ACCA Pre-Sept 26 mock

Ben Wilson's answers

Tutorial notes are provided for each requirement, giving you extra guidance.

These answers were planned and written under exam conditions, to time.

They are NOT perfect, but who you what is achievable in the time allowed.

See the 'examiner's answers' for the 'perfect' answer

Ben Wilson
AAA Expert Tutor

Question 1 Claire Co – Ben's answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

Briefing notes

To: Partner
From: Mnager
Subject: Claure audit planning
Date: 1 July X5

Introduction

These briefing notes will evaluate and priortise significant audit risks, design adiut procedures over share based payments and deferred tax, and discuss factors to consider over relying on internal audit.

(a) Audit risk evaluation

Materiality (PBIT)

Materiality range $7.25m to $14.5m (5-10% of PBIT).

$7.25m materiality level set (low level). High risk audit due to external pressure of securing bank loan. Increases risk of misstatement as maangement have an incentive to present positive financial position to get the loan. Brings more balances into scope for testing.

Sale and leaseback

Material by size at $125m (86% of PBIT, a hugely significant balance)

Sale and leaseback would be appropriate (with profit on disposal)only if a genuine sale has taken place. Key to this is control, if control has passed to Temple.

Control has been retained by Calire. They contrinue to operate the assets, under a contract length (15 years) that is not the full life of the buildings. Option to repurchse at end of contract, with Claire to decide (a critical factor), shows that decision making around the building is retained. -Clair are likely to take up the option and will control asset over remainder of useful life.

Substance over form, this is not a genuine disposal. Inappropriate to recosgnise a sale and leaseback.

Re-recognise assets and depreciate. Cash received should be show as a liability.

Property (PPE) understated. Depreciation undersatated. Long term liabilities underastanted, profit on disposal overstated

Risk priotisied due to scope for management bias (over the 'judgement' that control has passed to Temple). This allows management to present higher profits in the short term and help secure the bank loan.

+44 7968 702318
ben@benwilsonaaa.com

Deferred tax asset

$285m asset is material by size.

Asset can only be recognised if probable that can be used. That future profits of same trade (hotels) will be sufficient to offset the losses and save tax.

Management judgement, they are 'confident' that the asset can be used may be inapproprite/biased.

Current £145m PBIT is mainly a $125m exceptional item (property disposal), it hasn't been generated from same trade. Underlying trading profits may not be enough to justify recognitionof the asset.

Deferred tax asset overstated, tax expenses understated

Risk prioritised due to the potential size of the write down. Would turn profit to loss, fundamentally changing the presentation of the accounts, would be hugelysignificant for a user of the accounts.

Revenue

20% deposit should be shown as deferred income, then recogsised as revenue when performance obligations met (hotel stay takes place).

Expected deferred income balance at year end for bookings that haven't taken place yeat. No deferred income shown in SFP extract. This key detail is lacking, it is required for fuller analysis. May be missing as maangement don't want todraw attention to it.

Revenue growth of 25% is ahead of indusrty 20%. May be be recognising revenue too early (on booking/deposit) rather than on hotelstay, to boost revenue.

5% extra growth is $36m ($713 x 5%), potentialerror is material by size

Revenue overstated, deferred income understated.

Share options

$14m expense is material by size and by nature (impacts director pay).

Equity settled scheme should be measured at fair value at grant date (April X5). Expense then recognised/spread over grant period (5 years). At each reporting date, consider if grant criteria met (e.g. if employees leave) and adjust the expense recognised.

Scope for error here. Technical accounting performed for the first time, maangement may lack experience. Mid year introduction of thescehme, the required pro-rata of expense oculd be incorrect.

Assumptions unrealistic. All options are assumed to vest. Unlikely that all staff will remain at company for 5 years, and not all performance targets will be met. This overstates the expense

Operating expenses overstated, Equity overstated.

Provision

$15m provision is material by size

Provide only if all 3 critieria are met.
- Past event. Flood took place in June X5, before year end. Criteria met.
- Relaible measurement of outflow. Forecast cost of $15m, criteria apprears to have been met.
- Present obligation. Claire are not contractually commited to the repair. Hotels are closed andthe refurb hasn't started. Could decide not to restore the hotels. Criteria not met.

