The principal activity of Bateleur Zoo Gardens (BZG) is the conservation of animals. Approximately 80% of the zoo's income comes from admission fees, money spent in the food and retail outlets and animal sponsorship. The remainder comprises donations and investment income.

Admission fees include day visitor entrance fees (‘gate’) and annual membership fees. Day tickets may be pre-booked by credit card using a telephone booking ‘hotline’ and via the zoo’s website. Reduced fees are available (e.g. to students, senior citizens and families).

Animal sponsorships, which last for one year, make a significant contribution to the cost of specialist diets, enclosure maintenance and veterinary care. Animal sponsors benefit from the advertisement of their names at the sponsored animal's enclosure.

BZG's management has identified the following applicable risks that require further consideration and are to be actively managed:

(i) Reduction in admission income through failure to invest in new exhibits and breeding programs to attract visitors;
(ii) Animal sponsorships may not be invoiced due to incomplete data transfer between the sponsoring and invoicing departments;
(iii) Corporate sponsorships may not be charged for at approved rates – either in error or due to arrangements with the companies. In particular, the sponsoring department may not notify the invoicing department of reciprocal arrangements, whereby sponsoring companies provide BZG with advertising (e.g. in company magazines and annual reports);
(iv) Cash received at the entrance gate ticket offices (‘kiosks’) may not be passed to cashiers in the accounts department (e.g. through theft);
(v) The ticket booking and issuing system may not be available;
(vi) Donations of animals to the collection (e.g. from Customs and Excise seizures and rare breeds enthusiasts) may not be recorded.

Required:

(a) Describe suitable internal controls to manage each of the applicable risks identified. (12 marks)

(b) Explain the financial statement risks arising from the applicable risks. (6 marks)

(c) Comment on the factors to be considered when planning the extent of substantive analytical procedures to be performed on BZG's income. (7 marks)

(25 marks)
Harrier Motors deals in motor vehicles, sells spare parts, provides after-sales servicing and undertakes car body repairs. During the financial year to 30 June 2004, the company expanded its operations from five to eight sites. Each site has a car showroom, service workshop and parts storage.

In May 2004, management appointed an experienced chartered certified accountant to set up an internal audit department.

New cars are imported, on consignment, every three months from one supplier. Harrier pays the purchase price of the cars, plus 3%, three months after taking delivery. Harrier does not return unsold cars, although it has a legal right to do so.

Harrier offers ‘trade-ins’ (i.e. part-exchange) on all sales of new and used cars. New car sales carry a three year manufacturer’s warranty and used cars carry a six-month guarantee. Many used cars are sold for cash.

An extensive range of spare parts is held for which perpetual inventory records are kept. Storekeepers carry out continuous checking.

Mr Joop, the sales executive, selects a car from each consignment to use for all his business and personal travelling until the next consignment is received. Such cars are sold at a discount as ex-demonstration models.

Car servicing and body repairs are carried out in workshops by employed and sub-contracted service engineers. Most jobs are started and finished in a day and are invoiced immediately on completion.

In May 2003 Harrier purchased a brand name, ‘Uni-fit’, which is now applied to the parts which it supplies. Management has not amortised this intangible asset as it believes its useful life to be indefinite.

Required:

(a) Using the information provided, identify and explain the audit risks to be addressed when planning the final audit of Harrier Motors for the year ending 30 June 2004. (12 marks)

(b) Identify and briefly explain the principal matters to be addressed in Harrier Motors’ instructions for the conduct of its physical inventory count as at 30 June 2004. (6 marks)

(c) Describe the audit work to be carried out in respect of the useful life of the ‘Uni-fit’ brand name as at 30 June 2004. (7 marks)

(25 marks)
You are the manager responsible for the audit of Eagle Energy, an energy generation company. The draft financial statements for the year ended 31 March 2004 show revenue of $287 million (2003 – $262 million), profit before taxation of $7·2 million (2003 – $23 million) and total assets of $242 million (2003 – $221 million).

The following issues arising during the final audit have been noted on a schedule of points for your attention:

(a) During the year Eagle Energy put its technical staff through a new training program. On the basis that this expenditure has been incurred solely for the purpose of generating future economic benefits the chief executive is adamant that the costs, amounting to $4·3 million, be capitalised as an intangible asset.

