

Singapore CA Qualification (Foundation) Examination

21 June 2018

Assurance

INSTRUCTIONS TO CANDIDATES:

1. The time allowed for this examination paper is **3 hours 15 minutes**, including 15 minutes of reading time. Only annotations are allowed on the question paper during the reading time.
2. This examination paper has **FOUR (4)** questions and comprises **SIXTEEN (16)** pages (including this instruction sheet and appendix A). Each question may have **MULTIPLE** parts and **ALL** questions are examinable.
3. Only calculators that comply with the SAC's regulations may be used during the examination. However, computers, mobile phones, tablets, and other electronic devices **MUST NOT** be used during the examination.
4. The number of marks allocated is shown at the end of each question.
5. Write legibly in black/blue ink only.
6. All answers must be written in the answer booklets provided.
7. Begin your answer to each question in a separate answer booklet.
8. This question paper **MUST NOT** be removed from the examination room.
9. This examination paper is the property of the Singapore Accountancy Commission.

MODULE-SPECIFIC INSTRUCTIONS:

10. Assume that all dollar amounts are in Singapore dollar (S\$) unless otherwise stated.
11. Unless specified otherwise, assume that all the reporting entities in all the questions adopt, for all the relevant years, the Singapore Financial Reporting Standards (SFRS) that were issued by the Accounting Standards Council as at 1 January 2018 and the Singapore Standards on Auditing issued by ISCA as at 1 January 2018.
12. This is a restricted open book examination. This means that you are allowed to only bring the following materials into the examination hall:
 - One A4-sized double-sided cheat sheet.

Question 1 – (a) – (n)

ABC Private Limited (ABC) hires 51 employees. All employees are paid a monthly salary via bank transfer on the last business day of each month. The payroll system calculates gross (basic salary), deductions for employee's Central Provident Fund (CPF) contribution, and net amount paid to the employee (net salary). The system also produces a payroll report that includes the following details:

- Employee number;
- Employee name;
- Basic salary;
- CPF – employer's contribution;
- CPF deduction – employee's contribution; and
- Net salary.

The basic salary total, CPF – employer contribution total, CPF employee deduction total, and net salary total are posted to the general ledger.

The payroll system also generates a bank payment list that includes the following details:

- Employee name;
- Employee bank account details (bank, branch, and account number); and
- Amount to be paid into the employee's bank account.

The Senior Accountant performs the following procedures on six random samples:

- (1) Select sample employees from the payroll report and agree their details to the bank payment list.
- (2) Select sample employees from the bank payment list and agree their details to the payroll report.

The Senior Accountant signs both the payroll report and the bank payment list. These documents are passed on to the Finance Director (FD) who signs both documents indicating approval. The signed bank payment list is then sent to the bank to initiate the cash transfers to the employees.

The monthly acknowledgement letters from CPF confirming details of CPF contributions received are filed in date sequence.

The audit programme detailed the following audit procedures to be performed:

Compare payroll reports from two different months, e.g. June and July:

- (ci) For employees not included in the payroll report for June but included in the report for July,
- (cii) Agree details to personnel records in the Human Resource Department and recalculate basic salary.

- (di) For employees included in the payroll report for June but not included in report for July,
- (dii) Agree details to personnel records in the Human Resource Department and recalculate basic salary.

The audit working papers documented that the FD does not personally review the payroll report or the bank payment list because the FD trusts that the Senior Accountant has ensured all details are in order. The FD has worked with the Senior Accountant for many years and has absolute confidence in the Senior Accountant's capability and integrity.

