Strategic Professional – Options

Advanced Audit and Assurance – International (AAA – INT)

September/December 2020 – Sample Questions

AAA INT ACCA EN

AAA – INT

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 It is 1 July 20X5. You are a manager in the audit department of Pegasus & Co, a firm of Chartered Certified Accountants. You are assigned to the audit of the Crux Group (the Group), which has a financial year ending 30 September 20X5, and is a listed entity. Pegasus & Co was appointed auditor to the Group in January 20X5. The Group operates in the travel industry, offering a selection of worldwide itineraries and has a fleet of 20 cruise ships. The Group operates three brands which provide different types of cruise experience.

You are provided with the following exhibits:

1. An email which you have received from Norma Star, the Group audit engagement partner.
2. Background information about the Group and other matters relevant to audit planning.
3. Selected financial information extracted from the Group management accounts.
4. Extracts from the meeting notes taken at a recent audit team meeting in relation to Group planning.

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 the audit engagement partner

To: Audit manager
From: Norma Star, Audit engagement partner
Subject: Audit planning for the Crux Group
Date: 1 July 20X5

Hello

I have provided you with some information which you should use to help you with planning the audit of our new client, the Crux Group (the Group), for the financial year ending 30 September 20X5.

I require you to prepare briefing notes for my own use, in which you:

(a) Using the information in all exhibits, evaluate the audit risks to be considered in planning the Group audit.

Note: You are NOT required to consider audit risks relating to foreign exchange transactions and balances as this will be planned separately. (26 marks)

(b) Design the principal audit procedures to be performed on the segmental information relating to the Group's revenue. (5 marks)

Using the information in the audit team meeting notes (Exhibit 4):

(c) Evaluate the matters to be considered in deciding whether Pegasus & Co should accept the engagement to provide advice on the Group's social and environmental information. (10 marks)

(d) Respond to my request regarding the use of audit data analytics to enhance audit efficiency, effectiveness and quality in the Group audit. (5 marks)

Thank you.

Exhibit 2 – Background information

Group operations

The Group operates cruises under three brands which offer passengers a variety of cruise itineraries with a wide choice of destinations. Cruises typically last for two weeks, though some last for up to six weeks.

The brands are internally generated and therefore are not recognised as intangible assets within the Group financial statements.

Information about the three brands operated by the Group is as follows:

Sunseeker Cruises – Cruises which visit beach destinations in the Caribbean, Europe and North America.

Explorer Cruises – Cruises which focus on visiting cities and landmarks around the world.

Pioneer Cruises – Cruises which take in areas of natural beauty including the Antarctic and Alaska.

Business developments in the year

Sunseeker Cruises

In this financial year, the Group will spend $75 million on upgrading and maintenance of the Sunseeker Cruise ships. These luxury ships have to adhere to a very high standard, so the Group regularly incurs high expenditure on their maintenance. As well as refurbishment, several ships have been enhanced by the installation of new entertainment facilities including cinemas and gyms. Equipment in the gyms will need to be replaced on average every three years.

Explorer Cruises

The Explorer Cruise ships, while still luxurious, are the oldest ships in the fleet, and the Group is gradually replacing these with new ships. During this financial year, two new ships with a total cost of $110 million will come into use. The ships took three years to build, and were constructed by Vela Shipbuilders Co, a company which is not owned by the Group. However, the chairman of the Group, Max Draco, is also the chairman of Vela Shipbuilders Co, and his son is the company's chief executive officer. The purchase of the ships was financed through a $110 million loan with a fixed interest rate of 6% per annum. A further three ships are currently under construction by Vela Shipbuilders Co. The Group has taken out a loan of $180 million with a 6·5% fixed interest rate to finance this capital expenditure.

Pioneer Cruises

These cruises are for more adventurous travellers and are growing in popularity. In order to visit certain destinations on these specialist cruises, the Group has to acquire operating licences from the local governments. The cost of licence acquisition is capitalised as an intangible asset.