Only recognsie expenses incurred before year end (August and September). Later costs (October onwards) should be recognised next year

Operating expenses overstated, provisions (liability) overstated

+44 7968 702318
ben@benwilsonaaa.com

Repair costs

All $15m recognised as an operating expense, material by size

Repairing and refurbishing is mentioned in the scenario. Should recognise an operating expense if repairing (bringing the hotels back to theirprevios condition). Capitalise costs if upgrading (refurbishment, or improving.). Judgemental as to whether improving, scope for error/bias.

Operating expenses overstated, PPE understated.

Impairment review

Severe damage, with $15m of repair cost required. Hotels are currently closed. All indicate that the value in use and resale value at year end are reduced and could be below carrying amount. An impairmentm review should have been triggered.

Review/impairment required, irrelevant that will be repaired within 6 months. Must consider condition of hotels at year end date (snapshot in time). Clear non-compliance with IFRS.

Property assets (PPE) overstated, impairment expense understated

Tutorial notes

This was the LAST question I did in the exam – leaving the balance of my time for this huge and important question. I reached here with c1 hour remaining. This was ridiculously time pressured. Had you done this question first, you would undoubtedly have overrun and been under pressure.

23 marks….less 3 marks for materiality…..20 marks for ROMMs. With 3 marks per well explained risk, I was happy with 6 or 7, as there will be a few marks for the calculations I included in the answer

Prioritisation – easy to forget to do this…..doesn't take long and earns you a professional skills mark. Also, you can earn technical marks for the explanation too. Well worth doing

Lots of classic examiner tricks here
- First risk in the scenario was complex (allows you to get stuck and overrun)
- Technical accounting (scares you, throws you off)
- Easiest / most obvious risk came last in the scenario (impairment of asset – onlybest stucents get there)
- WAY too much to read and do in the time (overload)
- Numbers given, some helpful, lots not needed (scope to waste time)

+44 7968 702318
ben@benwilsonaaa.com

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b) Principal audit rpocedures

Share based payment expense (measurement)

Grant date (April X5), specific employees included and performance conditions are all core terms that will drive the expense. Agree spoecific details to HR records and employee contracts to ensure correctly reflected in management calculations. Make sure expense is approprioately pro-rata's calcuation (mid year grant) and the correct staff are included in the calculation as this drives the expense.

Reculatulate expense. THe 5 year vesting period and mid year grant add complexity that could lead to error. As a new scheme, miore scope for management error as they lack esperience.

Technical calculation. 5 year period requires discounting, with scope for bias / error. Expert required (management may have comissionsed to do the calcuation already). If so, agree the calculation to their report. Or, engage an auditor's expert to evaluate the calculation.

Assumption that all options will vest requires all staff to remain empoloyed and hit performance targets.

All staff remain employed (none leaving) seems unrealistic. Assess historic staff turnovoer from HR records of senior level (like those in the scehme). Challenge management over why 0% has been assumed (a key judgement) particulary if historic rates are higher.,

Performance targets. Obtain management forecasts that show all targets being met by all staff (another key juidgement). Critically evaluate assumptions, assess if realistic and considtent with budgets/forecasts/ historic performance.

Deferred tax asset (recognition AND measurement)

Historic losses (X1-X4), agree size of losses to tax filings and communications with tax authorities (ideally agreeing size of losses). Losses drive the size of the asset

Unutilised portion. Agree to management calculations, ensure they are consistent with tax filings and any profits in that period (eg in X2 or X3, which may have been profitable).

Check the tax rules, that losses don't time out (X1 losses can be rolled forward). Consider using an expert to confirm this.

Future profits. Obtain management forecasts, ensure they show sufficient future profits to utilise tax losses. Profiuts must be from same trade (confirm this to the forecasts). Confirm that assumptions are reasonable (a key judgement), is it realisitic that past losses won't retunr, and that growth is consistent with the audtors market understanding.

Tutorial notes

Principal procedures – main ones only. I avoided anything minor (like 'add up/cast'), to reduce the risk of losing a PSM for not adhering to the requirements. The examiner's answer includes lots of 'basic' tests…..going against their own advice. Do as the examiner SAYS not as they DO!

I focused my answer on 'judgemental' matters, and used the word 'judgemental' in my answer – to make it super clear to marker, so I would get the PSM for judgement.

