

Fundamentals Level – Skills Module

# Audit and Assurance

March/June 2018 – Sample Questions



F8 ACCA

**Time allowed:** 3 hours 15 minutes

This question paper is divided into two sections:

Section A – ALL 15 questions are compulsory and **MUST** be attempted

Section B – ALL THREE questions are compulsory and **MUST** be attempted

**Do NOT** open this question paper until instructed by the supervisor.

**Do NOT** record any of your answers on the question paper.

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

# F8 Paper

Think Ahead



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Accountants

**Section B – ALL THREE questions are compulsory and MUST be attempted**

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 16** Raspberry Co operates an electric power station, which produces electricity 24 hours a day, seven days a week. The company's year end is 30 June 20X8. You are an audit manager of Grapefruit & Co, the auditor of Raspberry Co. The interim audit has been completed and you are reviewing the documentation describing Raspberry Co's payroll system.

**Systems notes – payroll**

Raspberry Co employs over 250 people and approximately 70% of the employees work in production at the power station. There are three shifts every day with employees working eight hours each. The production employees are paid weekly in cash. The remaining 30% of employees work at the head office in non-production roles and are paid monthly by bank transfer.

The company has a human resources (HR) department, responsible for setting up all new joiners. Pre-printed forms are completed by HR for all new employees and, once verified, a copy is sent to the payroll department for the employee to be set up for payment. This form includes the staff member's employee number and payroll cannot set up new joiners without this information. To encourage staff to attend work on time for all shifts, Raspberry Co introduced a discretionary bonus, paid every three months, for production staff. The production supervisors determine the amounts to be paid and notify the payroll department. This quarterly bonus is entered into the system by a clerk and each entry is checked by a senior clerk for input errors prior to processing. The senior clerk signs the bonus listing as evidence of undertaking this review.

Production employees are issued with clock cards and are required to swipe their cards at the beginning and end of their shift. This process is supervised by security staff 24 hours a day. Each card identifies the employee number and links into the hours worked report produced by the payroll system, which automatically calculates the gross and net pay along with relevant deductions. These calculations are not checked.

In addition to tax deductions from pay, some employees' wages are reduced for such items as repayments of student loans owed to the central government. All employers have a statutory obligation to remit funds on a timely basis and to maintain accounting records which reconcile with annual loan statements sent by the government to employers. At Raspberry Co student loan deduction forms are completed by the relevant employee and payments are made directly to the government until the employee notifies HR that the loan has been repaid in full.

On a quarterly basis, exception reports relating to changes to the payroll standing data are produced and reviewed by the payroll director. No overtime is worked by employees. Employees are entitled to take 28 holiday days annually. Holiday request forms are required to be completed and authorised by relevant line managers, however, this does not always occur.

On a monthly basis, for employees paid by bank transfer, the senior payroll manager reviews the list of bank payments and agrees this to the payroll records prior to authorising the payment. If any errors are noted, the payroll senior manager amends the records.

For production employees paid in cash, the necessary amount of cash is delivered weekly from the bank by a security company. Two members of the payroll department produce the pay packets, one is responsible for preparing them and the other checks the finished pay packets. Both members of staff are required to sign the weekly payroll listing on completion of this task. The pay packets are then delivered to the production supervisors, who distribute them to employees at the end of the employees' shift, as they know each member of their production team.

Monthly management accounts are produced which detail variances between budgeted amounts and actual. Revenue and key production costs are detailed, however, as there are no overtime costs, wages and salaries are not analysed.

**Required:**

**(a) In respect of the payroll system for Raspberry Co:**

- (i) Identify and explain FIVE KEY CONTROLS which the auditor may seek to place reliance on; and**
- (ii) Describe a TEST OF CONTROL the auditor should perform to assess if each of these key controls is operating effectively.**

Note: Prepare your answer using two columns headed Key control and Test of control respectively. The total marks will be split equally between each part. (10 marks)

**(b) Identify and explain FIVE DEFICIENCIES in Raspberry Co's payroll system and provide a recommendation to address each of these deficiencies.**

Note: Prepare your answer using two columns headed Control deficiency and Control recommendation respectively. (10 marks)

The finance director is interested in establishing an internal audit department (IAD). In the company she previously worked for the IAD carried out inventory counts, however, as this is not relevant for Raspberry Co, she has asked for guidance on what other assignments an IAD could be asked to perform.

**Required:**

**(c) Describe assignments the internal audit department of Raspberry Co could carry out. (5 marks)**

Raspberry Co deducts employment taxes from its employees' wages on a weekly/monthly basis and pays these to the local taxation authorities in the following month. At the year end the financial statements will contain an accrual for income tax payable on employment income.

**Required:**

**(d) Describe the substantive procedures the auditor should perform to confirm the year-end accrual for tax payable on employment income. (5 marks)**

**(30 marks)**

- 17** You are an audit senior of Loganberry & Co and are planning the audit of Blackberry Co for the year ending 31 March 20X8. The company is a manufacturer of portable music players and your audit manager has already had a planning meeting with the finance director. Forecast revenue is \$68.6m and profit before tax is \$4.2m.

