Strategic Professional – Options

Advanced Audit and Assurance – International (AAA – INT)

March/June 2019 - Sample Questions



Time allowed: 3 hours 15 minutes

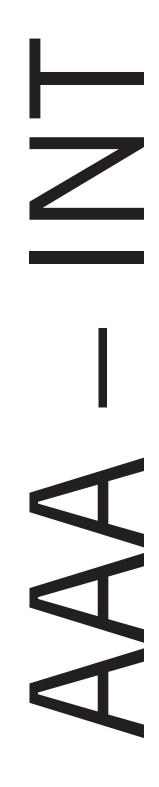
This question paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

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

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



Think Ahead ACCA



The Association of Chartered Certified Accountants

Section A – This ONE question is compulsory and MUST be attempted

1 You are a manager in the audit department of Snow & Co, a firm of Chartered Certified Accountants, and you are responsible for the audit of Margot Co. The company has a financial year ending 30 June 20X9, and you are about to start planning the audit.

Margot Co produces fruit-based food products using agricultural produce grown on its farms. Ben Duval, the audit engagement partner, met with the company's finance director last week to discuss business developments in the year and recent financial performance.

You are provided with the following exhibits:

- 1. An email you have received from Ben Duval, in respect of the audit of Margot Co.
- 2. Notes of a meeting which Ben held recently with the finance director of Margot Co.
- 3. A reference document prepared by Snow & Co containing an overview of the accounting requirements applied in the agriculture sector.
- 4. Extracts from the latest management accounts of Margot Co and accompanying notes, including the results of preliminary analytical procedures, which have been performed by a member of the audit team.
- 5. An email which the audit engagement partner received from Len Larch, a production manager working at one of the company's olive farms.

Required:

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

(46 marks)

Note: The split of the mark allocation is shown in the partner's email (Exhibit 1).

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

(50 marks)

Exhibit 1 - Email from Ben Duval

To: Audit manager

From: Ben Duval, Audit engagement partner for Margot Co

Subject: Audit planning for Margot Co

Hello

I have provided you with some information in the form of a number of exhibits which you should use to help you with planning the audit of Margot Co for the financial year ending 30 June 20X9.

Using the information provided, I require you to prepare briefing notes for my own use, in which you:

- (a) Evaluate the significant risks of material misstatement to be considered in planning the company's audit. You should not include risks of material misstatement relating to the valuation of the company's bearer plants or biological assets, which will be evaluated separately. (20 marks)
- **(b)** Design the principal audit procedures to be used in the audit of:
 - (i) The impairment of the factory, and
 - (ii) The development cost capitalised in respect of the new packaging.

(10 marks)

(c) Discuss the matters to be considered in planning to use an auditor's expert in the audit of the fruit, which are recognised as biological assets of the company. (6 marks)

In Exhibit 5, I have provided you with an email I received from Len Larch, one of the company's production managers. In respect of this, in your briefing notes you should also:

(d) Discuss the audit implications of the email from Len Larch, recommending any further action to be taken by our firm. (10 marks)

Thank you.

Exhibit 2 - Notes of a meeting held on 28 February 20X9

Meeting attendees:

Ben Duval, audit engagement partner, Snow & Co Ayana Easton, finance director, Margot Co

Business background

Margot Co was established 30 years ago by Jim Margot, who began processing the fruit grown on his family farm to make a small range of food products including canned fruit and fruit juice. The business was relatively small until ten years ago, when the company began to expand by acquiring more farmland with different crops, and building new production facilities. This extended the range of food products which could be processed, which now includes olive oil, packaged nuts and frozen fruit. The company sells its products under the 'Fructus Gold' brand name, and the goods are sold in major supermarkets and online on the company's website.

The company is not listed, and the Margot family members are the company's majority shareholders. Jim Margot retired several years ago, his daughter, Mia Margot, is the company's chief executive officer, and other family members hold positions in senior management.

Business developments in the year

Online sales

In the last year, sales made through the company's website grew significantly. The finance director believes that this was in response to an advertising campaign costing \$225,000, which promoted the 'Fructus Gold' brand and coincided with the launch of a new online sales portal on the company website designed to make online ordering easier. To encourage online sales, the company has regular special offers, with discounts periodically offered on a selection of product lines, and offers such as 'Buy One Get One Free' for a limited time on some products.