Question 1 required:

- (a) For procedures (1) and (2) above performed by the Senior Accountant, explain ONE purpose of each procedure from the perspective of internal controls.
(4 marks)
- (b) Describe TWO Tests of Controls that the auditor could perform to confirm the operating effectiveness of control (1) performed by the Senior Accountant.
(4 marks)
- (c) Describe ONE Test of Controls that the auditor could perform to confirm that the Finance Director has approved the payroll report and bank payment list appropriately.
(2 marks)
- (d) State TWO Tests of Details that the auditor could perform to confirm that the employees are bona fide employees of the company.
(2 marks)
- (e) State ONE Test of Details that the auditor could perform to confirm that the gross basic salary in the payroll record is correct.
(1 mark)
- (f) State ONE Test of Details, other than recalculation, that the auditor could perform to confirm that the Central Provident Fund (CPF) deduction for employee's contribution is accurate.
(1 mark)
- (g) State ONE Test of Details that the auditor could perform to confirm that the Central Provident Fund (CPF) contributions (employee and employer amounts) have been paid to the CPF Board.
(1 mark)

- (h) State ONE Test of Details that the auditor could perform to confirm that all employees are included in the payroll report. **(1 mark)**
- (i) State ONE Test of Details that the auditor could perform to confirm that employees who have left the company were only paid to their last day of work and not beyond. **(1 mark)**
- (j) Explain ONE objective of audit procedure (ci). **(1 mark)**
- (k) Explain TWO objectives of audit procedure (cii). **(2 marks)**
- (l) Explain ONE objective of audit procedure (di). **(1 mark)**
- (m) Explain TWO objectives of audit procedure (dii). **(2 marks)**
- (n) In accordance with Ethics Pronouncement (EP) 100 the ISCA *Code of Professional Conduct and Ethics*, identify and explain ONE ethical threat arising from the way the Finance Director approves the payroll payment. **(2 marks)**
- (Total: 25 marks)**

Question 2 – Part 1 and Part II

Part I

You are the audit assistant assigned to audit the financial statements of a perfume manufacturer, Chara. One of its perfumes, No. z13, is selling very well. When you requested the costing documents for the production cost of work-in-progress and finished goods, management refused, citing protecting Chara's trade secrets as the reason for their refusal. The costing documents reveal the ingredients used, information which they believe should be kept confidential. The inventory balance in the draft statement of financial position represents 15% of total assets.

Question 2 Part I required:

- (a)** Explain the implications of lack of access to costing documents on the audit of Chara. **(2 marks)**

- (b)** Explain whether the issue in (a) above will have a material and/or pervasive impact on the financial statements. **(4 marks)**

The Chief Financial Officer suggested that a viable way to get out of this impasse is for the audit opinion to remain unmodified, but for an emphasis of matter paragraph to be included in the audit report to explain the issue relating to inventory valuation.

- (c)** Propose an appropriate audit opinion if the above issue cannot be resolved and explain why your firm should not agree to the suggested emphasis of matter paragraph. **(4 marks)**

When the audit manager communicated the proposed audit opinion in (c) above to management, management reacted negatively and stated they will consult a larger audit firm on the above issue to see whether the larger audit firm has a similar opinion to your firm's proposed audit opinion.

(d) Describe the ethical threat affecting your firm arising from the reaction of management stated above. **(2 marks)**

(e) Describe the ethical threat affecting the larger audit firm if it were to accept the engagement to offer an opinion as requested. **(2 marks)**

Question 2

Part II

Chara's latest product, No. z21, was highly anticipated and the first and only batch of No. z21 produced this year was sold out to retailers by year end. However, a scientific report published one day after year-end confirmed that an ingredient used in No. z21 contained a toxic element. The entire first batch of No. z21 sold to retailers was returned to Chara within a week of the scientific report being published. Chara has issued a press statement that it will donate its entire inventory of No. z21 and the toxic ingredient in stock to the laboratory that published that scientific report for further research.

- (a)** Describe the impact arising from the return of No. z21 by the retailers on the revenue recognised in Chara's current year's statement of comprehensive income. **(2 marks)**
- (b)** Describe TWO substantive procedures to be performed to verify the issue in (a) above is correctly accounted for. **(2 marks)**
- (c)** Describe the impact that the donation of No. z21 and the associated toxic ingredient will have on Chara's current year's financial statements. **(2 marks)**

Shortly after the release of the press statement, Chara received a legal letter from a major retailer seeking compensation from Chara for damaging its reputation because of the product recall. The amount of damages sought is considered material to Chara's financial statements. Chara's draft financial statements currently do not reflect this legal claim in any way.

