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 **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, 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) through (e)

Pluto Co (P) is planning to acquire 80% of the issued share capital of PT Satiam (S), a company listed in Indonesia. S will issue new shares to P if the acquisition goes ahead. P has engaged your firm, DEKP LLP (DEKP), to perform a limited review on the unaudited financial statements of S for the financial year ended on 31 March 20x7. This would be the first time S has prepared its financial statements using Singapore Financial Reporting Standards, which was requested by P for the purpose of due diligence review. P also has secured, with the agreement of S and S’s auditor, BGR LLP (BGR), for your firm to review the audit working papers of BGR for the year ended 31 March 20x6.

The Audit Senior has highlighted the following issues for the engagement manager’s attention:

**Issue 1 – Guarantee**
The bank confirmation performed by BGR identified two outstanding guarantees (amounting to a total of US$20 million) that S gave to Conway Bank in favour of a Suss Co. The financial statements of 20x6 did not reflect these guarantees. BGR documented in the working papers that S’s management denied the existence of any guarantee and the bank made a mistake in its confirmation reply. However, S’s management did not highlight the error to Conway Bank.

**Issue 2 - Investment**
The 20x6 statement of financial position included investments in financial assets, at a cost of US$20 million, classified as current assets. The note disclosed these as investments in quoted perpetual bonds acquired in 20x3. BGR’s working papers documented that the market price of these bonds at 31 March 20x6 were US$15 million but there was no need to write down to fair value as the accounting policy was to state investment at cost.
The 20x7 statement of financial position did not include the US$20 million investment in bonds. S’s management explained that the bonds were sold to Suss Co on 3 April 20x6 for US$20 million and the sale proceeds were collected.

**Issue 3 – Loan payable**

There is an unsecured loan of US$30 million payable to Conway Bank, classified as non-current loan payable in both the 20x6 and 20x7 statements of financial position. The bank confirmation in BGR’s working papers shows that the loan was due for repayment on 30 April 20x7. S’s management explained that the bank agreed on 29 April 20x7 to extend the loan repayment date until 30 September 20x9.

There is another loan of US$40 million from LOL Bank, secured on the head office building of S. The audit working papers of BGR showed that the loan would be repayable on 30 June 20x9. There is a loan covenant that requires S to maintain a current ratio of at least 2.0. The 20x7 statement of financial position showed current assets of US$100 million and current liabilities of US$50 million.

P subsequently proceeded with the acquisition of S for the following consideration terms:

- Cash payable of US$200 million; and
- Five year unconvertible bond payable with a face value US$50 million.

P engaged an independent valuer who determined the bond’s fair value to be US$40 million at acquisition. As the regulations in Indonesia require the acquisition to be paid in cash, P paid S US$250 million as cash consideration, issued the bond with a US$50 face value, and received US$50 million cash from the seller on the acquisition date. P accounted for goodwill on acquisition of US$10 million and recognised a gain on the bond issue of US$10 million.
Question 1 required:

(a) Suggest THREE reasons why it is important to report Issue 1 to the management of Pluto Co. (6 marks)

(b) As an auditor, explain how professional scepticism should be applied in relation to Issue 2. (6 marks)

(c) With reference to appropriate Singapore Financial Reporting Standards, assess the risk of material misstatement in relation to the classification of the loan payable to Conway Bank (Issue 3). Include in your discussion whether the risk of misstatement is due to fraud or error. (6 marks)

(d) Explain the misstatement in Goodwill on Acquisition of PT Satiam. (4 marks)

(e) Outline whether the acquisition and the related goodwill should be included as Key Audit Matters in the audit report. (3 marks)

(Total: 25 marks)
Question 2 – (a) through (e)

You are an audit manager of PKED LLP, and you are the audit engagement manager in charge of the audit of Golden Resources Ltd (GR). The following issue has been identified during the interim audit.

GR is a Singapore listed company. Upon business acquisition of a mine in 20w9, GR acquired a 10-year mining licence due to expire in 20x9. Significant goodwill arose from the acquisition. As at 31 March 20x7, goodwill accounted for 30% of the group’s total assets. Most of the mining plant and equipment have remaining useful lives of two years.

