

UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

MSC ACCOUNTANCY & FINANCIAL MANAGEMENT

SEMESTER ONE EXAMINATION 2019/20

ADVANCED AUDIT AND ASSURANCE

MODULE NO: ACC7507

Date: Thursday 16 January 2020

Time: 2.00 – 5.00

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 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

SECTION A

Question 1

You are an audit manager at Garry & Co, a medium-sized firm of chartered certified accountants.

You have been assigned to the audit of Mike Co for the year ending 31 December 2016. Mike Co has been a client of Garry & Co for the last five years.

You are provided with the following exhibits:

- 1 Email from the audit engagement partner
- 2 Notes from meeting with the finance director of Mike Co
- 3 Recent press articles relating to Mike Co

Exhibit 1 – Email from audit engagement partner

To: Audit manager

From: Audit engagement partner

Subject: Audit planning - Mike Co

Hello

I have provided you with some information in the form of a number of exhibits which you should use in planning the audit of Mike Co. I held a meeting yesterday with Terry Clive, the finance director of Mike Co, and we discussed a number of issues which will impact on the audit planning.

Exhibit 2 – Notes from meeting with Mike Co

Mike Co is a specialist in the quarrying of aggregate materials for use in the building trade. Revenue for the year ended 31 December 2016 is expected to be £31.5 million (2015: £37.3 million); profit before tax is £2.4 million (2015: £3.2 million); and total assets are £23.0 million (2015: £22.1 million).

Exhibit 2 continues over the page

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

Exhibit 2 continued

On 1 January 2016 Mike Co was granted a five year licence by a local council to quarry stone near a national park. The stone is being sold exclusively for use in the construction of a new motorway, the M219, which is due to open in four years. Although the licence did not cost Mike Co anything, the directors have capitalised the licence in the statement of financial position at an estimated fair value of £750,000. They argue that the licence is an asset because they control it and it will produce economic benefits over a number of years.

The licence was granted with one condition, that Mike Co converts the quarry into a lake and nature reserve at the end of the licence period. The directors are providing £75,000 a year to cover the total estimated cost of restoration works.

The local government has awarded Mike Co a £200,000 grant to recruit and train a local workforce and to employ them for the duration of the project. The grant has been recognised in full within revenue this year.

In order to facilitate this new project, Mike Co has purchased new machinery at a cost of £1,250,000, and some new vehicles to transport the stone at a cost of £150,000. The assets are to be depreciated on a straight line basis over ten years, with no residual value. Mr Clive has stated that the new vehicles will be redeployed at the end of the M219 project. It is expected that the machinery will be sold for £250,000 at the end of the project.

Exhibit 3 – Recent press articles relating to Mike Co Fatal accident

An employee was killed in an accident at one of Mike Co's quarries. Mike Co has refused to accept liability as they claim the accident was caused because the employee failed to follow company health and safety procedures. Mike Co has offered the employee's widow £100,000 in compensation as a goodwill gesture however she has refused the money, threatening to sue Mike Co for more substantial compensation. A provision of £100,000 is included in the financial statements for the year ended 31 December 2016.

Exhibit 3 continues over the page

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

Exhibit 3 continued

Environmental protests

Environmental protests have been carried out at the quarry site following the discovery, and consequent relocation of, a rare species of bird. The protest group are planning a legal case to close down the site. The managing director of Mike Co says the company consulted the local council and various experts about the best way to safely relocate the birds, adding that Mike Co was a caring company and that they do everything possible to ensure that the local wildlife is affected as little as possible.

Required:

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

Professional marks will be awarded for the presentation and logical flow of the briefing notes and the clarity of the explanations provided. **(4 marks)**

Using the information and exhibits provided answer the following questions:

(a) Evaluate the audit risks to be considered when planning the audit of Mike Co for the year ended 31 December 2016. **(20 marks)**

(b) Recommend the additional information which would be relevant in the evaluation of audit risk. **(6 marks)**

(c) Design audit procedures to be performed in respect of the useful life of the licence. **(6marks)**

(d) Using the information provided in Exhibit 3:

(i) Explain the auditor's responsibilities and the actions our firm should take in relation to compliance with laws and regulations at Mike Co. **(8 marks)**

(ii) Design audit procedures to be performed in respect of the provision for the fatal accident. **(6 marks)**

(Total: 50 marks)

END OF QUESTION 1

END OF SECTION A

Questions continue over the page

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

SECTION B (All questions compulsory)

Question 2

You are a manager in the audit department of Brian & Co, responsible for the audit of Fred Co which has a financial year ended 31 March 2015. The financial statements show profit before tax of £115 million and total assets of £305 million. The audit is nearing completion and the following issue has been brought to your attention.