- (d)** State ONE audit procedure that can be performed to confirm the existence of this legal claim. **(1 mark)**
- (e)** State ONE audit procedure that can be performed to assess the probable outcome of the legal claim (i.e. whether the major retailer is likely to be successful in its claim). **(1 mark)**
- (f)** Explain how the legal claim should be addressed in Chara's current year's financial statements. **(2 marks)**
- (g)** Assuming management has agreed to the treatment in (f) above, state ONE audit procedure that can be performed to confirm that the legal claim has now been correctly addressed in the current year's financial statements of Chara. **(1 mark)**

(Total: 25 marks)

Question 3 – (a) to (i)

You are an audit assistant assigned to audit the 31 March 20x8 financial statements of Everlasting Stationery Pte Ltd. You are familiarising yourself with the audit programmes provided to you by the audit senior.

For the audit of purchase transactions, the following audit procedures are included in the audit programme:

1. Select samples of purchase orders, agree details in the purchase orders to goods received notes (stapled together with the suppliers' delivery notes), and agree the details to the supplier invoices and to the accounts payable ledger.
2. Select samples of supplier invoices in the accounts payable ledger, agree the details to the supplier invoices, goods received notes (and supplier delivery notes attached), and then to the purchase orders.
3. Select samples of supplier invoices and recalculate the invoiced amounts.

Question 3 required:

- (a)** State the assertions verified by each one of the above audit procedures (i.e. 1, 2, and 3). **(3 marks)**
- (b)** Explain the implications on purchases and accounts payable if audit procedure 1 above cannot be completed because:
- (i)** A supplier's invoice cannot be found in the accounts payable ledger. **(2 marks)**
 - (ii)** There are no supplier invoices (i.e. suppliers have not yet sent the invoices). **(2 marks)**

- (c)** Describe ONE further audit procedure to be performed for situation (b)(ii) above.
(2 marks)

Everlasting Stationery Pte Ltd replaced all its office desktop computers during the year. All old office desktop computers were disposed of for no consideration with proper authorisation. The audit programme for property, plant, and equipment (PPE) contained the following audit procedures:

Obtain a list of the new desktop computers during the year, select samples, and perform the following:

1. Inspect the supplier invoices;
2. Inspect ownership documents;
3. Recalculate the depreciation charged in the month of acquisition; and
4. Physically inspect the PPE.

- (d)** For each audit procedure performed on PPE (i.e. 1, 2, 3, and 4) above, explain the assertions verified.
(4 marks)

Two of the new desktop computers cannot be found on the premises. The Finance Manager said they were returned to the manufacturer's service centre for repair as they were faulty.

- (e)** Describe ONE audit procedure to be performed to obtain evidence to support this explanation.
(2 marks)

- (f)** Suggest ONE ownership document that can be used to confirm that the desktop computers belong to Everlasting Stationery Pte Ltd. **(2 marks)**

The Senior Accountant suggested providing you with a written statement to confirm that the desktop computers belong to Everlasting Stationery Pte Ltd.

- (g)** Comment on the appropriateness of this written statement as evidence to confirm ownership. **(2 marks)**

During the Test of Details on the depreciation charge, you noticed the desktop computers that were disposed of had been fully depreciated three years ago. The company's depreciation policy is to depreciate computer equipment over three years. This means the disposed desktop computers had been used for six years. Everlasting Stationery Pte Ltd will continue to depreciate the new desktop computers over three years.

- (h)** Comment on whether the accounting treatment of the new desktop computers by Everlasting Stationery Pte Ltd is appropriate. **(3 marks)**

Everlasting Stationery Pte Ltd is in the process of reviewing its depreciation policy for its computer equipment. The management believes a useful life of six years more accurately reflects the usage of computer equipment.

- (i)** Based on the prior usage pattern of six years, describe what Everlasting Stationery Pte Ltd should do about its depreciation policy for the new desktop computers to comply with Singapore Financial Reporting Standard (SFRS) 16 *Property, Plant, and Equipment* and SFRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. **(3 marks)**

(Total: 25 marks)

Question 4 – (a) to (e)

The following internal control procedures relating to the purchase of inventory were identified by the audit senior from the review of system documentation of the procurement system of BB Pte Ltd (BB).

