



AUDIT AND ASSURANCE

This paper consists of **SIX** short-form questions (20 marks) and **THREE** long-form questions (80 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.
2. Answer each question in black ballpoint pen only.

Short-form Questions (1 – 6)

3. Answer the short-form questions in note form only. Complete sentences are not required.
4. Answers to each short-form questions must be submitted in numerical order.

Long-form Questions (7 – 9)

5. Answers to each long-form question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
6. The examiner will take account of the way in which answers are presented.
7. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet) it will be classed as misconduct.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

You **MUST** enter your candidate number in this box.

**DO NOT TURN OVER UNTIL YOU
ARE INSTRUCTED TO BEGIN WORK**

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- 1 Grayling LLP (Grayling) is the external auditor of Sewin plc (Sewin), which is a listed company. The directors of Sewin have requested that Grayling undertakes an engagement to revalue a class of the company's assets which amount to 12% of total assets.

Explain why Grayling should refuse this request. **(3 marks)**

- 2 There is an expectations gap between the users of assurance reports and an accountancy firm's responsibilities in respect of those reports.

Briefly explain four steps that have been taken to try to reduce that gap. **(4 marks)**

- 3 Your firm has a recurring audit assignment, Westernhay Ltd (Westernhay). The partner in charge of the assignment is aware that it is not always necessary to issue a new audit engagement letter every year, but she appreciates that it is necessary to consider whether a new letter is required. You have been asked to advise whether an engagement letter should be issued for Westernhay in relation to this year's audit.

What indicators would you look for to help you advise her? **(3 marks)**

- 4 Funding Ltd (Funding), a long standing client of your firm, has asked you to examine and report on a cash flow and profit forecast for the next two years, to support the company's application for an increased overdraft facility. Funding's managing director understands that you will not be issuing a 'true and fair' opinion on the information.

Explain how and why the level of assurance provided by the report on the forecasts differs from the level provided by the audit report on the annual financial statements. **(2 marks)**

- 5 You are the qualified senior on the audit of Merchant Ltd and you will be supervising two junior members of staff and reviewing their work before passing the work on to the audit manager.

What would you expect your role to be in terms of briefing your juniors and explaining their role, and what aspects will you consider when reviewing the juniors' work? **(4 marks)**

- 6 Jacaranda Ltd (Jacaranda) has applied to its bank for a loan to fund the expansion of its retail business into online sales. Currently, Jacaranda trades only from its ten stores located in shopping malls. The bank has requested a three-year profit forecast for the online business, which is to be independently reviewed and reported on by your firm and your firm is currently planning this assurance engagement.

Identify and explain the factors that give rise to a risk of misstatement in Jacaranda's profit forecast for the online business. **(4 marks)**

Total: 20 marks

**QUESTION 6 COMPLETES THE SHORT FORM QUESTIONS
LONG FORM QUESTIONS (7 – 9) FOLLOW**

7 7.1 External auditors are required to communicate significant deficiencies in internal controls identified during the audit to those charged with governance. Identify and explain the attributes that such communications should have in order to be effective. **(5 marks)**

7.2 During the external audit of Green Ltd, audit procedures revealed the following deficiencies in internal control:

- (a) Company policy requiring all purchase orders to be placed by the company's buying department was not adhered to in 20% of the transactions examined.
- (b) A quality issue with materials from one supplier, discovered by the production quality controller, resulted in a significant amount of materials being returned to the supplier. Green's accounts department had paid the invoices relating to these materials as it had not been notified of the returns. The staff in the accounts department rely on the warehouse staff to inform them, by telephone, of any returns.
- (c) As the company does not have a policy of reconciling supplier statements with payables balances, the failure to notify the accounts department was not discovered until the supplier's credit notes arrived in the accounts department.

For each deficiency, outline the possible consequence(s) of the deficiency and provide recommendation(s) to remedy each deficiency.

You should present your answer in a two-column format using the headings:

- Consequences
- Recommendations

(15 marks)

Total: 20 marks

- 8 Your firm has recently been appointed external auditors of Wireless Communications Ltd (WCL), a company that manufactures Wi-fi network components and accessories. It is late January 20X9 and you are preparing for a planning meeting with the finance director for the audit of the financial statements for the year ending 31 March 20X9. The management accounts for the nine months to 31 December 20X8 are set out below with comparatives.