Notice that each of my procedures follows the same structure. 1) Fact & 'evidence'. 2) Explain 'how' the test works. 3) Explain 'why' I am doing the test. Do these 3 things to earn a full mark.

This was the 2nd requirement I answered (after part c). I like procedures, I am generally on strong ground – so I tend to answer them first, to build my confidence up.

+44 7968 702318
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c) Discussion of factors (reliance on internal audit (IA)

Direction and reporting.
Who decides on IA's work /who to IA report to shows their status in the company. If self directed, or direted/reporting to the audit committee (independent non executivess), shows they are more independent. If executive directors (e.g. FD) control IA, shows a low level of autonomy and independence.
Less reliance could be placed on IA's work if they lack independence.

Reporting and results.
If IA's findings are acted on by board, it shows their credibility and that IA are respected within company. More likely to rely on IA's work if thier reports are taken seriously.

Quality of work.
IA's work should be properly planned, with appropriate staffing levels. Evidence documented on file should support conclusions drawn. Only rely on IA's work if quality is robust.

Qualifications and experience of internal auditors.
IAs should be quitablyqualified and active members of professional body (e.g. ACCA), showing their technical competence and that theyare bound by an ethical code. Place more reliance on conclusions drawn if the individuals are technically competent.

Quality control.
Work should be reviewed by a more a senior IA, with that review evidenced on the file. In judgemental areas, should be evidence of challenge and secpticism. Work more likely to be reliable if subjected to robust quality control.

Risk.
Consider the assessed risk of misstatement in that area (and the level of subjectivity/management judgement). Cannot rely in IA if a high risk area (high levels of managment judgemental). Internal audit inherently biased as employed by company.

COnclusion

Rely on IA's work in lower risk areas only. Key factor in placing reliance is that their work is properly planned and performed. Assess this in detail prior to placing relaince.

Tutorial notes
As this was 8 marks – I used sub headings (I do this if the number of marks is 8 or more).
Sub headings make your answer easier to mark, and help to earn a communication PSM in Q1.

I did this part FIRST. It is a (relatively) easy question, only exhibit 4 needed. Easier to stick to time.

I didn't quite get to the 8 points I wanted, I only had 7. That's more than enough to pass. CRITICAL that you stick to time. Saving time here gave me more time for parts a) and b)

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ben@benwilsonaaa.com
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AAA Expert Tutor

Question 2 Foxglove Co - Ben's answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

(i) Contract and going concern

Matters to consider (3)

Significant by size (highly material). At 82% of PBIT, client would still profitable if tender is lost, but would be a huge reduction in scale of the business. Loss of other contracts may result from negative publicity over losing this tender. Consider as going concenr could be impacted.

Renewal date (30 Sept X5) is 6 months after year end. Will be within 12 months of accounts signing. Relevant to going concern assumption inder the ISAs.

Competitive tender vs a larger rival. May lose tender (or win at lower price). Management bias could be shjown here, overstating likelihood of winning as it will be preported in a public document (financial statements) that will bepubloished before tender dcided.
Consider as management could be trying to give a positive and confident impression to dept of transport if they read the accounts before deciding on the tender.

Evidence (3)

GOing concern assessment. Critical evaluation of reasonbleness of managements assumptions. Stress testing / sensitivity analysis on file, can they meet debts as they fall due if the contract is not renewed (key variable).

Latest communications from client. Emails / letters or any other dcouemtns post bid beingsubmitted. Assess their response (including any reference to current service levels/quality). Could indicate likelihood of renewal and support

Board minute review, focusing on discussion of likelihood of contract renewal (a sensitive matter, board likely to have discussed). Reviuew for contingency plans if not renewed, are they realistic and do they support going concern assumption if if tender is lost.

(ii) Vehicles

Matters to consider (3)

Indicator of impairment, change in leagla regulations. Vehicles wont be compiant, this should have triggered an impairment review by management. It has not performed.

Material issue as both carrying amount and retrofit cost are material. Management may not understanding responsibilities under the ISAs or may be delivberately not complying. Both are concerning.

New audit without a built up understanding of management competence / trustowrthiness. May need to place lessreliance on management representations of lowermateriality level (currenlty at 10% of PBT, complies with guidelines, could need to adjust lower to reflect this). Noted that we are at the completion phase, but this should still be considered before signing the audit report.

