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ACCA – Paper F8 Audit and Assurance September and December 2015 Final Assessment

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Notice to Markers

- 1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

<ul style="list-style-type: none">• Time management	<ul style="list-style-type: none">• Handwriting	<ul style="list-style-type: none">• Presentation and layout	<ul style="list-style-type: none">• Use of English
<ul style="list-style-type: none">• Points clearly and concisely made	<ul style="list-style-type: none">• Relevance of answers to question	<ul style="list-style-type: none">• Coverage and depth of answer	<ul style="list-style-type: none">• Accuracy of calculations
<ul style="list-style-type: none">• Calculations cross-referenced to workings	<ul style="list-style-type: none">• All parts of the requirement attempted	<ul style="list-style-type: none">• Length of answers equates to marks available	<ul style="list-style-type: none">• Read the question carefully

- 2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

ACCA Final Assessment

Audit and Assurance

September and December 2015

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL TWELVE questions are compulsory and MUST be attempted

Section B – ALL SIX questions are compulsory and MUST be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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Paper F8

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SECTION A – ALL TWELVE QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED

- 1 Which of the following statements is true in relation to laws and regulations?**
- A Management are responsible for ensuring the organisation complies with the applicable laws and regulations.
 - B Auditors are responsible for ensuring the organisation complies with the applicable laws and regulations.
 - C Auditors must report any instances of non-compliance to the police. **(1 mark)**
- 2 Which of the following is a benefit of an audit?**
- A The auditor will advise the company on strategy for the future.
 - B The audit report may detect fraudulent activity.
 - C The financial statements will be verified as being correct. **(1 mark)**
- 3 Which of the following statements is correct in terms of audit reports?**
- A An audit report may be modified without modifying the opinion.
 - B A qualified opinion means there is a material and pervasive issue.
 - C An emphasis of matter paragraph is used to provide information to the user which management have not provided in the financial statements.
 - D An opinion can be modified without modifying the audit report. **(2 marks)**
- 4 Which TWO of the following activities would be performed at the completion stage of an audit?**
- (1) Assessment of going concern
 - (2) Understanding the entity and its internal control systems
 - (3) Subsequent events review
 - (4) Agreement of the terms of engagement of a new client
- A (1) and (2)
 - B (2) and (4)
 - C (3) and (4)
 - D (1) and (3) **(2 marks)**

5 Which TWO of the following statements are correct?

- (1) Completeness is an assertion relevant only to transactions and events.
- (2) Occurrence means the transaction pertains to the entity.
- (3) Cut-off relates to transactions being recorded in the correct accounting period.
- (4) Assets and liabilities must be tested for accuracy.

- A (1) and (3)
- B (1) and (2)
- C (3) and (4)
- D (2) and (3)

(2 marks)

6 Where the auditor relies on the work of others, this is mentioned in the audit report. Is this statement true or false?

- A True
- B False

(1 mark)

7 Which of the following are examples of self-interest threats?

- (1) Applying for a job with the client
- (2) Overdue fees
- (3) Representing the client in court
- (4) Preparing the financial statements

- A (1) and (2)
- B (2) and (3)
- C (3) and (4)
- D (1) and (4)

(2 marks)

8 Which of the following is NOT a control objective relevant to the payroll cycle?

- A Only valid employees are paid
- B Employees are paid at the correct amount
- C Employees are appropriately qualified for the job
- D Payroll amounts are completely recorded in the ledgers

(2 marks)

- 9 Which of the following procedures is NOT an example of a test of control?**
- A Observe the despatch process to ensure goods are checked before despatch.
 - B Inspect the purchase invoice for evidence of authorisation.
 - C Recalculate the bank reconciliation to ensure arithmetical accuracy.
 - D Inspect the purchase invoices to ensure they are sequentially numbered and confirm a sequence check has been performed. **(2 marks)**
- 10 Sampling risk is the risk the auditor fails to detect the material misstatements in the financial statements. Is this statement true or false?**
- A True
 - B False **(1 mark)**
- 11 Which of the following statements are true in respect of the role of an auditor?**
- (1) An auditor must be a member of a recognised supervisory body.
 - (2) An auditor must have at least 10 years' experience to be authorised to sign off audit reports.
 - (3) An auditor must have a university degree.
 - (4) An auditor is required to undertake continuing professional development once qualified.
- A (1) and (4)
 - B (1) and (3)
 - C (2) and (3)
 - D (2) and (4) **(2 marks)**
- 12 Which TWO of the following statements are true in respect of computer controls?**
- (1) An application control is one which applies to the computer environment
 - (2) Passwords are an example of a general control
 - (3) Application controls are more important than general controls
 - (4) Batch controls are a type of application control
- A (2) and (3)
 - B (1) and (4)
 - C (2) and (4)
 - D (3) and (4) **(2 marks)**

