagement partner

To: Audit manager
From: Audit engagement partner
Subject: Audit planning – Olympus Co
Date: 1 July 2021

Hello

I have provided you with some information in the form of a few exhibits which should help you with planning the audit of Olympus Co for the financial year ending 30 September 2021.

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

- (a) (i) **Evaluate the audit risks to be considered when planning the audit.**
(21 marks)
- (ii) **Identify and explain any additional information which would be relevant to your evaluation.**
(6 marks)
- (b) **Design the audit procedures to be used in the audit of:**
 - (i) **segment information, and**
 - (ii) **international restructuring.****(6 marks)**
- (c) **Discuss why quality control policies and procedures are necessary and outline procedures that would be required to ensure that the policies are met.**
(7 marks)
- (d) **Discuss the importance of documenting audit conclusions in the working papers and the benefits of using standardised audit working papers.**
(6 marks)

Exhibit 2 – Background information on Olympus Co

The principal activity of Olympus Co is retailing under the Vazan brand name. The retail industry has recently suffered from a reduction in consumer spending.

Olympus Co has two operating divisions: Domestic and International. Each retail division is sub-divided into four business units: Ladieswear, Menswear, Home furnishings and Foods. The international retail business consists of three broad geographic areas: Africa, South America and the Far East. Robert Bracco is represented by affiliated offices in all relevant countries.

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Question 1 Continued....

Exhibit 3 – Financial extracts for the year ending 30 September 2021

(1) Financial extracts

Statement of profit or loss	<i>Note</i>	<i>2021</i> £m	<i>2020</i> £m
Revenue		2,585.0	2,638.8
Total operating profit		129.1	120.0
Provision for loss on operations to be discontinued	(i)	(83.8)	–
Finance cost (net)		(4.7)	(4.8)
Profit before tax		40.6	115.2
Statement of financial position	<i>Note</i>	<i>2021</i> £m	<i>2020</i> £m
Land and buildings		950.5	964.0
Store fit out, fixtures and equipment		448.9	481.8
Inventory	(ii)	164.2	165.9
Trade and other receivables		22.5	36.9
Cash and cash equivalents		53.7	104.6

Notes:

- (i) The company has announced its intention to close loss-making businesses in Africa, subject to the full consultation that the board recognises will need to take place. The decision to close would be taken only after consultation with employee representative bodies and if no other solution is found during the consultation. Net closure costs of £83.8 million have been provided, covering future trading losses, losses on disposal of assets and redundancy costs.
- (ii) Inventory is valued at the lower of cost and net realisable value using the retail method (i.e., by reducing sales value by the appropriate percentage gross profit margin).

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Question 1 Continued....**(2) Segment information**

	<i>Turnover</i>		<i>Operating profit</i>	
	<i>2021</i>	<i>2020</i>	<i>2021</i>	<i>2020</i>
	£m	£m	£m	£m
International				
Africa	99.0	96.7	(11.8)	(9.0)
South America	264.0	250.5	11.1	5.3
Far East	38.3	38.9	2.8	(1.2)
	—	—	—	—
Total International	401.3	386.1	2.1	(4.9)
Domestic	2,183.7	2,252.7	127.0	124.9
	—	—	—	—
Total operating activities	2,585.0	2,638.8	129.1	120.0

Number of stores

	<i>2021</i>	<i>2020</i>
International		
Africa	14	13
South America	86	87
Far East	4	4
	—	—
Total International	104	104
Domestic	107	106
	—	—
Total	211	210
	—	—

(3) International restructure

The company has this week announced the intention to close all African operations (representing 14 stores); and sell the South American businesses.

END OF SECTION A

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SECTION B: Answer BOTH questions

Question 2

It is 1 July 2021. You are a manager in the audit department of Dali & Co, a firm of Chartered Certified Accountants, responsible for the audit of Nesto Co for the year ended 31 March 2021. Nesto 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 (2020 – £1.95 million) and total assets of £13.8 million (2020 – £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 2021, Nesto 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, Nesto Co will lease the property back from Clive Co for a period of ten years.

Nesto 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

Nesto Co owns a building which it has used as a warehouse to store inventory. On 1 April 2020 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, Nesto 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 2021, 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)

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Question 2 continued....