Impairmen required if carrying amout is higher than recoverable amount

Recoverable amount consider fair value less costs to sell. Likely to be low (could easily be below carrying amount) as vehicles not compliant in near future (use prohibited by 1 April X7). Buyer would be taking on cost / hassle of retrofitting.

OR considers value in use, reflecting costof retrofitting. THe $4m is an estimate, management could be understating to justify decision not to impair.

Evidence (3)

New legislation. Evidence that understood in detail by the ausditor, including impact on client and timelines . Highly technical (and a new client), conswideration of using an auditors expert to ensure professional competence.

$4m retrofit cost is a subjective management assessment. Third party evidence over assumptions should be on file (e.g. quotes from contractors, with an assessment of their resonableness vs market rates). This is a key variable in the impairment review

Resale value (fair value less costs to sell), an independent valuation should be on on file. A technical and subjective assumption, prone to management bias to support not impairing (should be higher than $22.6m).

+44 7968 702318
ben@benwilsonaaa.com

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b) Critical appaisal (8)

Opinion paragraph

Unmodified opinion is inappropriate. Doesn;t reflect $5.8m disagreeement/misstatement with managment over the impairment.

Clear mistatement. Management not complying with IASs (IAS36). Impairment should have been recognsied, assets and profits overstated by $5.8m.

Material by size as over $1.52m threshold.

New legislation. Could be of particular interest to a user as it indicates management disregard for rules. Listed company with wider public interest in management integirty, the matter could have wider significance.

However, it is clearly not pervasive. Wouldn't turn profit to a loss ($15.2m profit would fall to $9.4m), does not fundamentally change presentation of accounts. Issue is not widespread, being limited to this particular class of assets.

Qualified except for opinion required. Accounts fairly presented "execpt for" matter descirbed in basis of qualified opinion paragraph.

Opinion title inappropriate. Change to 'qualified opinion' to signpost the opinion. Users more likelyto notice /pay attention.

Basis paragraph

Title should change to 'basis of qualified opinoin' to be consistent with the opinion, reducing confusion for a user.

Update content to feflect reasons for modification. Non complinance with legislation (quantifying $5.8m issue and setting out impact of correcting (reducing assetsandprofit). This content is currently contained in the KAM section, move it over.

Reference to relevant IAS missing (IAS 36), not just non-compliance with legislation. Adds relevant extradetail for a user

KAM section

Going concern reported on separately, not in KAM section. Presented in the wrong section, should be moved.

More detail required on the audit work performed over the forecasts, supporting ability to continue as a going concerrn. Listed client with wider public interest, more trasparency needed to build confidence in the adiut work performed.

Tutorial notes (a)
MATTERS TO CONSIDER is a wider requirement, you have to respond to whatever is in the scenario. Here it was financial reporting, but it could be anything (e.g. ethics, quality)

TECHNICAL LANGUAGE there was some horrible specific and technical industry specific words used in the scenario here (peri-urban, freight forwarding, EURO IV legislation). This does happen in the real exam. Important not to worry about it! You didn't need to know the meaning of these words to be able to answer the question.

TIME. So much to do, so many issues to explain. You had to be disciplined and keep moving on.

EXAMINER TRICK Notice that the first issue was the most time consuming…..a classic examiner trick to throw you off

Tutorial notes (b)
Critically evaluating an audit report is being tested more and more regularly.
Good technique is to set out WHAT is wrong (1/2 mark) and WHY thats a problem (1/2 mark).

Bland, generic points don't score. You have to make use of the information given in the scenario so that you can criticise with authority.

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ben@benwilsonaaa.com
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Question 3 Oakwood Group - Ben's answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

Mahogany

Evaluation

Significant acquisition (20% of group revenue and 16% assets) Highly material change to the group strucutre, the croup is much bigger. More audit resources required to complete audit, this has not been considerede by the partner - a wrrying lapse in planning

Regulated industry. Auditor must understand relevant laws regulations and assess if breached. To comply with the ISAAs and qaulityt managmenet standards. This is a significant source of audit risk. Fines for non compliance (and unrecorded liabilities fpr the client) coud result. Pperating license removed, impacting going concern. Without expertise., the auditor cannot assess the matters.