Fred Co is a company involved in energy production. It owns several nuclear power stations which have a remaining estimated useful life of 20 years. Fred Co intends to decommission the power stations at the end of their useful life. The statement of financial position at 31 March 2015 recognises a provision in respect of decommissioning costs of £97 million which has been measured using current costs. The audit senior has calculated that the provision should be £83 million after taking into account inflation and discounting. The notes to the financial statements disclose the opening and closing value of the provision but no other information is provided.

Required:

- (a) In respect of the decommissioning provision, comment on the matters that should be considered, and explain the audit evidence you should expect to find when reviewing the working papers. **(11 marks)**
- (b) Discuss the implications for the auditor's report, if any, if no adjustments are made to the financial statements. **(4 marks)**

You are also the manager responsible for the audit of Will Co, a large client of your audit firm, operating in the pharmaceutical industry. The audit work for the year ended 31 March 2015 is nearly complete, and you are reviewing the draft auditor's report which has been prepared by the audit senior. You are aware that Will Co is developing a new drug and has incurred significant research and development costs during the year, most of which have been capitalised as an intangible asset. The asset is recognised at a value of £4.4 million.

Total assets recognised in the draft statement of financial position are £55 million, and Will Co has a draft profit before tax of £3.1 million. Having reviewed the audit working papers, you are aware that management has not allowed the audit team access to the results of scientific tests and trials performed on the new drug being developed. An extract from the draft auditor's report is shown below:

Question 2 continues over the page

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

Question 2 continued

Basis of opinion

Evidence available to us in respect of the intangible asset capitalised was limited because of restrictions imposed on our work by management. As a result of this we have been unable to verify the appropriateness of the amount capitalised, and we are worried that the asset may be overvalued.

Because of the significance of the item, and the lack of integrity shown by management, we have been unable to form a view on the financial statements as a whole.

Opinion: Disclaimer on view given by financial statements

Because of the lack of evidence that we could obtain over the intangible asset, we are unable to form an opinion as to whether the financial statements are properly prepared in accordance with the relevant financial reporting framework.

(c) Required:

Critically appraise the draft auditor's report of Will Co for the year ended 31 March 2015, prepared by the audit senior.

(10 marks)

(Total 25 marks)

END OF QUESTION 2

QUESTIONS CONTINUE OVER THE PAGE

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

Question 3

You are the manager in Simon & Co, a firm of Chartered Certified accountants. You are responsible for the audit of Javed Co, a supplier of components used in the manufacture of vehicle engines. Due to a downturn in the economy, and in the automotive industry particularly, the company has suffered a decline in sales and profitability over the last two years, mainly due to the loss of several key customer contracts. Many of Javed Co's non-current assets are impaired in value, and a significant number of receivables balances have been written off in the last six months.

In response to the deteriorating market conditions, the management of Javed Co decided to restructure the business. The main manufacturing facility will be reduced in size by two thirds, and investment will be made in new technology to make the remaining operations more efficient, and to enable the manufacture of a wider variety of components for use in different types of engines and machinery. In order to fund this restructuring, the management of Javed Co approached the company's bank with a request for a significant loan. You are aware that without the loan, Javed Co is unlikely to be able to restructure successfully, which will cast significant doubt over its ability to continue as a going concern.

Your firm has been asked to advise on the necessary forecasts and projections that the bank will need to see in order to make a decision regarding the finance requested. Management has also requested that your firm attend a meeting with the bank at which the forecasts will be discussed.

Required:

(a)

(i) Recommend the procedures that should be performed in order to examine and report on the forecast to be provided to the bank. **(10 marks)**

(ii) Comment on the ethical and other implications of the request for your firm to provide advice on the forecasts and projections, and to attend the meeting with the bank.

(5 marks)

Question 3 continues over the page

University of Bolton
Institute of Management
MSc Accountancy & Financial Management
Semester 1 Examinations 2019-20
Advanced Audit & Assurance
ACC7507

Question 3 continued

(b)

Additionally Simon & Co needs advice about Auditor's liability as there has recently been an increase of legal claims made against Auditing firms in the past few years.

Critically appraise the methods that can be used by an Audit firm to restrict their liability in relation to statutory audit work. Use examples to illustrate your answer.

(10 marks)

(Total 25 marks)

END OF QUESTIONS

END OF EXAMINATION