



**CA PROFICIENCY 2**  
**AUDIT AND ASSURANCE**  
**INTERIM ASSESSMENT – SEPTEMBER 2017**  
**PAPER AND SUGGESTED SOLUTION**

**Information Note:**

This report contains the following documents:

Page 3: Exam question booklet (as sat on 2<sup>nd</sup> September 2017)  
Page 11: Formal suggested solution

As with all examinations, the solution is a 'suggested' solution only. Candidates who present alternative, valid solutions to any question will always receive the appropriate credit in an examination.

**This suggested solution is written to the CAP2 Competency Statement 2016/2017**



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*All references to the masculine gender within this document are intended to refer to both male and female as appropriate.*

# CA Proficiency 2



## AUDITING AND ASSURANCE

### INTERIM ASSESSMENT

Saturday 2 September 2017: 12:30 pm – 2:00 pm

#### INSTRUCTIONS TO CANDIDATES

1. Answer **ALL** questions.
2. Candidates should deem each monetary amount shown with the €/£ symbol to be stated in their relevant currency.
3. All workings should be shown.
4. Answers should be illustrated with examples, where appropriate.
5. This is an Open Book Exam.

**Audit area examined: Costs and Expenses**

# CAP 2 Auditing & Assurance Interim Assessment

## Background

You are an audit senior in BEJ Chartered Accountants and have just learned you are to review the audit work performed to date on Packit Packaging Limited ('PACKIT'). PACKIT purchases packaging products from manufacturers mainly based in Asia and resells these goods to local companies. You are keen to impress on this engagement as you are aware BEJ's partners take an interest in everything to do with PACKIT, probably because it is their biggest client.

The board of PACKIT, under pressure from their shareholders to grow revenue, have pursued an aggressive growth strategy since the start of 2016. BEJ's business advisory department were engaged to review PACKIT's markets and they concluded that their traditional market of supplying furniture manufacturers and dry goods suppliers was saturated. Following BEJ's advice, PACKIT expanded into the food packaging market with mixed results. They were successful in gaining market share, however the additional costs of regulation in this market were underestimated.

Your audit partner leaves you the following voicemail:

*"I want you to review the work performed on expenses. When reviewing PACKIT remember we deem the audit to be high risk due to the lack of effective controls so ensure the audit approach, and evidence obtained, are appropriate."*

You obtained the following extracts from the current year audit file:

<u>Document</u>	<u>Page</u>
Unaudited statement of profit or loss	3
Client's analysis of expenses	4
Audit junior's working paper	5
Supporting documentation from audit file	6 - 7

Materiality has been set by the audit partner at €/\$ 500,000.

## Requirement:

- a) Explain TWO potential ethical issues in the audit of PACKIT **and** suggest safeguards you feel may be appropriate for the issues identified;  
**18 marks**
- b) Review the analytical review testing on *page 4*. Comment on the quality of audit work performed **and** suggest any further work you deem necessary (if any). Ignore 'Other Expenses' which is dealt with in part c);  
**35 marks**
- c) Review the tests of detail performed on 'Other Expenses' (*pages 5-7*). State any concerns you have **and** further testing you believe should be undertaken (if any);  
**32 marks**
- d) Set out any journal adjustments you believe necessary following your conclusions in parts b) and c) above.  
**15 marks**

**Total 100 marks**

## Packit Packaging Limited

### Statement of profit or loss for the year ended 31 December 2016

	2016 €/ <b>£</b> '000	2015 €/ <b>£</b> '000
<b>Revenue</b>	<b>50,000</b>	<b>42,500</b>
Cost of sales	(40,000)	(30,000)
	<hr/>	<hr/>
<b>Gross profit</b>	<b>10,000</b>	<b>12,500</b>
Administrative costs	(5,000)	(6,000)
Distribution expenses	(3,000)	(3,000)
Other expenses	(5,000)	(300)
	<hr/>	<hr/>
	<b>(3,000)</b>	<b>3,200</b>
Finance expense	(600)	(500)
	<hr/>	<hr/>
<b>(Loss)/profit before tax</b>	<b>(3,600)</b>	<b>2,700</b>
Tax expense	-	(700)
	<hr/>	<hr/>
<b>(Loss)/profit</b>	<b>(3,600)</b>	<b>2,000</b>
	<hr/>	<hr/>

## BEJ Chartered Accountants

**Client:** Packit Packaging Limited  
**Subject:** Expenses  
**Year end:** 31 December 2016

**Prepared by:** Audit Junior  
**Reviewed by:** You  
**Date:** 9 July 2017

### Objective:

To gain assurance that expense account balances are free from material misstatement.