Lack of auditor expertise leads to detection risk increased (unidentified misstatements, errors in the accounts not being picekd up, and an inappropriateaudit opinion being given). Nelgigent auditing, could be fined by regulator or users of accounts. As a listed client, with many interested parties, risk heightened

Partner shows lack of understanding of ISAs. Assessment of auditor competence must be performed mas there has been a material change to group

Component auditor. May not be qualified / independent / competent, no evidence on file of a formal evaluation. May not be able to rely on their work, concenring given importance of Mahogany to the group.

Lack of direction of compenent auditor (e.g. materiality/risks) means their methodology may not be consistent with ISAs. Materiality may be too high, siginificant groups audit risks may have been overlooked. Insuffiocient evidence may have been gathered

Actions

Appoint an external expert (pharma exeprt). Review audit file and evidence obtained, esure that industry specifc laws/regulations have been followed.

Evaluate Ash & Co formally. Evidence that competent (e.g. references), fill out an- independenc questionairre (particularly important givenrecommended by the FD, may be a familiarity issue).

Issue formal group audit instructions. Include materiality guidance and significant risks. Review their existing group reporting in detail, does it comlpy with guidance. Ensure evidence supports the conclusions drawn

Spruce

Evaluation

Derivitives highly material by size (6.6% total assets). Valuation is complex and judgemental, heightned risk of erroer. Appropriate to use an expert and to assess as high risk.

Duty of confirdentiality to client. Sharing sensitive information with 3rd party without informed consent is a serious breach of ethical standards. Also, damage client relationship (lack of trust) has wider significance. Client may be unwilling to share sensitive data in future (information and explanations are a core reequirement for audit). Shows a lack of professional behaviour from the ausitor.

Expert report not evaluated. No documentation not on file. Not compliant with ISAs, must evaluate experts work toesnure it has been properly planned and performed. Specifically that the valuation methodology is aprrorpiate and conslucions are supported by evidence

Actions

Inform management/TCWG abiout the breach of confidentiality. Give full detail of information shared with Fern and seek to obtain retrospective consent

Obtain detail of Fern's work. Compare valuation methods to industry standard and consider using an independent specialist valuer to verify their work (as it is so complex)/

+44 7968 702318
ben@benwilsonaaa.com

EQR

Evaluation

Appropriate to perform EQR. Listed client, a public interest entity, performi9ng an EQR to comply with ISAs. This - extra scrutiny of audit process and significant judgements made helps to reduce audit risk.

Review partner lacks objectivity. As engagemnet partner last year they are overly familiar with client staff (and audit team). They could accept work performed without challenge as evidenced by lack of detailed review of working papers

Self review threat. Reluctant to identify shortcomings in audit process as heavily involved in its design. Also unwilling to criticise significant audit judgements as may havebeen involved in making them. Could explain superficial review

Fieldwork ongoing, during EQR, this is inapproprite. Reviewer cannot assess if audit concslusions supproted by evidence f evidence still being collected.

Actions

Appont new EQR partner. Ensure objective and has expertise in the diverse range of client activities

Perform EQR in detail to comply with ISAs. Must be completed before audit report signed

Monitoring

Evaluation

Firm wide issues. Same problems as on this audit showing that problems have been allowed to continue woith a lack of remedial actions. Leadership not taking quality management seriously, they are aware of problems and are not fixing them

Actions

Update firm wide processes. More robust system of quality management to address issues and prevent problems on other/future audits.

Conclusion

Significant weaknesses in the planning and performance ofthis audit. Partiocularly the breach of client confidentiality, lack of audit evidence in key areas and an inappropriate EQR partner.

Delay audit report (due to be signed next week) to allow time to do obtain required evidence to support audit opinion and perform the EQR properly.

Tutorial notes

STRUCTURE was tough here. I used the exhibits for my sub headings, rather than the requirement (which was huge, and not suited to sub headings). This allowed me to just deal with each issue that I found in the scenario

FIRST scenario was the most detailed, easy to overrun there

TMI big time! Far too much here for 20 marks, you had to be disciplined and move on. The temptation to overrun everywhere was huge.

MINDSET….assume everything is wrong with the audit, your job is to explain it. It's the quality of your explanations that really counts here.

+44 7968 702318
ben@benwilsonaaa.com