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 **FIFTEEN (15)** pages (including this instruction sheet). Each question may have **MULTIPLE** parts and **ALL** questions are examinable.

3. This is an open book examination, and 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. Unless specified otherwise, assume that all the reporting entities in all the questions adopt, for all the relevant years, the Singapore Financial Reporting Standards that were issued by the Accounting Standards Council as at 1 January 2017.

11. Assume the functional and presentation currency is the Singapore dollar (S$) unless otherwise stated.
Question 1 – (a) to (f)

Peter Ting is the audit engagement partner for two companies, Tom Pte Ltd (Tom) and Jerry Pte Ltd (Jerry). Both Tom and Jerry have the same financial year end, i.e. 30 November 20x7. The final audit of both companies is underway. Except for Peter, the two audit engagement teams are made up of different team members.

During the review of the audit working papers, Peter saw that Tom and Jerry are involved in a legal claim against each other. Tom, who is a customer of Jerry, is claiming $20 million against Jerry for defective products that caused a direct loss to Tom’s operations. Jerry is disputing the claim and is counter claiming $10 million against Tom for non-payment and specification error in product requirements.

Tom and Jerry have engaged different law firms to represent them in court. The confirmation reply from the lawyers were general in nature. Both lawyers stated they were not able to provide any professional opinion at this juncture as they just have been formally appointed and briefed on the case.

The audit working papers for Tom documented that a discussion with the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) was held and both the CEO and CFO were confident of their claim being successful. In their opinion, it is virtually certain that Jerry would have to pay the amount claimed and they have recorded the claim as receivable. This is based on the email from Jerry’s directors requesting for a meeting to negotiate an out-of-court settlement. Thus, the counter claim from Jerry is ignored, although both companies admit they were at fault with the specification.

Peter has not yet started reviewing the audit working papers for Jerry in detail, although he is aware that Jerry’s books do not account for this legal counter claim. The draft financial statements do not reflect this legal counter claim at all.

Peter is concerned he may have a problem continuing as the audit engagement partner for Tom and Jerry as they are involved in a legal dispute with each other.
Question 1 required:

(a) Besides the confirmation from the lawyers, describe TWO other pieces of evidence that could be obtained by the audit team to help the Audit Engagement Partner understand the nature of the dispute. Your answer should include the objective of the evidence to the auditor. (4 marks)

(b) Explain the concern that Peter has in continuing as Audit Engagement Partner for both Tom Pte Ltd and Jerry Pte Ltd. Your answer should identify TWO ethical principles involved. (4 marks)

(c) Recommend ONE action that the Audit Engagement Partner could take to resolve the conflict identified in (b) above. (2 marks)

(d) Explain TWO potential misstatements in the way Tom Pte Ltd accounted for this legal claim and the counter-claim. (4 marks)

(e) As the audit report date for Jerry Pte Ltd is planned for one month after the completion of audit field work, recommend THREE further audit procedures to be performed on the legal claim and the counter-claim prior to the audit report date. (6 marks)
(f) Assuming at the audit report date, the legal claim remained unresolved and no progress had been made in relation to settlement, and the claim is very material to the financial statements of Jerry Pte Ltd, describe the impact on the audit report:

(i) If the legal claim is correctly accounted for in the financial statements;

   (3 marks)

(ii) If the legal claim is not correctly accounted for in the financial statements; and

   (1 mark)

(iii) In relation to (f)(ii) above, recommend an appropriate audit opinion, with a brief description on any necessary modification to the Basis for Opinion section, and suggesting any additional section to be included in the audit report.

   (1 mark)

(Total: 25 marks)
Question 2 – (a) to (f)

You are an audit senior assigned to audit the financial statements for Oceangate Pte Ltd (OG) for the year ending 31 December 20x7. OG is a new audit client and is a retailer of consumer products supplied by several local distributors. You are supervising a new audit associate who joined the firm direct from university. The new associate documented the following narrative description for the purchasing system based on interviewing OG personnel. The audit associate is waiting for your next instruction.

Purchasing System Note
The purchasing system is not computerised.

All inventory is stored on racks in a central warehouse in Jurong. Re-order levels are marked on the rack in red. The warehouse supervisor will make a round every morning and if an item of inventory is reaching or dropping below the marked re-order level, the supervisor will fill in a purchase requisition form (PRF), according to the re-order quantity policy approved by management. The PRF is sent to the chief retail manager for approval. The chief retail manager reviews the PRF and signs the document as evidence of approval. The signed PRFs are forwarded to the purchasing department.

The purchasing staff contact the suppliers on the approved suppliers list endorsed by management to negotiate and agree pricing and delivery dates. The purchase orders (PO) prepared by the purchasing staff are reviewed and approved by the purchasing manager before they are sent to the suppliers.

The suppliers deliver the goods to the warehouse in Jurong. The warehouse receiving staff note the supplier’s delivery note number on a goods received form (GRF) and check the goods for quantity and quality. They then record the quantity accepted on the GRF and forward the GRF (attached with the supplier’s delivery note) to the accounts payable section of the accounting department.
The accounts payable executive compares the supplier invoice to the GRF and records the invoice in the payables ledger if the invoice details match the GRF. For supplier invoices that are not matched to a GRF, the accounts payable executive files them separately.