Research and development

Recently, concern over the level of plastic used in packaging has encouraged food producers to investigate the use of plastic-free packaging for their products. In July 20X8, the board approved a budget of \$400,000 to be spent on research and development into new packaging for its products. By 28 February 20X9, \$220,000 has been spent, with this amount being paid to ProPack, a firm of packaging specialists, to design and develop a range of plastic-free bottles, bags and containers. It is anticipated that the packaging will be ready for use in two years' time at which point the company will introduce it for use across its product range. ProPack is currently testing prototypes of items which have been developed, with encouraging results.

Loan

A loan of \$375,000 was taken out during the year to support the company's research and development plans.

Factory damage

One of the company's several factories, used to process fruit and produce fruit juice, was damaged in August 20X8 when a severe storm occurred. High winds destroyed part of the factory roof, and heavy rain led to flooding and damage to machinery and processing equipment. The factory has not operated since the storm, and the finance director has performed an impairment review on the building and plant and equipment; details of the impairment review are given in the extract from the management accounts (Exhibit 4).

Use of an auditor's expert

The fruit growing on trees and the harvested agricultural produce are biological assets which were recognised at fair value of \$3·1 million in the 20X8 audited financial statements. Due to the specialised nature of these assets, an auditor's expert will be used to provide evidence relating to their valuation. A resource document containing an overview of the accounting requirements in relation to the company's activities is provided in Exhibit 3.

Exhibit 3 – Reference document – Extract from Snow & Co's internal technical guidance for audit staff working with clients in the agriculture sector

IAS® 16 Property, Plant and Equipment – Bearer plants

Definition: A bearer plant is defined under IAS 16 as 'a living plant that:

- is used in the production or supply of agricultural produce;
- is expected to bear produce for more than one period; and
- has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales."

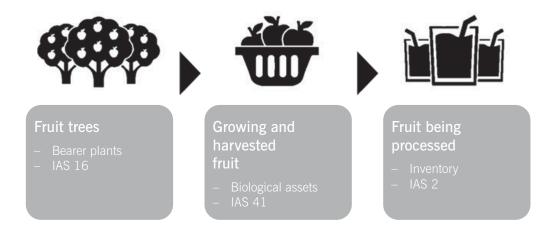
In line with the requirements of IAS 16, bearer plants are recorded at accumulated cost until they reach maturity and then they are depreciated over their useful life.

IAS 41 Agriculture - Biological assets

Produce growing on bearer plants, and harvested agricultural produce are biological assets and should be accounted for under IAS 41. Biological assets are measured on initial recognition and at subsequent reporting dates at fair value less estimated costs to sell, unless fair value cannot be reliably measured. A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in the statement of profit or loss for the period in which it arises.

IAS 2 Inventories - Agricultural produce

When agricultural produce enters the production process, it should be accounted for under IAS 2.



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Exhibit 4 - Extract from management accounts and results of preliminary analytical procedures

	Note	As at 30 June 20X9 Projected \$'000	As at 30 June 20X8 Actual \$'000
Extract from statement of financial position: Total assets		12,500	11,900
Included in total assets: Intangible assets Property, plant and equipment	1 2	525 6,150	50 6,470
Total current assets Cash included in current assets		3,350 760	2,190 750
Current ratio Gearing ratio		2·6 28%	1·4 32%
Extract from statement of profit or loss: Total revenue Online sales included in total revenue		35,600 2,495	32,750 1,310
Operating margin Return on capital employed		28% 5%	26% 4.5%
Profit before tax		2,100	1,900
Extract from statement of changes in equity: Dividend payments		1,200	1,000
Notos			

Notes:

1. Intangible assets includes the following items:

	20X9	20X8
	\$'000	\$'000
Software development costs	80	50
Advertising costs relating to 'Fructus Gold' brand	225	0
Development costs in respect of new packaging	220	0
Total	525	50

Software development costs of \$30,000 were capitalised during the year, which relate to development of the online sales portal. The finance director suggests that both the software development costs and the advertising costs should be capitalised because the increased sales in the year are a direct result of the advertising campaign and improvements in the online sales portal.

The 'Fructus Gold' brand name is not recognised in the statement of financial position, as it is an internally generated asset. This accounting treatment has been confirmed as correct and in accordance with IAS 38 *Intangible Assets*. The notes to the 20X8 financial statements disclosed that the estimated fair value of the brand name is \$18 million.

2. Property, plant and equipment

The carrying amount of \$6.15 million includes \$880,250 relating to the storm-damaged factory (referred to in Exhibit 2) and its fixtures and fittings. The factory is a cash-generating unit for the purpose of impairment testing. The finance director has provided a summary calculation, detailing the following impairment review which indicates that an impairment loss of \$210,250 needs to be recognised: