

Singapore CA Qualification Examination

20 June 2018

Assurance

INSTRUCTIONS TO CANDIDATES:

1. The time allowed for this examination paper is **3 hours 15 minutes**.
2. This examination paper has **FOUR (4)** questions and comprises **FOURTEEN (14)** pages (including this instruction sheet). Each question may have **MULTIPLE** parts and **ALL** questions are examinable.
3. This is an open book examination. During the examination, you are allowed to use your laptop and any calculators that comply with the SAC's regulations. Please note that mobile phones, tablets, and all other electronic devices **MUST NOT** be used during the examination.
4. This examination paper is the property of the Singapore Accountancy Commission.

MODULE-SPECIFIC INSTRUCTIONS:

5. Unless specified otherwise, assume that all the reporting entities in all the questions adopt, for all the relevant years, the Singapore Financial Reporting Standards (International) (SFRS(I)) 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.

Question 1 – (a), (b), and (c),

Suarez Krystal (SK) is a diamond trader, and sources its diamonds from overseas ethical producers and sells them in ten retail outlets. SK is a new audit client of your audit firm. In the planning meeting with the Finance Director of SK, the Chief Internal Auditor was introduced to the Audit Engagement Partner. The following are extracts from the meeting notes between the Audit Engagement Partner, the Finance Director, and the Chief Internal Auditor.

New inventory (stock) control system

During the year, the company introduced a new inventory control system that integrates the recording of inventory movements in SK's main warehouse with all ten retail outlets. The internal audit (IA) team have been kept busy reviewing the controls during the system implementation and documenting the controls within the new system. Besides drawing up a flowchart of the new system, the IA team was responsible for reviewing the system testing and user testing results. Prior to letting end-users access the system live, the IA team reconciled the data transfer from the existing inventory system to the new system.

The Chief Internal Auditor, who is the President of the local chapter of the Institute of Internal Auditors (IIA), believes it is important that controls are built into the new system prior to the system going live and has thus made the review of the new system a major part of the IA team's work plan over the past nine months. The detailed work plan was approved by SK's Audit Committee, which is made up of independent non-executive directors. The IA team was expanded from three to five to facilitate the review of the new inventory control system, all reporting directly to the Chief Internal Auditor. The team members were recruited from public accounting firms or IA departments of other large listed companies. Their work methodology complies with the quality control standards issued by the IIA.

Year-end inventory (stock) count

The issue of the year-end inventory count was also discussed during the planning meeting. The finance director confirmed that there would be a full inventory count at the main warehouse and at all ten retail outlets on the year-end date.

Both the Finance Director and the Chief Internal Auditor welcome the idea of working with the audit engagement team. The audit engagement partner has been invited to have a separate meeting with the Chief Internal Auditor about this before the year-end inventory count.

When the profile of the audit engagement team was introduced to the Finance Director, the Finance Director was surprised to find out that one of the audit assistants was a relative of a junior accounting assistant in SK's finance department.

Exemplify Question Number	Question 1 required:
	(a) In accordance with Singapore Standard on Auditing (SSA) 610 <i>Using the work of internal auditors:</i>
1	(i) State FOUR factors that the external auditor should consider <u>before</u> deciding on the extent of reliance to be placed on the work of the internal audit team of Suarez Krystal. (2 marks)
2	(ii) For each factor identified in (i) above, comment on whether the external auditor should place reliance on the work done by the internal audit team of Suarez Krystal. (8 marks)
3	(b) Identify and explain FOUR areas where the external auditor could specifically rely on the work performed by the internal audit team of Suarez Krystal. (8 marks)
4	(c) Considering the family relationship between the audit assistant and the junior accounting assistant:
4	(i) Identify and explain ONE ethical threat from the case; (2 marks)
5	(ii) Evaluate the significance of the threat identified in (i) above; and (2 marks)
6	(iii) Recommend and justify ONE appropriate safeguard the audit firm could implement to manage the threat identified in (i) above. (3 marks) (Total: 25 marks)

Question 2 – (a), (b), (c), and (d)

VBM Ltd (VBM) is a computer hardware manufacturer. Its main business is to manufacture computer hardware components for other established companies. This year, the company started to manufacture and market its own brand of personal computers. The financial year end of VBM was 30 April 20x8.

You are the audit manager responsible for the audit of VBM. As part of the preliminary analytical procedures during planning using the figures from the trial balance at 30 April 20x8, you identified two significant changes that require further attention:

1. Prepayments shown in the statement of financial position amount to \$20 million (prior year: \$0), representing 10% of total assets; and
2. An “Asset Under Construction” account with a balance of \$488,000 (prior year: \$0).

Upon enquiry, the Finance Director provided the following information:

Prepayment A

An amount of \$8 million was prepaid to enter into contract negotiations with the majority shareholder of KonKon & Co (KK) with a view to acquiring KK. KK is a company registered in British Virgin Islands (BVI). If this acquisition goes ahead, the \$8 million will be considered part of the purchase consideration. If the acquisition does not go ahead, the \$8 million will be refunded, latest by 1 April 20x9. The prepayment was made on 1 April 20x8.

Prepayment B

An amount of \$12 million was prepaid to a new supplier, YY & Co (YY) to secure supply of inventory for the next 24 months. The prepayment was made on 1 April 20x8. There will be 24 shipments (one per month) starting from 1 May 20x8. Each shipment is for the same volume of inventory.

Although not stated in the audit firm's standard audit programme, the audit manager instructed the audit assistant to perform audit procedures to identify the owners and directors of KK and YY. The audit manager also instructed the audit assistant to find out the reason for acquiring KK.

Asset Under Construction

The company embarked on a project from 1 May 20x7 to build a mini-super-computer (MSC) for in-house research purposes. The MSC was ready for use on 1 April 20x8, two months ahead of plan. VBM will officiate its use on 1 June 20x8 after an official ceremony. On 1 May 20x7, VBM took a one-year loan of \$400,000 with an interest of 5% per annum to finance the construction of the MSC. VBM estimates the useful life of its MSC to be three years, as it is the company's policy to use all computers for three years only. The cost of construction of \$488,000 includes:

- Component cost: \$298,000; and
- Engineer and staff cost: \$190,000.

**Exemplify
Question
Number**

Question 2 required:

- 7 (a) Explain to the audit assistant TWO objectives of verifying the owners and directors of KonKon & Co and YY & CO. (4 marks)
- 8 (b) Explain to the audit assistant TWO objectives of verifying the reason for acquiring KonKon & Co. (4 marks)
- 9 (c) For each prepayment noted in the case, describe THREE further audit procedures to be performed and for each procedure described, explain the purpose of the procedure. (12 marks)
- (d) For the Asset Under Construction:
- 10 (i) State and justify ONE audit procedure to be performed relating to the component cost. (1 mark)
- 11 (ii) State and justify ONE audit procedure to be performed relating to the engineer and staff cost. (1 mark)
- 12 (iii) Explain and quantify the potential misstatement of the costs capitalised. (3 marks)
- (Total: 25 marks)**

Question 3 – (a) and (b)

Mandom Consulting Pte Ltd (MC) is an Information Technology (IT) system integrator. It is a fully-owned subsidiary of Mandom Holding (MH).

MC's revenue is from two sources: system implementation service and helpdesk service. The consulting staff in MC perform both system implementation and provide the helpdesk service. All the consulting staff report to a Consulting Director.

Helpdesk service is available to system implementation customers and is on an annual contract basis. Not all system implementation customers sign up for helpdesk service. Helpdesk revenue contributed 20% of total revenue for MC and 40% of the loss for the year.

MC is struggling with reduced sales and margin due to keen competition from low cost competitors. The situation worsened this year as its loss wiped out the entire share capital and the cash position is very low.

To turn things around, the Chief Executive Officer (CEO) of MH hired a new Managing Director (MD) for MC. The MD immediately started new initiatives which include:

Terminate 30% of the consulting staff

All administration staff and accounting staff will be terminated on the last day of the financial year. For staff who have worked for MC for less than a year on the date of termination, no termination payment will be made. For staff who have worked for MC for one year or more on the date of termination, a termination payment equivalent to one month of their last drawn salary will be made three months after termination. All affected staff have been notified. Termination payments will be recorded only when payment is made.

Terminate existing office lease with remaining commitment of three years

All remaining staff will move to a shared office location. The landlord has agreed to accept a sum equivalent to one year of lease payments to release MC from its contractual obligation. MC will continue to record the lease payment monthly, as current practice, for the next one year.

Disposal of Property, Plant, and Equipment

All office furniture and fittings and personal computers previously used by the terminated staff will be sold after year end for cash. Prior to disposal, these assets will continue to be shown as Property, Plant, and Equipment and continue to be depreciated.

Discontinue the helpdesk service

No new customers will be signed up. Existing helpdesk contracts will be honoured until their expiration date. MC intends to present the helpdesk service as a discontinued operation in the financial statements.

Restructure loan

Restructure the current loan due for repayment three months after year-end. One month after year-end, the bank has agreed to extend the loan repayment date to fifteen months after year-end, with no other changes to the terms and conditions of the loan. The loan will be presented as a non-current liability in the balance sheet.

**Exemplify
Question
Number**

Question 3 required:

(a) For each of the following matters, propose and justify TWO audit procedures to be performed:

13 (i) Termination payment; **(2 marks)**

14 (ii) Termination of lease; **(2 marks)**

15 (iii) Planned disposal of property, plant, and equipment; **(2 marks)**

16 (iv) Discontinued helpdesk service; and **(2 marks)**

17 (v) Restructuring of loan. **(2 marks)**

(b) With reference to relevant Singapore Financial Reporting Standards (International) (SFRS(I)), explain why the proposed accounting treatment by Mandom Consulting Pte Ltd for the following matters might be incorrect:

18 (i) Termination payment; **(3 marks)**

19 (ii) Termination of lease; **(3 marks)**

20 (iii) Planned disposal of property, plant, and equipment; **(3 marks)**

21 (iv) Discontinued helpdesk services; and **(3 marks)**

22 (v) Restructuring of loan. **(3 marks)**

(Total: 25 marks)

Question 4 – (a) to (e)

Rajatin Pte Ltd (RJT) is a chain of four convenience stores across Singapore. RJT sells items such as soft drinks, cigarettes, snacks, and small household items, strictly on a cash basis. RJT recently computerised its systems such that the electronic point-of-sales (POS) cash registers, the accounting system, and the inventory system are now integrated. As goods are scanned at the POS, sales are updated in the general ledger, and inventory is reduced in the inventory system. Goods received in the convenience stores are scanned and updated in the inventory system.

Several months later, RJT conducted its first inventory count after computerisation and discovered significant discrepancies between the quantity counted and the quantity of inventory in the computerised records, resulting in a significant inventory write-off.

The Chief Executive of RJT, Mr Raja, believes there could be fraud in some of the convenience stores. He accepts some customers or staff may steal goods as being inevitable but he does not think this is significant. He also believes some cashiers could have omitted recording legitimate cash sales and pocketed the cash. This could have caused the discrepancies as goods taken by customers would not be recorded.

Mr Raja has engaged your audit firm, DMX LLP, which has not previously provided any professional services to RJT, to investigate the deficiencies in internal controls to reduce the risk of such fraud.

RJT operates two POS cash registers in each store. There are two cashiers in each store per shift and there are two shifts of eight hours each per day. A store shift supervisor supervises the cashiers. The eight store shift supervisors are sons and daughters of Mr Raja. The 16 cashiers are not family members.

There is a common sign-in identification (ID) in use for the POS cash registers, i.e. one sign-in ID for all 16 cashiers. Although the POS system allows individual sign-in IDs for each cashier, this was not implemented for convenience sake.

The cashiers leave the cash in the cash machines after their shift. Every morning, a Controller from the head office, Mrs Raja, will go to each store and collect the cash. She leaves \$1,000 in different denominations in each POS cash register as a float for the day. As each POS cash register updates the cash sales in the general ledger directly, she does not perform any recording and just deposits the cash takings into the RJT bank account.

Cash sales invoices can be printed for customers, but not all customers want them. Although the POS system allows daily sales records to be viewed or printed, this feature has not been used as Mrs Raja does not think it necessary to waste paper.

**Exemplify
Question
Number**

Question 4 required:

Mr Raja would like your firm to focus its investigation on one store.

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(a) Using the results of the inventory count performed by Rajatin Pte Ltd, explain how DMX LLP might select ONE store for investigation. **(3 marks)**

24

(b) Using the information provided in the case, recommend FIVE internal control procedures in relation to the cashiers and in-store processes for Rajatin Pte Ltd to implement. For each internal control recommended, explain how it will help to address the issue. **(10 marks)**

25

(c) In terms of the report on internal control deficiencies to be submitted to Rajatin Pte Ltd, outline the assurance level to be provided, i.e. whether it is positive assurance, negative assurance, or no assurance. **(2 marks)**

Mr Raja has also proposed that DMX LLP be appointed as the company's external auditor of its financial statements. Although the company is legally exempt from having its financial statements audited and its financial statements have never been audited before, Mr Raja believes there are benefits from such an audit. He proposed that the audit fee be linked to the reduction of inventory write-off after your recommended internal controls are implemented. The lower the inventory write-off the higher the audit fee.

**Exemplify
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- (d)** Identify ONE ethical issue (the threat and the fundamental principle threatened) and outline the safeguards that the auditor in DMX LLP should consider in relation to the proposed audit fee arrangement. **(5 marks)**

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- (e)** Identify FOUR factors DMX LLP should consider in relation to the opening balances in the statement of financial position of Rajatin Pte Ltd if DMX LLP takes up the audit appointment. Your answer should also include any potential impact on audit opinion if there are issues relating to the opening balances that cannot be resolved. **(5 marks)**

(Total: 25 marks)

END OF PAPER