Payment system
The accounts payable executive files the supplier invoices with the GRF by due date. Five days before the due date, the accounts payable executive prepares a payment voucher that records the payee, the amount, and the invoice number, before attaching the GRF to the payment voucher for approval by the Finance Manager for payment.

For those invoices without a GRF, the payment voucher will indicate this as prepayment. Once the payment vouchers are approved, cheques are prepared for signing by two bank signatories, i.e. the Finance Manager and one Executive Director.
Question 2 required:

(a) Instruct the audit associate on the audit procedures to be performed to confirm the accuracy of the narrative description documented by the audit associate.  

(3 marks)

(b) Identify ONE internal control procedure from the Purchasing System Note, and:

(i) Explain how it is relevant to the audit; and  

(2 marks)

(ii) Describe a test of control to be performed to confirm the internal control procedure is operating effectively.  

(2 marks)

The test of details of transactions performed by the audit associate has identified two exceptions where:

• The quantity in the supplier invoices were higher than the quantity ordered in the purchase orders, although the quantity invoiced is the same as quantity received in the GRF; and

• The prices in the supplier invoices are higher than the prices in the purchase orders.

(c) For each exception noted above,

(i) Identify ONE control deficiency in the purchasing system that may allow such exceptions to happen.  

(4 marks)

(ii) For each control deficiency identified in (c)(i) above, recommend ONE improvement in the internal control procedure.  

(4 marks)
(d) For each exception noted above, describe ONE test of details of transactions that the audit associate would have performed that helped to discover the exceptions. (4 marks)

(e) The test of details of supplier payments and supplier statement reconciliations has identified several incidents of over-payment to suppliers. The supplier statements of account showed the net balance due from the suppliers.

(i) Identify the internal control deficiency in the payment system that could have allowed over-payment to suppliers to happen. (2 marks)

(ii) Recommend an improvement to the internal control procedure to reduce risk of over-payment. (2 marks)

(f) Explain whether the control deficiency identified in (e)(i) above should be reported to both the management and the Board of Directors of Oceangate Pte Ltd. (2 marks)

(Total: 25 marks)
Question 3 – Part I and Part II

Part I

You are a new audit associate that just joined the audit firm, DEKP LLP. You have completed the first-year associate induction training and are assigned to audit a local company, DMC Company (DMC) for the financial year ended 31 October 20x7. DMC trades in electronic products, such as original equipment manufacturer (OEM) remote controllers for electrical appliances and power adapters for notebook computers. You are assigned to audit the accounts receivable. The first step is to determine the sample size and select samples for accounts receivable circularisation. You are given the following information in the audit strategy and audit plan:

- Overall materiality = $1 million
- Performance materiality = $500,000
- R factor for test of details:
  - If relying on test of controls, R = 2
  - If not relying on test of controls, R = 3
- The planned audit approach for accounts receivable relies on test of controls to reduce test of details of transactions.
- The formula for determining sample size for test of details is as follows:
  - Sample size = $Population/$performance materiality x R
- All individual items above performance materiality will be tested and not subject to sampling.

You have obtained a list of accounts receivable as at year end. You have re-cast the list and agreed the total of $11.5 million to the general ledger. You have also agreed individual accounts receivable balances to the accounts receivable ledger. However, you noted there are two accounts receivable, namely AA Co ($840,201) and DHK ($659,799), that are individually higher than $500,000. These two accounts receivable amount to a total of $1.5 million. The remaining receivables are all individually less than $500,000.
Question 3 Part I required:

(a) Using the firm’s sample size formula, determine the sample size for accounts receivable circularisation. (3 marks)

(b) Explain why the total number of accounts receivable that will be selected for circularisation might be different from the sample size determined in (a) above. (2 marks)

Based on the samples selected, you have prepared the circularisation letters to be printed on DMC’s letterhead for the Finance Manager’s signature. However, the Finance Manager of DMC told you she did not want circularisation to be sent to a customer (DHK) as DMC is in a legal dispute with DHK. The balance due from DHK at year end was $659,799. The lawyer for DMC advised the Finance Manager against circularisation as it might complicate the legal proceedings. Your colleague is auditing the liabilities side of the balance sheet.

(c) Explain whether you should select another accounts receivable to replace DHK for confirmation. (2 marks)

(d) Describe THREE further procedures you would perform in relation to the accounts receivable from DHK. (6 marks)

(e) Explain why you might want to inform your colleague who is auditing the liabilities side of the balance sheet about the DHK situation. (2 marks)
Part II

You have subsequently performed the circularisation and summarised the results of the circularisation. One receivable (MM Co) responded with a different balance. The accounts receivable executive has prepared the following reconciliation for the receivable that responded with a different balance. You have checked the casting of the reconciliation and you have agreed the balance to the confirmation reply letter and the accounts receivable ledger. Another audit team member is auditing the sales transactions.

