AUDIT AND ASSURANCE/ FINANCIAL REPORTING

AAT Fast-Track examination
12 December 2005

From 10.00am to 12.00pm
plus ten minutes reading time from 9.50am to 10.00am

Instructions to candidates

*Answer **three** questions in total: **Two** questions in **Section A** and **one** question in **Section B**. The marks available for each question are shown in italics in the right hand margin.*

All workings should be shown. Where calculations are required using formulae, calculators may be used but steps in the workings must be shown. Calculations with no evidence of this (for example, using the scientific functions of calculators) will receive no credit. Programmable calculators are not permitted in the examinations room.

Formula sheets, statistical tables, graph paper and cash analysis paper are available from the invigilator, where applicable.

Where a question asks for a specific format or style, such as a letter, report or layout of accounts, marks will be awarded for presentation and written communication.

Candidates may use the proforma sheets provided and submit them as part of their answer.

CIPFA

SECTION A – (Compulsory)

1

You are a qualified member of CIPFA and have joined a medium sized accountancy firm, “Alfred James and Co”, which is aiming to break into the public sector market. Shortly after your arrival you receive the attached note from Mr. James inviting you to give a seminar to the partners, explaining your role in the firm.

“Welcome aboard! I think it is important that you address our next partners’ meeting to describe the work we might be obtaining in the public sector.

“There are a number of topics you will need to cover: who undertakes external audit work in the public sector, the respective roles of internal and external audit, operational audits, and risk management. Including some examples of typical audit work would be of particular relevance.

“I am sure this will provide a most interesting topic for our meeting. I look forward to hearing your talk”.

- **Requirement for question 1**

(a) State who conducts the external financial audit of the following:
(i) A Central Government Department.
(ii) A local authority in England.
(iii) A Welsh University.
(iv) A Scottish NHS Board. *4*

(b) What factors determine the status of internal audit? *6*

(c) Describe key risks in the running of an in house print unit and the controls you would expect to see in place to address each of the risks you have identified. *12*

(d) Explain briefly the main recommendations of the Turnbull report. *8*

(30)

2

The following list of balances has been extracted from the records of Mercator plc as at 31 October 2005, the end of Mercator plc's most recent financial year.

Mercator plc
List of Balances as at 31 October 2005

	Note	£
Sales		19,700,000
Cost of sales		16,154,000
Investment income		16,900
Distribution costs		304,600
Administrative expenses	*4*	666,000
Debtors		2,463,000
Creditors		1,077,000
Provision for doubtful debts		49,300
Bad debts		216,700
Directors' remuneration	*3*	179,850
Debenture interest		70,000
Preference dividend paid	*1*	16,500
Ordinary dividend paid	*1*	150,000
Loss on sale of operation	*5*	203,500
Premises, at valuation		1,800,000
Investment property, at valuation		400,000
Equipment, at cost		1,300,000
Provisions for depreciation, as at 31 October 2005		
- premises		120,000
- equipment		1,300,000
Long term investments, at cost		241,000
Stock, 31 October 2005, at cost		796,600
Depreciation	*2*	290,000
Bank overdraft		86,500
Deferred taxation	*1*	66,700
Ordinary shares of 40 pence each		1,000,000
11% preference shares of £1		300,000
14% Debentures		500,000
Share premium		250,000
Revaluation reserve		317,000
Profit and loss account, as at 1 November 2004		429,000

The following additional information is available:

1 Most of the accounting adjustments for the year have already been recorded in the accounts. However, the following have still to be provided for in the accounts for the year ended 31 October 2005:

- audit and accountancy fees of £10,400
- corporation tax of £625,500 on the profits for 2004/2005
- the transfer of £21,400 from deferred taxation
- the preference dividend for the second half of the year
- the proposed final ordinary dividend of 8 pence per share

2 The depreciation charge for the year ended 31 October 2005 of £290,000 can be analysed as follows:

Depreciation by class of asset	£
- Buildings	30,000
- Equipment	260,000
	290,000

Depreciation by function	£
- Production	174,000
- Sales	72,500
- Administration	43,500
	290,000

3 Directors' remuneration for the year comprises the following:

	£
Managing director	47,770
Production director	47,770
Sales director	37,470
Finance director	46,840
	179,850

4 Administrative expenses include bank overdraft interest of £4,300.

5 During the year ended 31 October 2005 Mercator plc disposed of a loss making activity. The activity was sold at a loss of £203,500 which is included in the list of balances as at 31 October 2005. The contribution of the discontinued activity to the results for the year ended 31 October 2005 was:

	£
Turnover	7,880,000
Cost of sales	5,815,000
Distribution costs	73,000
Administrative expenses	160,000

These figures are included in the totals for these items in the list of balances as at 31 October 2005.

- **Requirement for question 2**

(a) Prepare the profit and loss account of Mercator plc for the year ended 31 October 2005. In so far as the information permits this should comply with Format 1 of the Companies Act 1985 and with the requirements of FRS 3. *32*

PLEASE NOTE:

- You need not provide the additional disclosures of expenses required by the Companies Act or a statement of accounting policies.
- Please provide clear workings showing how you have derived your figures.
- You are NOT required to prepare a balance sheet as at 31 October 2005.