SECTION B – ALL SIX QUESTIONS ARE COMPULSORY AND MUST BE ATTEMPTED

- 1 (a) Explain what is meant by the abbreviation VFM. (4 marks)
- (b) Apart from VFM assignments, explain THREE other types of assignments performed by a company's internal audit department. (3 marks)
- (c) Describe the factors the external auditor would need to consider before relying on the work of the internal auditor. (3 marks)

(Total: 10 marks)

- 2 You are an audit manager in Smith and Jones Co, responsible for the audit of The Chip and Pretzel Company which manufactures high quality, premium snack foods. The following issues have arisen during the audit.

Located around the clients premises are display stands of chips and pretzels which are available for any visitors to the site. The audit team have been told by the finance director to help themselves to as many packets as they like during the audit.

The FD, Margaret Lewis, has recently been recruited from your firm into the role. Margaret was previously the audit manager for this client having worked on audit for a number of years. As she is still settling into her role she has instructed you that she is not to be disturbed by excessive questions from the audit team. To avoid too much disruption to her working day she has requested that you have a brief meeting with her once a week and that under no circumstances should anyone other than you ask her any questions.

Due to the growth of the company, the board of directors has decided it is time to establish an internal audit function. They are not sure whether it will be more beneficial to employ an internal audit team which will report to the board of directors or whether to use an external provider such as your firm and have asked you for advice on this matter. If the decision is made to outsource, Margaret has indicated that she would prefer to use your firm as this will reduce the disruption of having another firm having to gain an understanding of the company.

Required:

- (a) (i) Explain THREE ethical threats which may affect the audit of The Chip and Pretzel Company; and
- (ii) For each threat, explain how it might be managed to an acceptable level. (6 marks)
- (b) Discuss the advantages and disadvantages of outsourcing an internal audit department. (4 marks)

(Total: 10 marks)

- 3** You are the manager responsible for the audit of OCC, a company which provides telecommunications to companies. The audit of the financial statements is nearing completion and the audit report is due to be signed next week.

During the review of the most recent board minutes it was discovered that one of the company's major customers has gone into liquidation after the year end owing OCC \$1m. This debt is included in receivables in the statement of financial position and it is unlikely that any of this debt will be repaid. This customer accounts for approximately 80% of OCC's revenue. The directors have discussed the effect that the loss of this customer will have on the future of OCC and have agreed that whilst it is a serious concern, they have actions they aim to take to make up for the loss of revenue.

- (a) Explain with reasons whether the above event is adjusting or non-adjusting. (2 marks)
- (b) Explain the additional procedures that should be performed and actions that should be taken by the auditor as a result of the liquidation of the customer. (4 marks)

Having completed the file review, you have concluded that the use of the going concern assumption is not appropriate. You have advised the directors that the financial statements need to be redrafted on the break up basis. The directors are refusing to do this.

- (c) Discuss the implications for the audit report of the directors' refusal. (4 marks)

(Total: 10 marks)

4 METCALF

You are the audit senior in charge of the audit of Metcalf Co which manufactures and sells tables and chairs directly to the public.

Current liabilities are shown on Metcalf Co's balance sheet as follows:

	<i>Current year</i>	<i>Prior year</i>
	\$	\$
Trade payables	884,824	816,817
Accruals	56,903	51,551
Provision for legal action	60,000	–
	1,001,727	868,368

The provision for legal action relates to a claim from a customer who suffered an injury while assembling a chair supplied by Metcalf Co. The directors of Metcalf Co dispute the claim, although they are recommending an out of court settlement to avoid damaging publicity against Metcalf Co.

Required:

Describe the substantive audit procedures that you should undertake in the audit of current liabilities of Metcalf Co:

- (i) Trade payables (4 marks)
- (ii) Accruals (2 marks)
- (iii) The provision for legal action. (4 marks)

(Total: 10 marks)

5 Introduction

Blake Co assembles specialist motor vehicles such as lorries, buses and trucks. The company owns four assembly plants to which parts are delivered and assembled into the motor vehicles.

