UNIVERSITY OF BOLTON

INSTITUTE OF MANAGEMENT

MSC ACCOUNTANCY AND FINANCIAL MANAGEMENT

SEMESTER ONE EXAMINATIONS 2022/2023

ADVANCED AUDIT AND ASSURANCE

MODULE NO: ACC7507

Date: Monday 9 January 2023 **Time: 2.00 – 5.00**

INSTRUCTIONS TO CANDIDATES:

There are THREE questions on this paper.
SECTION A consists of ONE question which is COMPULSORY

SECTION B consists of TWO questions, both are COMPULSORY

This is a closed book exam.

You must hand in the exam paper with your answer booklet.

Institute of Management
MSc Accountancy and Financial Management
Semester One Examination 2022/2023
Advanced Audit and Assurance
Module No. ACC7507

SECTION A

Question 1

You are an audit manager in Sadiq & Co, a firm of chartered, certified accountants, responsible for the audit of VirgoSports Co. VirgoSports Co is a national leisure group with sixteen centres around the country and a head office and has been a client of your firm for three years. Profit before tax for the year is expected to be £300,000.

The following exhibits, available below, provide information relevant to the question:

Exhibit 1 – Email from the audit engagement partner.
Exhibit 2 – Background information on VirgoSports Co.
Exhibit 3 – Notes from meeting with the finance director.

This information should be used to answer the question requirements within the response option(s) provided.

Required:
Respond to the email from the audit engagement partner. (40 marks)

Note: The split of marks is shown within the partner's email.

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, professional scepticism and judgement and commercial acumen in your answer. (10 marks)

(Total: 50 marks)

To: Audit manager
From: Audit engagement partner
Subject: Audit planning – VirgoSports 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 VirgoSports Co for the year ending 30 September 20X2.

Based on the analysis I have done on this industry, it is appropriate for overall materiality to be based on the profitability of the company.

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

(a) Evaluate the business risks facing VirgoSports Co. (10 marks)

Question 1 continues over the page – Please turn the page

Question 1 continued

(b) Evaluate and prioritise the risks of material misstatement to be taken into consideration when planning the audit of VirgoSports Co. (14 marks)

(c) Design the principal audit procedures to be used in the audit of:

(i) deferred income/contract liabilities (3 marks)

(ii) hydrotherapy pool. (4 marks)

(d) Suggest performance indicators that could be set to increase the centre managers' awareness of VirgoSports Co's social, environmental and sustainability responsibilities and the evidence which should be available to provide assurance on their accuracy. (9 marks)

Thank you.

Exhibit 2 – Background information on VirgoSports Co

Each leisure centre has a heated swimming pool, sauna, air-conditioned gym and fitness studio and provides supervised childcare.

Each centre is managed on a day-to-day basis, by a centre manager, in accordance with company policies. The centre manager is also responsible for preparing and submitting monthly accounting returns to head office.

Each centre is required to have a licence from the local authority to operate. Licences are granted for periods between two and five years and are renewable subject to satisfactory reports from local authority inspectors. The average annual cost of a licence is £900.

Members pay a £100 joining fee, plus either £50 per month for 'peak' membership or £30 per month for 'off-peak', payable quarterly in advance. All fees are stated to be non-refundable.

Staff lateness is a recurring problem and a major cause of 'early bird' customer dissatisfaction with sessions which are scheduled to start at 07.00. New employees are generally attracted to the industry in the short-term for its non-cash benefits, including free use of the facilities, but leave when they require increased financial rewards. Training staff to become qualified lifeguards is costly and time-consuming and retention rates are poor. Turnover of centre managers is also high, due to the constraints imposed on them by company policy.

Question 1 continues over the page – Please turn the page

Question 1 continued

Exhibit 3 – Notes from meeting with the finance director

The centre at Verne was closed from April to June 20X2 after a chemical spill in the sauna caused a serious accident. Although the centre was re-opened, VirgoSports Co has recommended to all centre managers that sauna facilities be suspended until further notice.