### Methodology:

Perform an analytical review on expenses obtaining corroborating evidence to support explanations where necessary.

### Results:

Expense	2016 (€/£'000)	2015 (€/£'000)	Explanation per Bill Boss (PACKIT's CEO)	Notes
Cost of sales	40,000	30,000	Up because revenue has increased.	1
Administrative costs	5,000	6,000	Savings made here as we knew other costs were increasing.	2
Distribution expenses	3,000	3,000	<i>[Explanation not sought as cost is in line with the prior year]</i>	n/a
Other expenses	5,000	300	Increase relates to costs of obtaining regulatory approval for supplying to the food industry.	3

### Notes:

1. Explanation appears reasonable, no further work necessary;
2. On further investigation, difference is mainly due to no rent expense being recorded in 2016. Per discussion with Bill Boss, this is due to a re-negotiation of terms with their landlord who gave them a rent free initial year in return for signing up to a ten-year lease commencing 1 January 2016. Repayments of €/\$ 2,000,000 per year started in January 2017. Appears reasonable;
3. Analytical procedures not appropriate - see tests of detail performed on schedule M11.

### Conclusion:

Expense account balances appear free from material misstatement.

## BEJ Chartered Accountants

**Client:** Packit Packaging Limited  
**Subject:** Other expenses  
**Year end:** 31 December 2016

**Prepared by:** Audit Junior  
**Reviewed by:** You  
**Date:** 9 July 2017

### Analysis of Other Expenses:

Cost	2016 (€/£'000)	Description	Audit work performed
Regulatory fee	800	Fee paid to government agency for approval to supply to the food sector	Agreed to correspondence from government agency – schedule M12
Additional storage facilities	2,200	New storage systems necessary to store packaging in hygienic environments	Agreed to invoice – see schedule M13
Deep cleaning costs	500	Cleaning required to bring the warehouses up to the standard required	Temporary staff employed from a local cleaning company to carry out this work – amount appears reasonable
Miscellaneous	700	Other expenses, individually of small value	All balances immaterial – no audit work necessary

# Department of Food Standards



15 June 2016

Packit Packaging Limited  
1 Estate Street  
Wilderness  
Ireland

**Re: Approval reference 2334/PPL**

Following our recent inspection visits to your premises, and the written undertakings you have provided to us, we hereby grant approval of your licence application to supply products to the food industry in Ireland. This approval is subject to payment of the statutory fees, details of which are provided below:

**Schedule of fees:**

	€/£
Initial application and inspection fees	300,000
5 year licence (commencing 1 July 2016)	500,000
Total costs	<u>800,000</u>

***This amount is payable immediately.***

We remind you that the licence will need to be renewed every five years and is subject to the satisfactory outcome of quarterly inspection visits.

Yours sincerely

A Inspector



**SSS****Superior Storage Systems**

1 January 2016

Packit Packaging Limited  
 1 Estate Street  
 Wilderness  
 Ireland

**Invoice: 54628**

<u>Description</u>	<u>Value</u>
Chemically balanced system compliant with food hygiene storage requirements:	
100,000 square foot storage system	€/£ 2,200,000
<hr/>	
Total net:	€/£ 2,200,000
VAT:	€/£ 440,000
<b>Total:</b>	<b>€/£ 2,640,000</b>

**Note:**

Due to the finite life of the chemicals used in the above products, the system will require replacement after eight years.

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# CA Proficiency 2 – Auditing & Assurance

## Interim Assessment 2017 Paper 3

### Suggested Solutions

## Part (a)

### Ethical issues:

1. **Issue:** Biggest client – obtaining a significant amount of fees from one client represents a potential self-interest threat as the level of fees could cloud judgment when considering whether to issue a modified audit opinion. Guidance is provided in Ethical Standard 4 – ‘Fees, remuneration and evaluation policies, litigation, gifts and hospitality’.

**Safeguard:** Monitor fee levels. If total fees earned from Packit will regularly exceed 15% of BEJ’s income, it is not permitted to accept/continue the audit engagement. If the fees will be greater than 10% but less than 15%, an external independent quality control review of the audit engagement should be undertaken before the auditor’s report is finalised.