<table>
<thead>
<tr>
<th>Receivable Confirmation Reconciliation – MM Co</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance per confirmation</td>
<td>280,234</td>
</tr>
<tr>
<td>(A) Add: customer payment not recorded in the accounts receivable ledger at year end, but recorded in the accounts receivable ledger after year end</td>
<td>60,832</td>
</tr>
<tr>
<td>(B) Add: sales invoices not recorded by customer</td>
<td>40,049</td>
</tr>
<tr>
<td>(C) Add: sales return by customer</td>
<td>20,003</td>
</tr>
<tr>
<td>Balance per accounts receivable ledger as at 31 October 20x7</td>
<td>401,118</td>
</tr>
</tbody>
</table>
Question 3 Part II required:

(a) Describe the most important audit procedure to be performed on item (A) in the above reconciliation.  
(2 marks)

(b) Describe the most important audit procedure to be performed on item (B) in the above reconciliation.  
(2 marks)

(c) Explain why you should inform your other audit team member who is auditing the sales transactions about item (B) in the above reconciliation.  
(2 marks)

(d) Describe TWO audit procedures to be performed on item (C) in the above reconciliation.  
(4 marks)

(Total: 25 marks)
Question 4 – (a) to (g)

Your audit firm, BBKP LLP (BBKP), has just been appointed as auditor of GV Pte Ltd (GV) for the financial year ending 31 December 20x7. The prior year’s audit report issued by the predecessor auditor was unmodified. GV has one overseas subsidiary CCC & Co (CCC), which has been audited by a local firm, BCG & Co (BCG) since the incorporation of CCC. CCC’s financial statements are material and are consolidated into the GV’s group financial statements. The audit is now in the planning stage.

The Finance Director of GV showed the audit manager a letter from the local regulator that regulates CCC. The letter instructed CCC to re-prepare, re-audit, and re-issue its financial statements for the year ended 31 December 20x6. The deficiency of the filed 20x6 financial statements was the non-consolidation of a subsidiary ZZ & Co (ZZ). In the jurisdiction where CCC and ZZ are located, International Financial Reporting Standards (IFRS) were made effective for financial statements with the year ended 30 December 20x6 or later. CCC does not own majority voting rights in ZZ, but has de-facto control through a contractual agreement. CCC did not apply the relevant IFRS and thus did not consolidate ZZ’s financial statements.

CCC’s local auditor, BCG, has responded to your firm’s letter of enquiry and confirmed the same fact. BCG also confirmed that the management of CCC will comply with the regulator’s instruction and has started re-preparing the 20x6 financial statements and will consolidate ZZ’s financial statements into CCC’s consolidated financial statements. BCG confirmed it had issued an unmodified audit report on CCC’s original 20x6 financial statements.

The Board of Directors of GV would like to know how this event will affect your audit of GV’s consolidated financial statements. GV would prefer to re-prepare and re-issue 20x6 consolidated financial statements. GV would seek waiver from the Accounting and Corporate Regulatory Authority (ACRA) to hold its annual general meeting by 30 June 20x8 to allow more time to prepare and audit the financial statements. The aim is to send audited re-issued 20x6 consolidated financial statements and 20x7 consolidated financial statements to shareholders for the next annual general meeting.
Question 4 required:

(a) Outline the impact of the GV Pte Ltd Board’s decision on the engagement letter that your firm already signed with GV.  

(b) Evaluate the impact of the above event on your firm’s audit of the GV Group consolidated financial statements for both 20x6 and 20x7.  

(c) Explain how the audit report issued by BBKP LLP should reflect that the prior year’s financial statements were audited by a predecessor auditor.  

(d) Explain how the re-issuance of the 20x6 group financial statements would be reflected in your audit report for the 20x7 consolidated financial statements, assuming there are no material misstatements in the re-issued 20x6 financial statements and 20x7 financial statements.  

(e) Outline whether the above event should be included as a Key Audit Matter (KAM) in the audit report for the 20x7 GV group consolidated financial statements.  

Your firm’s initial assessment of BCG & Co, the local auditor of CCC, has preliminarily concluded reliance could be placed on their work. The planned procedure was to have a planning meeting with them and review their audit working papers after they concluded the final audit.  

(f) Explain how the planned reliance on the component auditor will be revised given the above event.
BCG has just sent your firm an email providing an update on the CCC’s consolidation of ZZ. ZZ’s investment represented 50% of total assets of CCC’s 20x6 financial statements. ZZ is incorporated in Bermuda and its financial statements are not audited. ZZ’s management is not cooperative citing the reason that CCC is its parent company. BCG intends to issue a disclaimer of opinion on both CCC’s re-prepared 20x6 financial statements and the 20x7 financial statements.

(g) Assess the impact of the proposed disclaimer of opinion by BCG & Co on the audit report on the GV Group’s:

(i) 20x6 re-prepared consolidated financial statements: and (2 marks)

(ii) 20x7 consolidated financial statements. (3 marks)

(Total: 25 marks)