Exhibit 3 – Selected financial information

	Note	Projected to 30 September 20X5 $ million	Actual to 30 September 20X4 $ million
Group revenue	1	764	670
Operating profit		145	101
Profit before tax		**81**	**65**
Total assets		**1,800**	**1,780**
Included in total assets:			
Intangible assets – operating licences	2	56	57
Property, plant and equipment	3	1,520	1,510

Note 1
Revenue includes passenger ticket sales, which accounts for approximately 85% of revenue. When customers book a cruise they are required to pay a refundable 20% deposit, which is initially recognised as deferred revenue. The balance of 80% is paid at least six weeks before the cruise commences and at that point it is also recognised as deferred revenue. The full amount of the ticket price is transferred to revenue when the cruise starts irrespective of the duration of the cruise.

The remaining 15% of revenue is derived from on-board sales of food, drinks, entertainment and other items to passengers. Management monitor this revenue stream closely as it achieves a high gross profit margin, and staff are encouraged to maximise these sales to customers.

Revenue is presented on a segmental basis in the notes to the financial statements, with segments based on the three brands of the Group:

Revenue per operating segment	Projected to 30 September 20X5 $ million	Actual to 30 September 20X4 $ million
Sunseeker Cruises	320	288
Explorer Cruises	180	190
Pioneer Cruises	264	192
Total	764	670

Note 2
Operating licences are required for the Pioneer Cruise ships to visit certain destinations. Licences are amortised over the specific period to which each licence relates.

Note 3
Property, plant and equipment is comprised as follows:

Property, plant and equipment	Projected to 30 September 20X5 $ million	Actual to 30 September 20X4 $ million
Ships in use	2,041	2,010
Ships under construction	83	62
Other property, plant and equipment	180	173
	2,304	2,245
Accumulated depreciation	(784)	(735)
Carrying amount	1,520	1,510

Exhibit 4 – Extract from Audit team meeting notes

A meeting took place yesterday in which the audit engagement partner discussed several issues:

Recent development affecting Pioneer Cruises

Last week, the governments of several countries which form a major part of the Pioneer Cruise itineraries withdrew their operating licences with immediate effect. The governments have stated that this is likely to be a temporary measure being put in place to limit the number of tourists visiting areas of natural beauty, but they will not confirm when the Group can resume operations in these countries.

Cyber-security attack

Last month, the Group suffered a cyber-security attack in which the personal information of 1,400 customers, including their credit card details, were stolen. According to a representative of the Group audit committee, the Group's internal audit team had not properly assessed the risks relating to cyber-security, which is a requirement of recently introduced data protection legislation in the jurisdiction in which the Group operates. The issue which led to the cyber-security attack has now been resolved.

Social and environmental information

The Group audit committee has enquired whether Pegasus & Co can provide an additional service, to advise management on how to measure certain social and environmental information which is to be published on the Group's website and is required by new regulations in the industry and is required to be submitted to regulatory authorities. The social and environmental information relates to matters such as water efficiency, energy consumption, charitable donations and initiatives which support diversity in the workplace. In recognition that this work is quite urgent, as the deadline for submission to the regulatory authorities falls within the next month, the Group audit committee has stated it is willing to pay an 'enhanced fee' for this service.

Audit data analytics

The increased use of audit data analytics by many audit firms to provide several benefits including more efficient and effective audit work and enhanced audit quality was discussed. The audit engagement partner asked the team to prepare information describing how the use of data analytics can bring these benefits to an audit like that of the Crux Group.

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Question 2 begins on page 8.