In response to complaints about childcare facilities to the local authorities, VirgoSports Co has issued centre managers with revised guidelines for minimum levels of supervision. Centre managers are finding it difficult to meet the new guidelines and have suggested that childcare facilities should be withdrawn.

Three of the centres are expected to have run at a loss for the year to 30 September 20X2 due to falling membership. VirgoSports Co has invested heavily in a hydrotherapy pool at one of these centres, with the aim of attracting retired members with more leisure time. The building contractor has already billed twice as much and taken three times as long as budgeted for the work. The pool is now expected to open in November 20X2.

Cash flow difficulties in the current year have put back the planned replacement of gym equipment for most of the centres.

Insurance premiums for liability to employees and the public have increased by nearly 45%. VirgoSports Co has met the additional expense by reducing its insurance cover on its plant and equipment from a replacement cost basis to a net realisable value basis.

End of question 1
Questions continue over the page
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SECTION B

Question 2

You are a manager in Hussain & Co, a firm of Chartered Certified Accountants, responsible for the audit of Bridge Co. The audit for the year ended 31 March 20X2 is nearing completion.

The following exhibits, available below, provide information relevant to the question:

1 Completion matters – details regarding issues you have discovered during your review of the audit working papers.

2 Update on completion matters – provides an update on the outcome of initial discussions with the client.

This information should be used to answer the question requirements within the response option provided.

Required:

(a) Using the information in Exhibit 1, comment on the matters that you should consider, and state the audit evidence that you should expect to find, during your review of the audit working papers in relation to the issues identified. (20 marks)

(b) Using the information contained in Exhibit 2, discuss the implications for the auditor's report on the basis that no further adjustments have been made by management.

(5 marks)

(Total: 25 marks)

Exhibit 1 – Completion matters

Bridge Co is a company operating in the cosmetics industry. Due to recession, the company's revenue has fallen substantially, and the company is being forced to restructure its operations. The financial statements show a profit before tax of £3.2 million and total assets of £85 million.

The audit supervisor has brought the following matters to your attention:

(1) The company produces a line of cosmetics for older women called 'Like Fine Wine'. Falling sales revenues led the company to perform an impairment review of the assets in the cash-generating unit in March 20X2.

Question 2 continues over the page – Please turn the page

Question 2 continued

The directors concluded that the assets were not impaired, and so the assets remained in the financial statements at their carrying amount of £900,000. On 15 April 20X2, the line of cosmetics was sold to a competitor for £640,000. (8 Marks)

(2) On 26 March 20X2, the company announced that it was closing down production of its men’s cosmetics division, 'Metrosexual'. The closure is to take effect from 1 September 20X2, and all staff are to be made redundant and to receive redundancy based on their length of service and salary. The expected cost is £620,000, but no provision has been made in the financial statements as the closure will not take place until next year. (7 Marks)

(3) The company has changed the period over which it depreciates plant and machinery. A review of the average lives of plant, performed in February 20X2, showed that plant was lasting for five years when previously depreciation had been charged over three years. The directors have put through a prior year adjustment, and increased opening reserves by £240,000, representing the depreciation that would not have been charged on the company’s current plant if it had always been depreciated over a five-year period rather than three. (5 Marks)

Exhibit 2 – Update on completion matters following discussions with management

It is now 1 September 20X2 and the auditor’s report on Bridge Co’s financial statements for the year ended 31 March 20X2 is due to be issued in the next few days. You have discussed the three completion matters with management and they have indicated that they are not willing to make any further adjustments to the financial statements. You are now considering the form and content of the auditor’s report in relation to these matters.

End of question 2
Questions continue over the page
Please turn the page

Question 3
It is 1 July 20X2. You are an audit manager in Dawson & Co, a firm of Chartered Certified Accountants.