(b) During the year Eagle Energy assembled a laboratory on land which had been granted to it for 25 years, by the local authority, in 1995. Under the terms of the grant the laboratory must be dismantled and the site decontaminated when the grant term expires. This is expected to cost $18 million in 2020 and an annual provision of $1·2 million is being made.

(c) Eagle Energy receives significant funding from government sources and is required to report, monthly, on its financial performance and position. Every month end a journal entry is made, ‘Debit Sundry 1 account/Credit Sundry 2 account’. There is no narrative but the chief accountant explained that the journal is approved by the chief executive to ensure that reported debt ratios stay within government specified limits. The entries are then reversed at the beginning of the following month. The net movement on these accounts over the year to 31 March 2004 was $0·3 million.

Required:

For each of the above issues:

(i) comment on the matters that you should consider; and

(ii) state the audit evidence that you should expect to find,

in undertaking your review of the audit working papers and financial statements of Eagle Energy for the year ended 31 March 2004.

NOTE: The mark allocation is shown against each of the three issues.
Section B – TWO questions ONLY to be attempted

4 (a) Explain why quality control may be difficult to implement in a smaller audit firm and illustrate how such difficulties may be overcome. (5 marks)

(b) Kite Associates is an association of small accounting practices. One of the benefits of membership is improved quality control through a peer review system. Whilst reviewing a sample of auditor’s reports issued by Rook & Co, a firm only recently admitted to Kite Associates, you come across the following qualified opinion on the financial statements of Lammergeier Group:

‘Qualified opinion arising from disagreement about accounting treatment relating to the non-adoption of IAS 7

‘The management has not prepared a group cashflow statement and its associated notes. In the opinion of the management it is not practical to prepare a group cashflow statement due to the complexity involved. In our opinion the reasons for the departure from IAS 7 are sound and acceptable and adequate disclosure has been made concerning the departure from IAS 7. The departure in our opinion does not impact on the truth and fairness of the financial statements.

‘In our opinion, except for the non-preparation of the group cashflow statement and associated notes, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2003 and of the profit of the group for the year then ended, and have been properly prepared in accordance with …’

Your review of the prior year auditor’s report has revealed that the 2002 year-end audit opinion was identical.

Required:

Critically appraise the appropriateness of the audit opinion given by Rook & Co on the financial statements of Lammergeier Group for the years ended 31 December 2003 and 2002. (10 marks)

(15 marks)
You are a training manager in Hawk Associates, a firm of Chartered Certified Accountants. The firm has suffered a reduction in fee income due to increasing restrictions on the provision of non-audit services to audit clients. The following proposals for obtaining professional work are to be discussed at a forthcoming in-house seminar:

(a) ‘Cold calling’ (i.e. approaching directly to seek new business) the chief executive officers of local businesses and offering them free second opinions. (5 marks)

(b) Placing an advertisement in a national accountancy magazine that includes the following:

‘If you have an asset on which a large chargeable gain is expected to arise when you dispose of it, you should be interested in the best tax planning advice. However your gains might arise, there are techniques you can apply. Hawk Associates can ensure that you consider all the alternative fact presentations so that you minimise the amount of tax you might have to pay. No tax saving – no fee!’ (6 marks)

(c) Displaying business cards alongside those of local tradesmen and service providers in supermarkets and libraries. The cards would read:

‘Hawk ACCA Associates

For PROFESSIONAL Accountancy, Audit,
Business Consultancy and Taxation Services
Competitive rates. Money back guarantees.’ (4 marks)

Required:

Comment on the suitability of each of the above proposals in terms of the ethical and other professional issues that they raise. (15 marks)

NOTE: The mark allocation is shown against each of the three issues.

The Exposure Draft of ISA 240 ‘The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements’ distinguishes fraud from error, sets out the auditor’s responsibilities with respect to fraud, and provides additional guidance related to earnings management.

Required:

(a) Compare and contrast the auditor’s responsibility for the detection and reporting of fraud and of error. Your answer should distinguish fraud from error. (5 marks)

(b) Explain the term ‘professional skepticism’ and comment on its role in the detection of fraud. (5 marks)

(c) Comment on the difficulties which ‘earnings management’ present to the auditor. (5 marks)

End of Question Paper