(b) Calculate Mercator PLC's earnings per share for the year ended 31 October 2005. *3*

(35)

SECTION B – (Answer one question from this section)

3 The following is a list of the assets, liabilities and capital of Catzen Ltd as at 1 November 2004, the start of its most recent financial year.

Assets:	£000
Intangible fixed assets, net book value	485
Tangible fixed assets, net book value	1,228
Stock	875
Bank	10
	2,598
Liabilities:	
Trade creditors	556
Taxation	15
Accrued interest	30
Bank overdraft	345
10% Debentures	350
Deferred taxation	321
	1,617
Capital:	
Ordinary shares of £1 each	1,200
Share premium account	280
Profit and loss account	(499)
	981

The following is the summarised profit and loss account of Catzen Ltd for the year ended 31 October 2005:

Profit and loss account
for the year ended 31 October 2005

		£000
Turnover		5,660
Cost of sales		
Opening stock	875	
Purchases	3,131	
	4,006	
Closing stock	(997)	
		3,009
Gross profit		2,651
Operating expenses		(1,054)
Interest payable		(125)
Profit before tax		1,472
Taxation		
Corporation tax for current year	(368)	
Underprovision for previous year	(8)	
Deferred taxation	110	
		(266)
Profit after tax		1,206

The following additional information is available:

(i) The following is an analysis of fixed assets as at 1 November 2004:

Fixed assets	Cost	Aggregate depreciation	Net book value
	£000	£000	£000
Equipment	1,660	640	1,020
Motor vehicles	520	312	208
Development costs	220	55	165
Goodwill	400	80	320
	2,800	1,087	1,713

(ii) During the year ended 31 October 2005 equipment costing £110,000, which had a carrying value of £44,000, was sold for £67,000. Equipment costing £240,000 was purchased during the year.

(iii) Depreciation is provided for as follows:
- Equipment and motor vehicles: equally over 5 years
- Capitalised development costs: equally over 4 years.
- Goodwill: equally over 10 years.

In all cases, a full year's depreciation is charged in the year of purchase and no depreciation is charged in the year of disposal. Residual values are assumed to be zero.

(iv) During the year ended 31 October 2005
- 200,000 ordinary shares were issued at £1.40 each. All cash has been received.
- £600,000 8% debentures were issued and the 10% debentures were repaid.

(v) All sales were made on a cash basis and there are no trade debtors. No dividends were paid during the financial year.

(vi) At 31 October 2005 accrued interest was £8,000 and trade creditors were £642,000.

- **Requirement for question 3**

(a) Prepare Catzen Ltd's cash flow statement for the year ended 31 October 2005 using the indirect method.

Your cash flow statement should include a reconciliation of operating profit to net cash inflow from operating activities, but the other notes and reconciliations required by FRS 1 *Cash Flow Statements* are not required. *17*

(b) Using the pro forma balance sheet provided, prepare Catzen Ltd's balance sheet as at 31 October 2005. The note giving details of fixed asset movements during the year is not required. *12*

(c) Comment on how the liquidity of Catzen Ltd has changed during the year ended 31 October 2005. *6*

(35)

4

During the year ended 31 October 2005 Tropex plc commenced work on a construction contract for Egas Holdings plc. The agreed contract price is £300,000. The value of the work certified as done by 31 October 2005 was £90,000. Egas Holdings plc was invoiced for £72,000 of this and had paid £60,000 by 31 October 2005. The remaining £12,000 was paid on 11 November 2005. Costs incurred by Tropex plc up to 31 October 2005 were £70,000. It has been estimated that additional costs of £140,000 will be incurred to complete the contract and this includes £8,000 spent since 1 November.

Tropex plc uses a revenue approach to calculate the percentage of work completed to date. Revenue is to be based on independent surveyors' certificates. Cost of sales is to be calculated by adjusting turnover for attributable profit.

- **Requirement for question 4 (a)**

(a) Prepare figures illustrating how the results to date on the long term contract would be reported in Tropex plc's profit and loss account for the year ended 31 October 2005 and its balance sheet as at 31 October 2005. *13*

The following is a summary of the calculation of Tropex plc's taxable profit for its financial year ended 31 October 2005:

	£
Net profit reported in the profit and loss account	18,560,400
Permanent differences	420,000
Timing differences	(2,520,000)
Taxable profit	16,460,400

£2,380,000 of the timing differences is expected to reverse within the foreseeable future. The rate of corporation tax is 30% and there was a credit balance on the deferred taxation account of £1,260,000 as at 1 November 2004.

- **Requirement for question 4 (b)**

(b) (i) Distinguish between permanent and timing differences giving an example of each. *4*

(ii) Describe briefly the following methods of accounting for deferred taxation:

1) flow through
2) full provision
3) partial provision *5*

(iii) Which of the above methods should Tropex plc use to calculate its deferred taxation, and why? *2*

(iv) Prepare an extract from the profit and loss account of Tropex plc for the year ended 31 October 2005 showing net profit before tax, taxation and net profit after taxation. *3*

(v) Prepare extracts from the balance sheet of Tropex plc as at 31 October 2005 showing how the taxation balances would be reported. Include the appropriate format headings. *3*

(30)