Extracts from the management accounts for the nine months to:

	<i>31 December</i> 20X8 £'000	<i>31 December</i> 20X7 £'000
Operating results		
Revenue	34,557	28,650
Cost of sales	<u>(22,684)</u>	<u>(17,078)</u>
Gross profit	11,873	11,572
Operating costs	<u>(5,010)</u>	<u>(4,796)</u>
Operating profit	<u><u>6,863</u></u>	<u><u>6,776</u></u>

Statement of financial position items

Assets		
Inventory	6,159	3,544
Trade receivables	9,278	6,320
Bank	–	198
Liabilities		
Trade payables	2,836	1,478
Bank overdraft	487	

Other information that you have obtained prior to your meeting is as follows:

- Traditionally most of the company's customers have been based in the UK (both domestic and commercial). The company has expanded its customer base into Europe, where business is conducted in the customers' local currency.
- Many of the company's sub-components (which are assembled to make the finished products) are sourced from the Far East.
- Metal prices have risen dramatically leading to an increase in the cost of raw materials and sub-components.
- New legislation is being introduced in the European Union (EU) which will have an impact on the amount of radiation that domestic electronic equipment can emit. There will be a need to develop new technology to comply with this as currently most of the company's products would not meet the new standards.
- The finance director has been in his role for four months following the resignation of his predecessor due to apparent professional misconduct.

Requirements

- 8.1 State the sources of information that should be used when planning the audit of WCL. **(5 marks)**
- 8.2 Prepare briefing notes for your audit planning meeting with the client. Your notes should refer to the results of your analytical procedures and include the audit risks you wish to discuss. **(15 marks)**

Total: 20 marks

- 9 Your firm is the external auditor of Lagg Ltd (Lagg) for the year ended 30 November 20X1. The principal activity of Lagg is the installation of thermal and acoustic insulation systems for a wide range of industries.

The manager responsible for the audit of Lagg has received a phone call from Lagg's finance director who requested that the audit is completed by 31 January 20X2. The company is seeking to increase its overdraft facility and the company's bank requires the audited financial statements to be available prior to agreeing the new facility. The finance director has also requested that a member of your firm assists with the preparation of the financial statements so that the 31 January deadline can be met.

The finance director has performed an assessment of the company's ability to continue as a going concern, including profit and cash flow forecasts which indicate that the company can continue to trade profitably and meet its debts as they fall due in the year ending 30 November 20X2. The forecasts assume that the company's overdraft facility will be increased.

During the year ended 30 November 20X1, the company experienced a decline in demand for its services, mainly due to a fall in demand from the construction sector and competition from other companies which are undercutting Lagg's prices. The company has managed to pay its trade suppliers and stay within the current overdraft facility by delaying payments to HMRC. The finance director has recently agreed a deferred payments plan with HMRC to pay off the arrears of payroll taxes over the next four months.

All contracts entered into by Lagg are fixed-price and require the customer to pay the full contract price within seven days of the invoice date. The invoice is raised once the work has been completed and signed off by the customer. It is company policy to recognise revenue when a customer has signed off the work as having been completed satisfactorily. However, one customer who signed off the work as having been completed and was invoiced in September 20X1 has not yet paid. The amount due represents 12% of Lagg's year-end receivables balance.

Lagg's inventory of raw materials consists of consumable materials held in its stores department and unused insulating materials at customers' premises. The value of these items is not material to Lagg's financial statements. The insulating materials required for each contract are only ordered once a contract has been agreed and are delivered directly to the customers' premises.

All direct costs (labour and materials) relating to each contract are recorded in the company's job costing system which is integrated with the purchases and payroll applications. The job costing records are used by the finance director to estimate the value of work in progress for the monthly management accounts and the year-end financial statements. For the work in progress valuation, a percentage is added to the direct costs to cover overheads. The finance director determines the percentage by taking the overheads figure in the management accounts as a percentage of direct costs in the management accounts.

Many of the contracts entered into by the company require the removal of existing insulation material. Some of this material is classed as hazardous waste (harmful to health and the environment). The company is legally obliged to dispose of this waste in a safe manner. The company is currently being investigated by the regulatory authority for alleged illegal disposal of hazardous waste.

Lagg's freehold premises were valued by an external valuer in October 20X1. The premises are currently included in the accounting records at cost less accumulated depreciation. The directors wish to recognise the revalued amount in the financial statements for the year ended 30 November 20X1.

The audit manager has asked you to consider the following key areas of audit risk:

- (1) Going concern
- (2) Trade receivables
- (3) Work in progress
- (4) Property, plant and equipment.

Requirements

9.1 Explain why an auditor should consider whether a company is a going concern. Your answer should consider the implications for both the financial statements and the auditor's report. **(7 marks)**

9.2 Justify why the items listed in (1) to (4) above have been identified as key areas of audit risk and, for each item, describe the procedures that should be included in the audit plan in order to address those risks. **(20 marks)**

Note. You should present your answer in a two-columnar format using the headings

- Justification; and
- Procedures to address the risk.

9.3 Explain the matters that should be considered, including any actions to be taken, by you and your firm, if during the course of the audit you discovered that the directors of Lagg had authorised the illegal disposal of hazardous waste in order to save costs. **(6 marks)**

9.4 Identify and explain the principal threats to objectivity which arise from a member of your firm's staff assisting with the preparation of the financial statements as requested by the finance director of Lagg. State how your firm should mitigate these threats. **(7 marks)**

Total: 40 marks

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