Section B – BOTH questions are compulsory and MUST be attempted

2 **(a)** It is 1 July 20X5. You are an audit manager in Welford & Co, a firm of Chartered Certified Accountants. Your role includes performing post-issuance audit quality reviews, and you have been asked to review the audit work performed on Rivers Co for the financial year ended 31 January 20X5. You have gathered the following information from your review of the audit file:

Audit team and fees

Rivers Co is a listed company operating in the construction industry. The company complies with corporate governance regulations and has an audit committee. Rivers Co has been an audit client of Welford & Co for eight years, and Bob Newbold has been the audit engagement partner during this time. Rivers Co's auditor's report was signed by Bob Newbold and issued last week. The report contained an unmodified opinion.

Welford & Co requires its staff to record each hour they spend working on each client in the firm's time management system. From reviewing the time records relating to the audit of Rivers Co, you are aware that Bob and the other audit team members recorded the following amount of time on the audit:

Bob Newbold – audit engagement partner	2 hours
Pat Canley – senior audit manager	6 hours
Anesa Kineton – audit manager	35 hours
Six audit assistants	130 hours
Total time spent on audit	173 hours

It is apparent from your review that almost all of the detailed review of the audit working papers was completed by Anesa Kineton, who has evidenced her review by stating 'final review' on each page of the audit file. She has recently been promoted to audit manager.

You are also aware that Bob Newbold booked a total of 40 hours to Rivers Co in respect of non-audit work performed. The only information you can find in the documentation is that the non-audit work related to a 'special investigation', and that Bob confirms that it does not create a threat to auditor objectivity. The total fee charged for the audit was $250,000 and the fee for the 'special investigation' was $890,000.

Going concern

From reviewing the audit working papers, you are aware that going concern was identified as a significant audit risk at the planning stage of the audit due to low profit margins or losses being made on many of the company's construction contracts and increasing economic uncertainty. The company typically has 20 contracts ongoing at any time.

Most of the audit work on going concern was performed by Mary Loxley, an audit assistant who has just taken her last professional exam and is not yet qualified. The majority of the audit work performed on going concern focused on a review of five major contracts to determine their profitability. The management of Rivers Co identified the major contracts for review and provided Mary with forecasts indicating that the contracts would all make a small profit. Mary confirmed that the assumptions used in the forecasts agreed to assumptions used in previous years and concluded that the contracts which she had reviewed support the going concern status of the company. Having reviewed these major contracts, Mary completed the conclusion on going concern, stating that there is no significant uncertainty over going concern.

Required:

Comment on the quality of the planning and performance of the audit of Rivers Co, discussing the quality control, ethical and other professional issues raised and recommending appropriate actions to be taken.

(15 marks)

(b) You have also been asked to consider the acceptance of a potential new client, the Broadway Group (the Group). Welford & Co has recently been approached by the audit committee of the Group, to become its audit provider.

The parent company of the Group, Broadway Co, is a listed company, and the Group has a total of 14 subsidiaries, 10 of which are foreign subsidiaries. The Group is a food processor, and each of its foreign subsidiaries provides a particular ingredient used in the Group's main processing plant, which is based in this country. The subsidiaries produce raw ingredients including corn, wheat, vegetables and nuts.

If Welford & Co decides to accept the appointment, it will provide the audit for the Group consolidated financial statements, and for the individual financial statements of some of the subsidiaries. The Group audit committee has suggested that to keep the audit fee as low as possible, Welford & Co could audit the companies based in this country but the foreign subsidiaries would be audited by local firms. These foreign subsidiaries contribute 60% to the Group's total assets.

The Group has recently become involved with a business in Farland, a remote country, which produces tropical fruit. The business is not incorporated as a company and local regulations in Farland only require financial statements to be prepared or an audit to be performed for companies.

From an internet search regarding the Group, you have also obtained the following information:

Local protestors

One subsidiary, Palm Co, has been accused of environmental damage, due to its operations impacting on the rainforest and causing harm to wildlife. There have been some protests by concerned citizens in the country where Palm Co is located. Digital recordings of these protests have spread world-wide on social media.

Expansion of operations

The Group has recently expanded its operations in a certain country by acquiring a large area of land on which to grow wheat. To receive government approval for the acquisition, a significant 'incentive payment' was made to a government minister. This has been reported widely in the media.