The following exhibits, available below, provide information relevant to the question:

1. Shaikh Co – request to examine and report on the business plan.
2. Update on Shaikh Co's performance – provides an update on Shaikh Co's performance for the six months to 30 September 20X2.

This information should be used to answer the question requirements within the response option provided.

Required:

Using the information in Exhibit 1:

(a) Describe the general matters an auditor should consider before accepting an engagement to report on prospective financial information. (5 marks)

(b) Detail the procedures that the reporting auditor should undertake in relation to the cash flow forecast of Shaikh Co for the year to 30 September 20X3. (9 marks)

(c) Using the information in Exhibit 2, discuss the basis on which auditors should form a conclusion when reporting on prospective financial information, and consider whether the auditors of Shaikh Co may be liable to: (6 marks)

(i) Cranley Bank
(ii) Investors who subscribed for the new loan note.

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, professional scepticism and judgement and commercial acumen in your answer. (5 marks)
(Total: 25 marks)

Exhibit 1 – Shaikh Co
Shaikh Co, a company whose shares are publicly traded, has a credit facility with Cranley Bank of £6 million. The facility is due to expire on the 31 August 20X2. The

Question 3 continues over the page – Please turn the page

Question 3 continued

overdraft in the recently audited statement of financial position at 31 March 20X2 is £5.5 million. The directors of Shaikh Co have started negotiations with their bankers for a renewal of the facility and to increase the amount to £9 million. To support this request, the bank has asked Shaikh Co to provide a business plan consisting of a cash flow forecast supported by a profit forecast and forecast statement of financial position. The management of Shaikh Co have produced a cash flow forecast for the period 1 April 20X2 to 31 March 20X3 and, at the request of the bank, have asked their auditors to examine and report on it.

You have recently completed Shaikh Co's audit, and been asked to make a preliminary examination of the cash flow forecast and supporting material.

Key assumptions used in the forecast:

(i) The cash flows from sales revenues are based on the assumption of an overall increase in revenue of 24% compared to the previous financial year. Analysis shows that this is based on an increase in selling prices of 5% and an increase in the volume of sales of 18%. Just over a quarter of all Shaikh Co's sales are made to overseas customers.

(ii) The cost of sales in the recently audited income statement to 31 March 20X2 was 80% of sales revenue, giving a gross profit margin of 20%. In the forecast statement of profit or loss for the year to 31 March 20X3, cost of sales has fallen to 72%, giving a gross profit of 28%. Manufacturing costs are made up of approximately one third each of materials, labour and production overheads.

(iii) The trade receivables collection period used in the cash flow forecast is 61 days. In the year to 30 September 20X2 this period averaged 93 days. Management has stated that it is its intention to inform all customers of a new standard 60-day credit period. In addition, an early settlement discount of 1% will apply to customers who settle their account within 30 days of the statement. Conversely the credit period for trade payables has been extended from an average of 45 days in the current year to 90 days in the forecast.

(iv) The cash flow forecast showed that the maximum credit required during the period would rise to nearly £9 million in February 20X3.

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Question 3 continued

Exhibit 2 – Update on Shaikh Co’s performance
Your firm issued an assurance report with an unmodified conclusion on the cash flow forecast. The negotiations with Cranley Bank resulted in a renewal of Shaikh Co's existing credit facility of £6 million, but the bank would not agree to increase it to £9 million. As a result, Shaikh Co issued a circular to its existing shareholders inviting them to subscribe for a new £3 million Loan Note issue. The purpose of the circular was to show the intended use and the future benefits from the proceeds of the issue. It was supported by the same prospective financial information, including the assurance report provided to Cranley Bank. However, the directors of Shaikh Co had removed all references to its original purpose and restricted distribution.

The trading results of the first half of the year showed that the forecast information was proving to be over optimistic and that Shaikh Co was beginning to experience cash flow difficulties.

END OF QUESTIONS