1. Orders for purchase of inventory must be placed with a supplier on the supplier list approved by management, i.e. “Approved Suppliers List”.
2. Orders for \$5,000 or below must be approved by the Department Head that needs the inventory. Orders exceeding \$5,000 must be approved by both the Department Head and a Director. Approval is given by way of signing on the purchase orders.
3. The warehouse staff verifies supplier delivery notes to approved purchase orders before acceptance of deliveries. Any deliveries that cannot be matched to an approved order are not accepted.
4. The warehouse staff completes a Goods Received Note (GRN) for each supplier delivery accepted. The GRN records details such as purchase order number, supplier delivery note number, product code, and quantities accepted. A copy of the completed GRN (with the approved purchase order and supplier delivery note attached) is sent to the accounts payable section of the accounting department.
5. The accounts payable staff compare the supplier invoice received with the purchase order and GRN and key the supplier invoice details into the accounts payable ledger if the details can be matched.

Question 4 required:

- (a) For each of the above internal controls, describe ONE objective of the control to the company and describe ONE Test of Controls that can be performed to confirm that the control is operating effectively.

Present your answers using the following format:

Objective:

Test of Controls:

(10 marks)

At year end, the accounts payable staff go through all the Goods Received Notes (GRNs) that are still unmatched to the supplier invoices and produce a list of "Purchases Accrual", using the quantities in the GRN and the unit price in the approved purchase order. The total in this Purchases Accrual list is then posted to the general ledger.

- (b) Explain the purpose of the above year-end procedure and the impact on the accounts payable balance if this procedure is not performed. **(2 marks)**

The purchase of property, plant, and equipment (PPE) does not follow the same system as described above for the purchase of inventory. Each Department Head determines the purchase of PPE and contacts their preferred supplier directly for a quotation. Each department raises its own purchase orders to be signed by the Department Head. PPE items are delivered directly to the department. No GRN is recorded. The supplier sends its invoice directly to the Department Head who signs on the invoice as confirmation that the department has received the PPE. This supplier's invoice is then sent to the accounts payable staff for recording and payment.

- (c) Identify THREE negative business implications that may arise from allowing each Department Head to place orders for property, plant, and equipment directly with a supplier of his/her choice. **(6 marks)**

(d) Explain which TWO assertions are most susceptible to misstatement because the supplier invoices are sent directly to the Department Head instead of directly to the accounts payable staff. **(4 marks)**

(e) Determine whether the control deficiencies in relation to the purchase of property, plant, and equipment above are significant control deficiencies.

(3 marks)

(Total: 25 marks)

END OF PAPER

Appendix A - Common verbs used by the Examiner

Verb	Description
Comment	Comment is similar to evaluate in that you are required to make a judgment or provide your opinion based on the facts at hand. Professional judgment and scepticism (a questioning mind) are called for when commenting .
Describe	Describe requires you to provide the characteristics and features of an item or situation without going into step-by-step detail of how to perform that procedure.
Determine	Ascertain or conclude after analysis and evaluation the most appropriate course of action or most correct answer from a range of viable alternatives.
Explain	Explain requires you to write at least several sentences conveying how you have analysed the information in a way that a layperson can easily understand the concept or grasp the technical issue at hand.
Identify	Identify is similar to list , but requires you to also provide an explanation as to why the item/s that you have identified is/are relevant to the facts given in the question.
In accordance with	This instruction requires you to relate your answer back to a specific document. Failure to make specific mention of the document in your answer will result in a loss of marks.
Justify	Whenever you see justify , you <u>must</u> provide reasons for your answer, in other words, provide support for your argument or conclusion. If you fail to justify your answer, you will lose valuable marks.
List	Prepare an itemised list .
Propose/Provide	Put forward (for example, a point of view, idea, argument, alternatives, etc.) for consideration or action.
Suggest	Put forward (for example, a point of view, idea, argument, alternatives, etc.) for consideration or action.
State	State is similar to list , but the items require your professional judgement. For instance, " State any restrictions that apply". One of the easiest ways to make sure that you state comprehensively is to think, " list and justify ".