Required:

Evaluate the matters which should be considered before Welford & Co accepts the audit of the Broadway Group. (10 marks)

(25 marks)

3 **(a)** It is 1 July 20X5. You are the manager responsible for the audit of Myron Co, a listed company and you are in the process of completing the audit of the financial statements for the year ended 31 March 20X5. The auditor's report is due to be signed in the next few weeks. The company's principal operating activity is the publication of trade and scientific journals. The draft financial statements recognise revenue of $108 million (20X4 – $102 million), profit before tax of $9·3 million (20X4 – $8·2 million) and total assets of $150 million (20X4 – $149 million).

You are in the process of reviewing the audit working papers and have identified the following potential issues:

Sale of division

Myron Co is at the advanced stage of negotiations to sell its scientific publishing division to a competitor. This division contributed revenue of $13 million and profit before tax of $1·4 million during the year to 31 March 20X5. The draft sale agreement which is due to be finalised by 1 August 20X5 shows an agreed sale price after costs of disposal of $42 million. The division is a separate cash generating unit of Myron Co. None of the assets of the division are held under a revaluation policy and depreciation is charged on a straight-line basis over the determined useful life of the assets.

The finance director of Myron Co has not made any disclosures with respect to the upcoming sale in the financial statements for the year ended 31 March 20X5 as he considers it to be part of next year's accounting transactions. However, the division has been written down from its current carrying amount of $45 million to its estimated value in use of $41 million in the financial statements for the year ended 31 March 20X5.

First time adoption of IFRS® 16 *Leases*

Myron Co operates from leased premises and additionally holds leases for printing equipment for journals. These leases are material to the financial statements. The company has adopted IFRS 16 for the first time this year and has adjusted the opening balances and equity without restating comparatives as permitted by IFRS 16. There is, however, no reference in the financial statements to the change in policy or the reasons for making the change to accounting policies. The adjustments have already been checked by the audit team and deemed appropriate.

Required:

(i) Comment on the completion matters to be considered in relation to the issues described and recommend the further actions necessary before the auditor's report can be signed; and

(ii) Evaluate the implications for the auditor's report if no adjustments are made to the financial statements.
(15 marks)

(b) As part of your review of Myron Co, you have also been presented with an extract from the draft chairman's statement which will be published in the annual report alongside the financial statements for the year.

> Extract from chairman's statement
>
> The company's results for the year are extremely positive. Our year on year revenue growth is 5·9% and our profit growth is even stronger at 13·4%. All our revenue streams have performed well, especially the scientific publishing division, and we are looking forward to exciting and sustained growth levels again next year. As you can see from our auditor's report, the auditors agree that our results are strong and a sound basis for taking the company to an even greater place next year.
>
> We have also made significant progress with our social and environmental aims of reducing our carbon footprint and encouraging re-use and recycling across our divisions. We are proud to announce that we have now moved all our printed products to recycled paper.

To help with your review of the information, you also have the following analysis of the results for the year.

	Year ended 31 March 20X5			Year ended 31 March 20X4		
	Other divisions	**Scientific publishing division**	**Total**	**Other divisions**	**Scientific publishing division**	**Total**
	$ million	**$ million**	**$ million**	**$ million**	**$ million**	**$ million**
Revenue	95	13	108	93	9	102
Profit before tax	7·9	1·4	9·3	7·5	0·7	8·2

A file note from the audit supervisor states that at least three of the publications Myron Co sells are not prepared on recycled paper.

Required:

(i) Describe the auditor's responsibilities in relation to the other information presented with the audited financial statements and comment on the matters arising from the extract from the chairman's statement; and (5 marks)

(ii) Assuming no changes are made to the chairman's statement, evaluate the implications for the completion of the audit and the auditor's report. (5 marks)

(25 marks)

End of Question Paper