She has provided you with the following notes of the meeting:

**Planning meeting notes**

Inventory is valued at the lower of cost and net realisable value. Cost is made up of the purchase price of raw materials and costs of conversion, including labour, production and general overheads. Inventory is held in three warehouses across the country. The company plans to conduct full inventory counts at the warehouses on 2, 3 and 4 April, and any necessary adjustments will be made to reflect post year-end movements of inventory. The internal audit team will attend the counts.

During the year, Blackberry Co paid \$1.1m to purchase a patent which allows the company the exclusive right for three years to customise their portable music players to gain a competitive advantage in their industry. The \$1.1m has been expensed in the current year statement of profit or loss. In order to finance this purchase, Blackberry Co raised \$1.2m through issuing shares at a premium.

In November 20X7, it was discovered that a significant teeming and lading fraud had been carried out by four members of the sales ledger department who had colluded. They had stolen funds from wholesale customer receipts and then to cover this, they allocated later customer receipts against the older receivables. These employees were all reported to the police and subsequently dismissed. As a result of the vacancies in the sales ledger department, Blackberry Co decided to outsource its sales ledger processing to an external service organisation. This service organisation handles all elements of the sales ledger cycle, including sales invoicing and chasing of receivables balances and sends monthly reports to Blackberry Co detailing the sales and receivable amounts. Blackberry Co ran its own sales ledger until 31 January 20X8, at which point the records were transferred to the service organisation.

In December 20X7, the financial accountant of Blackberry Co was dismissed. He had been employed by the company for nine years, and he has threatened to sue the company for unfair dismissal. As a result of this dismissal, and until his replacement commences work in April, the financial accountant's responsibilities have been adequately allocated to other members of the finance department. However, for this period no supplier statement reconciliations or purchase ledger control account reconciliations have been performed.

In January 20X7, a receivable balance of \$0.9m was written off by Blackberry Co as it was deemed irrecoverable as the customer had declared itself bankrupt. In February 20X8, the liquidators handling the bankruptcy of the company publicly announced that it was likely that most of its creditors would receive a pay-out of 40% of the balance owed. As a result, Blackberry Co has included a current asset of \$360,000 within the statement of financial position and other income in the statement of profit or loss.

**Required:**

- (a) Describe Loganberry & Co's responsibilities in relation to the prevention and detection of fraud and error.**  
(4 marks)
- (b) Describe EIGHT audit risks and explain the auditor's response to each risk in planning the audit of Blackberry Co.**

Note: Prepare your answer using two columns headed Audit risk and Auditor's response respectively.  
(16 marks)

**(20 marks)**

**18** You are an audit manager of Cranberry & Co and you are currently responsible for the audit of Gooseberry Co, a company which develops and manufactures health and beauty products and distributes these to wholesale customers. Its draft profit before tax is \$6.4m and total assets are \$37.2m for the financial year ended 31 January 20X8. The final audit is due to commence shortly and the following matters have been brought to your attention:

**Research and development**

Gooseberry Co spent \$1.9m in the current year developing nine new health and beauty products, all of which are at different stages of development. Once they meet the recognition criteria under IAS<sup>®</sup> 38 *Intangible Assets* for development expenditure, Gooseberry Co includes the costs incurred within intangible assets. Once production commences, the intangible assets are amortised on a straight line basis over three years. Management believes that this amortisation policy is a reasonable approximation of the assets' useful lives, as in this industry there is constant demand for innovative new products.

**Depreciation**

Gooseberry Co has a large portfolio of property, plant and equipment (PPE). In March 20X7, the company carried out a full review of all its PPE and updated the useful lives, residual values, depreciation rates and methods for many categories of asset. The finance director felt the changes were necessary to better reflect the use of the assets. This resulted in the depreciation charge of some assets changing significantly for this year.

**Bonus**

The company's board is comprised of seven directors. They are each entitled to a bonus based on the draft year-end net assets, excluding intangible assets. Details of the bonus entitlement are included in the directors' service contracts. The bonus, which related to the 20X8 year end, was paid to each director in February 20X8 and the costs were accrued and recognised within wages and salaries for the year ended 31 January 20X8. Separate disclosure of the bonus, by director, is required by local legislation.

**Required:**

- (a) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Gooseberry Co's research and development expenditure.** (5 marks)
- (b) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the matters identified regarding depreciation of property, plant and equipment.** (5 marks)
- (c) **Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the directors' bonuses.** (5 marks)

During the audit, the team discovers that the intangible assets balance includes \$440,000 related to one of the nine new health and beauty products development projects, which does not meet the criteria for capitalisation. As this project is ongoing, the finance director has suggested that no adjustment is made in the 20X8 financial statements. She is confident that the project will meet the criteria for capitalisation in 20X9.

**Required:**

- (d) **Discuss the issue and describe the impact on the auditor's report, if any, should this issue remain unresolved.** (5 marks)

**(20 marks)**

**End of Question Paper**

