AUDIT AND ASSURANCE/ FINANCIAL REPORTING

AAT Fast-track Examination

10 December 2007

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

Instructions to candidates

*There are **four** questions on this question paper*

*Answer **three** questions in total*

Two compulsory** questions from **Section A
One** of the two questions from **Section B

*The questions in Section A carry, in total, **65** marks*
*The questions in Section B each carry a total of **35** marks*

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.

Proforma booklets, 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.

AT THE HEART OF
YOUR CAREER

SECTION A (Compulsory – answer both questions)

1

The firm of Walker, Harrison and Wilding has recently taken on the internal audit of a local authority. The authority had previously participated in an internal audit consortium.

The Audit Commission, who are the external auditors of the authority, has written to invite the partner responsible for the audit, Mrs. Wilding, to discuss arrangements for working together in the future. In particular the external auditors have indicated that they want to discuss how internal audit can assist them with their detailed audit objectives. The meeting is also to consider operational auditing activities and risk management.

You are a manager in the firm and you have been asked to prepare a briefing note for Mrs. Wilding on your new internal audit client.

- **Requirement for question 1**

(a) Explain the advantages and disadvantages of an internal audit consortium. *8*

(b) Briefly summarise the financial statement assertions relating to transactions applicable to a public sector body as laid down in ISA 500 and associated guidance. *6*

(c) Identify the risks which would be considered when conducting an operational audit of a vehicle fleet. *8*

(d) Explain the four broad alternative courses of action which risk managers can take to deal with a risk and give an example of each. *8*

(30)

2

The following trial balance has been extracted from the records of Baldrick plc as at 31 October 2007, the end of its most recent financial year.

	Notes	Dr	Cr
		£000	£000
Sales			12,908
Other operating income			330
Cost of sales	*4*	8,750	
Inventory, 31 October 2007	*9*	800	
Administrative expenses		770	
Distribution costs	*4*	1,230	
Dividends paid		320	
Corporation tax	*6*	75	
Non-current asset investments	*5*	1,310	
Investment income			110
Interest payable	*8*	36	
Freehold properties, at valuation			
Land	*1, 4*	500	
Buildings	*1, 4*	2,500	
Equipment, at cost	*1, 2, 4*	3,300	
Accumulated depreciation, 31 October 2006			
Buildings	*1*		300
Equipment	*1, 2*		1,200
Cash received on sale of assets	*2*		66
Goodwill, at cost	*3*	400	
Trade receivables and payables		1,425	1,250
Allowance for doubtful debts, 31 October 2006	*7*		40
Cash at bank and in hand		220	
Bank loans			
Due for repayment 1 July 2008			300
Due for repayment 2011			900
9% Debentures 2012			800
Deferred taxation			200
Issued share capital			2,000
Share premium account			300
Revaluation reserve			400
Retained earnings			532
		21,636	21,636

The following additional information is available:

1 The costs or valuations of tangible non-current assets as at 1 November 2006 were:

	£000
Land	500
Buildings	2,500
Equipment	2,550

2 During the year ended 31 October 2007 equipment with a carrying value of £60,000 (cost £410,000) was sold for £66,000. The proceeds have been recorded but no other entries have been made in respect of the sale. Any surplus or deficit on the disposal of non-current assets is to be included in cost of sales.

3 £150,000 is to be written off to recognise the impairment of goodwill during the year ended 31 October 2007.

4 Baldrick plc's depreciation policies are:

- Land: no depreciation charged.
- Buildings: 2% per year using the straight line method.
- Equipment: 30% per year using the diminishing balance method.

Depreciation is charged for a full year in the year of acquisition; no depreciation is charged in the year of disposal.

Depreciation is to be allocated equally between cost of sales and distribution costs. No depreciation is charged to administrative expenses.

5 Non-current asset investments include equity investments which cost £176,000. These were revalued upwards to £226,000 during the year ended 31 October 2005. Baldrick plc's directors have now decided to recognise a permanent diminution in the value of these investments by writing them down to £145,000 as at 31 October 2007. There are no participating interests resulting from holdings of equity shares.

6 The balance on corporation tax represents an overpayment of corporation tax for the year ended 31 October 2006. Corporation tax on the profits for 2006/2007 is estimated at £600,000.