GR has assumed the licence will be renewed for another 10 years even though GR has not yet commenced negotiations to renew the mining license that would expire in two years’ time. In the goodwill impairment analysis for the year ended 31 March 20x7, management concluded that there was no impairment, as the projected gross cash inflow based on full capacity income stream of the mine up to 20y9 was higher than goodwill by $1 million. The projected gross cash inflow was discounted to present value using an inflation rate of 1.2%.

The Audit Assistant has approached you to apply for leave during the final audit, as she will be getting married. Upon further enquiry, you discover that she will be marrying the Finance Director of GR whom she first met when the interim audit started.

The audit engagement partner will be meeting with the Audit Committee of GR next week and would like you to keep her up-to-date with the issues to be discussed.
Question 2 required:

(a) Comment on the ethical issues involved in the Audit Assistant's relationship with the Finance Director of Golden Resources Ltd and the actions you, as the audit manager of the company should now take. Your answer should include an evaluation of the significance of any ethical threats identified. (4 marks)

(b) State the audit and ethical issues to be discussed with the Audit Committee. Your answer should include any risk of material misstatements, and suggested actions that the Audit Committee should take. (6 marks)

(c) Describe the audit procedures to be performed to assess the reasonableness of:

(i) Using the full capacity of the mine to project the cash inflow; (4 marks)
and
(ii) Using the inflation rate as the discount rate. (4 marks)

GR has an 85% owned subsidiary, Silver Resources (SR), with a financial year-end of 31 January 20x7. SR is also audited by PKED LLP and the audit report has been signed and handed over to the management of SR. SR has not yet issued the audited financial statements and the audit report to its shareholders. The audit opinion is unmodified. Yesterday, GR's management decided to close SR and move its entire operations to Thailand to save costs. GR has instructed SR's management to commence the closing down process from 1 July 20x7.

(d) Describe the impact of Golden Resources Ltd's decision to close down Silver Resources on the financial statements of Silver Resources for the year ended 31 January 20x7. (3 marks)
(e) Explain the impact on the audit report for Silver Resources if the financial statements failed to account for Golden Resources Ltd's decision to close Silver Resources.  

(4 marks)  

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

Part I

Global Ltd (Global), a Singapore publicly listed company, has decided to outsource its internal audit function to your firm, TSO LLP. The Audit Committee Chairman of Global has expressed the following concerns that he would like the assigned internal audit team to look into:

**Issue 1 – Sale of properties to directors and key management**

As Global is a property developer, it is common to have its directors, key management, and their families buying units in a new property launch at a discount to the public launch price. It is important for these transactions to be identified for related party transactions disclosure. It is also important for the company's discount policy to be followed. Currently, Global relies on the directors and key management to declare their purchases of property units. Global also gives discounts to important business partners and buyers who buy in bulk, such as property funds. The Audit Committee Chairman is concerned that the related party transactions are not completely identified, resulting in incomplete disclosure.

**Issue 2 – Purchases controls**

Global uses a wide range of construction firms as the main contractor for property development. Global also uses specialist firms such as electrical engineering firms for electrical work and painting firms for maintenance work. Global aims to implement stringent internal controls in procurement of goods and services, some of such controls include:

- Mandatory minimum three quotations for all orders with a value exceeding $10,000 and up to $50,000;

- Mandatory closed tender for all orders with a value exceeding $50,000 and up to $100,000; and
• Mandatory open tender for all orders with a value exceeding $100,000.

The Audit Committee Chairman is concerned that procurement staff have been bypassing these controls by breaking large value orders into smaller value orders.