(iii) Retail store

Nesto Co purchased a Retail store on 1 April 2019 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 2020 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 2020.

Nesto Co conducted a further impairment review as at 31 March 2021 which indicated that the property's recoverable amount, based on value in use, was now £8.85 million. As a result, Nesto 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 retail store:

Summary of transactions

Date		£ million	Accounting treatment by management
1 April 2019	Cost of asset	9.500	
	Depreciation (9.5m/20 years)	(0.475)	Depreciation charge for the year to 31 March 2020
	Impairment	(0.775)	Impairment loss charged to profit for the year to 31 March 2020
31 March 2020	Year-end carrying amount	8.250	
	Depreciation (8.25m/19 years)	(0.434)	Depreciation charge for the year to 31 March 2021
		7.816	Carrying amount prior to impairment review
	Reversal of Impairment	1.034	Reversal of impairment credited to profit for the year to 31 March 2021
31 March 2021	Year-end carrying amount	<u>8.850</u>	

(6 marks)

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Question 2 continued....

Required:

- (a) 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.

It is now 1 September 2021 and the auditor's report on Nesto Co's financial statements for the year ended 31 March 2021 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 Retail store and you are now considering the form and content of the auditor's report in relation to these matters.

Required:

- (b) 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 retail store. (5 marks)**

(Total: 25 marks)

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Question 3

You are an audit manager in Davidson & Co, a firm of Chartered Certified Accountants. You have recently been assigned to the audit of Hygiene Co for the year ended 31 March 2021. Hygiene Co is an unlisted company and has been an audit client of your firm for a number of years.

Hygiene Co is a national distributor of cleaning products. The company buys the cleaning products from wholesalers and employs a team of approximately 750 sales staff around the country who sell the company's products to both domestic households and small to medium-sized businesses. Around 75% of Hygiene Co's sales transactions are cash-based and each of the company's sales staff prepares a cash sales report on a monthly basis. According to Hygiene Co's chief executive, Simon Blackers, and in order to foster 'an entrepreneurial spirit' amongst his staff, each staff member (including the senior management team) is encouraged to make cash sales and is paid on a commission basis to sell the company's products to friends and family. Mr Blackers leads the way with this scheme and recently sold cleaning products with a value of £33,000 to a business associate of his. He has transferred these funds directly into an off-shore bank account in the company's name on which he is the sole signatory.

Review of audit working papers

Your review of the audit working papers and an initial meeting with Mr Blackers have identified the following potential issues:

Following your review of the audit engagement letter and the working papers of the taxation section of the audit file, you have established that Davidson & Co performed the taxation computation for Hygiene Co and completed the tax returns for both the company and Mr Blackers personally. All of the taxation services have been invoiced to Hygiene Co as part of the total fee for the audit and professional services. Mr Blackers' personal tax return includes a significant number of transactions involving the purchase and sale of properties in various international locations. The taxation working papers include a detailed review of a number of off-shore bank accounts in Mr Blackers' name which identified the property transactions.

During your initial meeting with Mr Blackers, he informed you that Hygiene Co is planning to develop a new website in order to offer online sales to its customers. He has asked Davidson & Co to provide assistance with the design and implementation of the website and online sales system.

As a result of your audit review visit at the client's premises, you have learned that the audit team was invited to and subsequently attended Hygiene Co's annual office party.

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Question 3 continued....

The client provided each member of the audit team with a free voucher worth £30 which could be redeemed at the venue during the party. The audit senior, Paula Metcalfe, who has worked on the audit for the last three years has informed you that the audit team has always been encouraged to attend the party in order to develop good client relations.

Required:

- a. (i) **Discuss the policies and procedures which Davidson & Co should have in place in relation to an anti-money laundering programme, and** (4 marks)
- (ii) **Evaluate whether there are any indicators of money laundering activities by either Hygiene Co or its staff.** (6 marks)
- b. **Comment on the ethical and professional issues arising from your review of the audit working papers and recommend any actions which should now be taken by Davidson & Co.** (15 marks)

(Total: 25 marks)

END OF SECTION B

END OF QUESTIONS