7 Based on past experience and a review of receivables as at 31 October the allowance for doubtful debts is to be adjusted to 4% of trade receivables.

8 The interest payable on the 9% Debentures for the six months ended 31 October 2007 was paid on 9 November 2007.

9 The inventory valuation as at 31 October 2007 includes items which were valued at their cost of £23,000 which should have been written down to their scrap value of £2,000.

- **Requirement for question 2**

Prepare Baldrick plc's income statement for the year ended 31 October 2007 and its balance sheet as at 31 October 2007 in so far as the above information permits. Additional notes and disclosures are not required.

(35)

SECTION B (Answer one from two questions)

3

A trainee member of the accounting staff at Oktagown plc has prepared the following draft (but incorrect) calculation of the company's cash flow from operations using the indirect method:

	£
Profit for the year after tax	453,550
Interest paid	(16,365)
Depreciation charges	(346,450)
Surplus on sale of tangible non-current assets	2,500
Corporation tax recognised in income statement	100,000
Increase in inventories	3,000
Decrease in trade receivables	(271,800)
Prepaid interest	(750)
Increase in trade payables	19,100
Increase in accrued expenses	2,050
	(55,165)

You have the following additional information:

(i) The trainee member of staff has calculated the figures correctly and, where appropriate, has accurately identified whether there was an increase or a decrease, but was not sure either of the layout or whether the figures should be positive or negative.

(ii) The interest paid figure of £16,365 is the actual amount paid during the financial year and includes a prepayment of interest of £750 as at 31 October 2007. There were no prepayments as at 31 October 2006.

(iii) Accrued expenses as at 31 October 2006 and 2007 were wages and salaries.

(iv) The following information has been taken from the financial statements for the year ended 31 October 2007. All these figures are correct.

	£
Sales	10,590,615
Purchases	7,803,000
Discounts allowed	21,200
Discounts received	20,000
Wages and salaries	982,500
Other expenses excluding interest and depreciation	893,800
Corporation tax payable at end of year	130,000
Corporation tax payable at the start of the year	110,000

- **Requirement for question 3**

(a) Using the figures prepared by the trainee member of staff prepare a corrected calculation of the cash flow from operating activities using the indirect method. *12*

(b) Prepare a clear calculation of the cash flow from operating activities using the direct method.

Note: interest paid is to be treated as an operating cash flow. *14*

(c) Calculate the gross profit percentage for the year ended 31 October 2007. *3*

(d) A director of Oktagown plc has suggested that the company could increase its profits for the year ended 31 October 2008 by raising its selling prices.

Discuss the impact that raising prices would have on profit and profitability. *6*

(35)

4

Ashan Airlines wishes to raise funds by selling and leasing back one of its airliners. The carrying value of the airliner was £3.5 million on 31 October 2007. It was sold for its fair value of £10 million on that date and leased back over its remaining useful economic life of 10 years.

The financial year end of Ashan Airlines is 31 December 2007.

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

(i) How should the profit on the sale of the airliner be dealt with in the financial statements of Ashan Airlines plc to conform to the requirements of IAS17 *Leases*? *4*

(ii) Explain how the treatment would differ if Ashan Airlines leased the airliner back for only two years. *2*

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

According to IAS18 *Revenue* what conditions need to be satisfied before revenue can be recognised on the sale of goods? *10*

The disclosure note on pension costs in the corporate report of a company uses the following terms:

(i) defined contribution scheme
(ii) defined benefit scheme
(iii) actuarial valuation.

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

Explain each of the above terms and their significance within the context of IAS19 *Employee benefits*. Your answer to (iii) should identify the factors that an actuarial valuation will normally take into account, and the basis for measuring the assets and liabilities of the fund. *13*

A company has received a government grant of 40% towards the cost of installing new equipment with low carbon emissions. The new equipment cost £280,000 (before the grant) and is to be written off over its estimated economic life of 20 years.

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

Explain how the government grant should be treated in order to conform to the requirements of IAS20 *Accounting for Government Grants and Disclosure of Government Assistance*. Illustrate your answer with appropriate figures. *6*

(35)