2. **Issue:** Advisory services – BEJ provided non-audit services to Packit. The nature of these services, being advisory, represents a management threat to auditor independence as BEJ could advise Packit to take a certain decision and then subsequently audit the outcome of that decision. Guidance is provided in Ethical Standard 5 – ‘Non-Audit Services Provided to Audited Entities’.

**Safeguard:** Ensuring the audit service and the non-audit services are delivered by separate teams with separate responsible partners. A hot file review could also be performed.

## Part b)

### Cost of sales:

- Inadequate explanation – sales have risen 17.6% however cost of sales have risen 33.3%
- Relying on a management representation here is not sufficient. Further testing is required....
- Obtain a breakdown of the charge for this year and conduct tests of detail on a sample e.g:
  - Vouch to invoice for purchases; or
  - Vouch to payroll records for employee costs classified as cost of sales; and
  - Vouch to bank statement

### Administrative costs:

- IAS17 *Leases* requires rent free periods to be recognised over the lease term however Packit have not recorded any charge for 2016.
- Total lease payments will be  $9 \times \text{€}/\text{£}2\text{m} = \text{€}/\text{£}18\text{m}$  for a 10 year period so the annual charge should be  $\text{€}/\text{£}1.8\text{m}$  – **see journal 1 in part (d)**
- Obtain a copy of the lease agreement and agree lease term and costs.
- Vouch post year end payments of rent and ensure in line with lease agreement
- We still need to audit the remaining admin costs. Obtain an analysis of the  $\text{€}/\text{£}5\text{m}$  and perform additional procedures e.g. agreeing sample to invoice

### Distribution expenses:

- The cost may be in line with the prior year however this does not make sense. You would expect distribution costs to rise in line with revenue which has increased by 33.3%
- Further work is required here. Enquire from management as to why distribution costs represent 7.5% of cost of sales in 2016 when they represented 10% in 2015
- Substantiate the explanations received by agreeing a sample of costs to invoice or other supporting documentation
- Perform unrecorded liabilities testing to ensure all distribution charges relating to 2016 are accrued.

## Part c)

### Regulatory fee:

- €/ $\pounds$ 500k of the fee is for a licence which covers a 5 year period, only 6 months of which relate to the 2016 year.
- The other 4.5 years, i.e. €/ $\pounds$ 450k, should be treated as a prepayment. **See journal 2 in part d)**
- Review subsequent correspondence with the government department to ensure Packit are still in compliance with the quarterly inspection visits.

### Additional storage facilities:

- This cost appears to be capital in nature therefore should be treated as a non-current asset. **See journal 3 in part d)**
- Physically inspect asset
- Agree cost of €/ $\pounds$ 2,640,000 to bank statement

### Deep cleaning costs:

- Conclusion that the “amount appears reasonable” is insufficient audit evidence as no basis for such a conclusion is stated
- If a local cleaning company supplied the labour, trace the cost to supplier invoice and bank statement

### Miscellaneous:

- All balances may, individually, be immaterial however the overall balance is material therefore further work is necessary
- Obtain a breakdown of the €/ $\pounds$ 700k and perform audit procedures thereon e.g. agreeing sample to supporting documentation and evidence of payment.

### Other:

- The schedule does not tot to €/ $\pounds$ 5m, it totals €/ $\pounds$ 4.2m.
- Enquire of management as to what the difference of €/ $\pounds$ 800k relates to and perform further audit work on the explanation provided as the difference is material.

**Part d)**

Journals necessary:

**1. Rent**

	P&L		SOFP	
	Dr	Cr	Dr	Cr
	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>
Rent	1,800,000			
Accruals				1,800,000
<i>Being recognition of rental accrual</i>				

**2. Regulatory fee**

	P&L		SOFP	
	Dr	Cr	Dr	Cr
	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>
Prepayments			450,000	
Other expenses		450,000		
<i>Being prepayment of regulatory fee applicable to subsequent years</i>				

**3. Additional storage facilities**

	P&L		SOFP	
	Dr	Cr	Dr	Cr
	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>	<u>€/£</u>
Non-current assets			2,200,000	
Other expenses		2,200,000		
Depreciation charge	275,000			
Accumulated Dep'n				275,000
<i>Being capitalisation of the storage system and accounting for the associated depreciation</i>				

**END OF DOCUMENT**