**Issue 3 – Potential inducement**

The procurement staff are organised by property development project. This means that procurement staff have full control of all purchasing activities within the projects to which they are assigned. Thus, it is common that two or more procurement staff could be placing different orders for the same thing, such as sand or cement, with different suppliers or with the same suppliers. Global runs an average of three property development projects concurrently. The Audit Committee Chairman is concerned with procurement staff receiving inducements from suppliers and awarding purchase contracts that are not the best value for money.
Question 3 Part I required:

(a) For Issue 1, recommend THREE appropriate internal controls that Global Ltd could implement to efficiently identify and report purchases of properties by directors, key management, their families, and staff.  
(6 marks)

(b) For Issue 2, describe THREE substantive procedures to be performed to identify any purchase orders that have been split into smaller value orders to bypass internal controls.  
(6 marks)

(c) For Issue 3, describe THREE substantive procedures to be performed to identify any purchases that might indicate an inducement may have been given.  
(6 marks)
Part II

Global has been shortlisted as one of two finalised in a tender for an overseas property development. The contract is to be awarded by the central government. In the pre-tender award contract negotiation meeting, the central government official responsible for the tender, Mr Miki, requested the following changes be made to the draft contractual arrangement:

- The tender value of US$30 million to be increased by 10%;
- The central government will assign a project manager, who will be Mr Miki, to co-manage the project with Global;
- Mr Miki, as the project manager, will be given a project manager allowance of US$3 million for the entire duration of the project of two years; and
- The project manager allowance of US$3 million will be paid by Global directly to Mr Miki in 24-monthly instalments.

When Global’s Bid Manager asked Mr Miki ‘what if Global is not able to agree to the requested changes?’ Mr Miki responded by saying, ‘I will then negotiate the same requirements with the other finalist bidder and whichever bidder is agreeable to these terms will be awarded the contract’.
Question 3 Part II required:

(a) Identify and explain the ethical issues that the Bid Manager of Global Ltd is facing. Your answer should include an evaluation of the significance of the ethical issues. (4 marks)

(b) Suggest THREE actions to be taken by the Bid Manager of Global Ltd in dealing with the ethical issues identified in (a) above. (3 marks)

(Total: 25 marks)
Question 4 – (a), (b), (c), and (d)

Champ Engineering Ltd (CE) is a listed company involved in the provision and installation of heating equipment for corporate and individual customers. You are the Audit Manager responsible for the audit of CE’s financial statements for the year ended 31 May 20x7. CE has a number of overseas subsidiaries. Tonway Co (Tonway) is one of CE’s subsidiaries and is audited by a local audit firm. This subsidiary has a financial year-end of 31 March 20x7.

In the planning meeting with the Audit Committee of CE, the Audit Committee Chairman informed you that the Board has decided to form an investigation committee to review certain irregular transactions at Tonway’s newly formed coating division.

Apparently, there was an instance of payment of unsupported expenses paid by Tonway to YY Co (YY), a rival company in the same business as Tonway’s coating division. The assets invested in the coating division are material. However, the coating division reported disappointing revenue, way below budget, but the expenses exceeded budget by a significant amount. It appeared that orders were slow, but this contradicted the asset utilisation report from the engineering department of the coating division. The report showed that coating equipment was mostly out on the field providing coating services to customers. The CE Board suspected YY was set up by some management personnel in Tonway to operate a business using the assets and resources of Tonway and bill Tonway for fictitious services.

The auditor of Tonway, Kenacon, responded to your query on this matter and stated that the ultimate outcome of the matter cannot presently be determined, as internal investigations are still in progress. However, as the revenue contribution from the coating business is not material to Tonway for the year ended 31 March 20x7, Kenacon does not intend to modify the audit opinion in respect of this matter.

CE’s Board enquires the feasibility of your firm to provide a special audit on Tonway in relation to the suspected irregularities.
Question 4 required:

(a) State whether you agree with Kenacon’s view given that revenue from Tonway Co’s coating business is immaterial, therefore it does not affect the audit opinion. (5 marks)

(b) Explain the ethical issue involved and your decision to accept or decline the proposed special audit engagement on Tonway Co. (5 marks)

(c) Describe the further audit procedures you would request Kenacon to perform:

   (i) To determine whether the shareholders and key management of YY Co are connected to Tonway’s director and management; and (4 marks)

   (ii) To identify the potential understatement of revenue in the coating division, because the services performed using Tonway Co’s resources have been billed to customers by YY Co instead of by Tonway Co. (4 marks)

(d) Describe the further procedures you would request Kenacon to perform to determine:

   (i) The control deficiencies in the payment process; and (6 marks)

   (ii) The actual payee of the unsupported expenses. (1 mark)

(Total: 25 marks)

END OF PAPER