The motor vehicles are assembled using a mix of robot and manual production lines. The 'human' workers normally work a standard eight hour day, although this is supplemented by overtime on a regular basis as Blake has a full order book. There is one shift per day; mass production and around the clock working are not possible due to the specialist nature of the motor vehicles being assembled.

Wages system – shift workers

Shift-workers arrive for work at about 7.00 am and 'clock in' using an electronic identification card. The card is scanned by the time recording system and each production shift-worker's identification number is read from their card by the scanner. The worker is then logged in as being at work. Shift-workers are paid from the time of logging in. The logging in process is not monitored as it is assumed that shift-workers would not work without first logging in on the time recording system.

At least 400 vehicles have to be manufactured each day by each work group. If necessary, overtime is worked to complete the day's quota of vehicles. The shift foreman is not required to monitor the extent of any overtime working although the foreman does ensure workers are not taking unnecessary or prolonged breaks which would automatically increase the amount of overtime worked.

Payment of wages

Details of hours worked each week are sent electronically to the payroll department, where hours worked are allocated by the computerised wages system to each employee's wages records. Staff in the payroll department compare hours worked from the time recording system to the computerised wages system, and enter a code word to confirm the accuracy of transfer. The code word also acts as authorisation to calculate net wages. The code word is the name of a domestic cat belonging to the department head and is therefore generally known around the department.

The list of net pay for each employee is sent over Blake's internal network to the accounts department. In the accounts department, an accounts clerk ensures that employee bank details are on file. The clerk then authorises and makes payment to those employees using Blake's online banking systems. Every few weeks the financial accountant reviews the total amount of wages made to ensure that the management accounts are accurate.

Termination of employees

When employees leave Blake, the personnel department sends an e-mail to the payroll department detailing the employee's termination date and any unclaimed holiday pay. The receipt of the e-mail by the payroll department is not monitored by the personnel department.

Salaries system – shift managers

All shift managers are paid an annual salary; there are no overtime payments.

Salaries were increased in July by 3% and an annual bonus of 5% of salary was paid in November.

Required:

(a) **As the external auditors of Blake Co, write a management letter to the directors in respect of the shift-workers' wages recording and payment systems which:**

- (i) **Identifies FIVE deficiencies in that system**
- (ii) **Explains the possible effect of each deficiency**
- (iii) **Provides a recommendation to alleviate each deficiency.**

Note up to two marks will be awarded within this requirement for presentation.

(17 marks)

(b) **Describe THREE substantive analytical procedures you should perform on the shift managers' salary system.**

(3 marks)

(Total: 20 marks)

6 Your firm has recently been appointed as auditor for Wover Co, a small car manufacturer. The audit partner has recently attended a planning meeting with William Harris the Finance Director and has left the following notes to assist with your planning of the audit.

The draft results are showing revenue of \$198m (2014: \$200m), gross profit of \$71m (2014: \$71m) and profit before tax of \$40m (2014: \$46m). Performance in the first half of the year was stronger than the same period in 2014, however, due to a series of safety issues with some cars (see below), sales in the second half were not as strong resulting in an overall reduction in revenue compared with the prior year.

All cars are sold with a 5 year warranty which enables customers who experience problems with their car, that are not due to normal usage and wear and tear, to take the car to an approved mechanic for repair or replacement free of charge.

During the year, 50 customers experienced severe safety issues with their car and as a result are suing Wover Co. The matter has not yet been brought to court. Given the circumstances of the safety issues, Wover's lawyers believe an out of court settlement will be less costly and less risky than allowing the matter to go to court.

The company replaced a significant part of its production line during the year to improve the quality of production following the safety issues. As a result of the disposal of the old equipment there is a significant loss on disposal recognised in the statement of profit or loss. The company also revalued its factory premises 3 months before the year end to a value of \$5m. This valuation figure is used in the financial statements.

In order to finance the replacement of the production line, Wover took out a 5 year loan for \$3m which is repayable in quarterly instalments.

Extracts from the statement of financial position are shown below.

	2015	2014
	\$m	\$m
Inventory	11	8
Trade receivables	22	17
Cash	0.9	1.4
Trade payables	13	10
Other current liabilities	9	9

Required:

- (a) Calculate FIVE ratios for both years which could assist when planning the audit. (5 marks)**
 - (b) Using the information provided and the ratios calculated, describe FIVE audit risks and explain the auditor's response to each risk when planning the audit of Wover Co. (10 marks)**
 - (c) Explain FIVE items that should be included on every working paper. (5 marks)**
- (Total: 20 marks)**