Optional Professional - Module

advanced Audit and Assurance

Time allowed : 15 minutes for reading and planning

3 hours for writing

December 13 – 2025

Do not open this paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Accountancy & Audit Profession Org. Council - Sudan

Paper P7

AAPOC

advanced Audit and Assurance P7

SECTION (A) – COMPULSORY QUESTION

Innovation Co

Date: 1 July 2025

You are the audit manager in Creativity & Co, responsible for the audit of Innovation Co, a listed company with a financial year ending on 30 September 2025.

Innovation Co is the country's leading retailer of small domestic pets, pet food, and pet accessories, operating 264 stores nationwide.

The following exhibits provide information relevant to the case:

1. **Email from the audit partner – received from Mr. Ahmed, the engagement partner.**
2. **Background information – key details and issues relevant to audit planning.**
3. **Selected financial information – extracts from Innovation Co's management accounts, including the results of preliminary analytical procedures performed by a team member.**
4. **Meeting notes – extracts from a recent meeting with the company's Finance Director.**

You should use this information to respond to the requirements below.

Required:

a) **Respond to the instructions in the audit partner's email. (40 marks)**

b) **The mark allocation is shown in Exhibit 1 (Partner's email).Professional marks will also be awarded for:**

Communication skills, Analysis and evaluation, Professional scepticism and judgement, Commercial acumen (10 marks)

Total (50 Marks)

Exhibit 1 – Partner's Email

To: Audit Manager

From: Ahmed, Engagement Partner

Subject: Audit Planning – Innovation Co

Date: 1 July 2025

Hello,

As the year-end approaches, I need you to commence the planning for the audit of Innovation Co.
I met last week with the company's Finance Director, Kate Fleming, to discuss recent business developments. You have been provided with a summary of the issues discussed and some projected financial information.

Based on my industry analysis, it is appropriate to use profit before tax as the benchmark for overall materiality, as this measure is key for both investors and finance providers.

Please prepare preliminary planning notes for my use, covering the following:

a) **Evaluate the key business risks faced by Innovation Co.** **(8 marks)**

b) **Evaluate and prioritise the significant risks of material misstatement to be considered when planning the audit.** **(18 marks)**

   Note: Do not assess risks relating to the audit of pet inventory, as these will be handled later by an audit expert as in prior years.

   You must use all exhibits when conducting your risk assessment.

c) **Discuss and conclude on the impact of outsourcing the credit control function on our audit planning.** **(7 marks)**

d) **Design the key audit procedures to be performed regarding employee leave obligations.** **(7 marks)**

Thank you,

Exhibit 2 – Background Information

Innovation Co is a large listed company established 15 years ago when the founders identified the growing demand for pet-related products. The company has grown steadily and is now the largest retailer of such products in the country, employing over 7,000 staff, most of whom work in stores.

In addition to selling products for a variety of pets, the stores also sell small live animals such as rabbits and fish. Staff receive comprehensive training to advise customers on animal nutrition and health and are also trained to handle all animals sold.

Some stores sell exotic pets (e.g., spiders, snakes, reptiles), which require compliance with import restrictions and animal welfare standards.

Most stores also operate veterinary clinics, supervised by qualified veterinarians who provide a full range of services. Customers can either pay per visit or subscribe to an annual pet healthcare plan, which covers the cost of basic vaccinations and quarterly health checks.

These healthcare plans are highly popular, typically representing about 10% of annual company revenue.

However, costs of vaccinations and health checks have risen in recent years, while the company has not increased prices due to customer price sensitivity.

The company's accounting policy recognises revenue from healthcare plans at the start date of the plan.

Exhibit 3 – Selected Financial Information (for the year ending 30 September 2025)

Financial Statement	2025 (Forecast, £m)	2024 (Actual, £m)
Revenue	803	745
Operating profit	172	110
Profit before tax	60	56

Balance Sheet Extracts

Item	Note	2025 (Forecast, £m)	2024 (Actual, £m)
Total assets	–	1,078	957
Retail stores acquired from Lake Co	(1)	171	–
Trade receivables	(2)	42	22
Goods in transit	(3)	12	–
Cash and cash equivalents	–	36	81
Employee leave obligations	(4)	21.1	11.6
Bank loans	–	251	75
Number of employees	(4)	7,000	6,200
Current ratio	–	2.6	1.4
Gearing ratio	–	31%	11%

Notes:

1. **Stores acquired from Lake Co:**

   Innovation Co purchased 20 retail stores from Lake Co (a clothing retailer) on 1 May 2025 for £171 million, using cash reserves.

   Lake Co was experiencing going concern issues and sold the stores as part of a restructuring plan.

   The stores require full refurbishment costing £9m each.

   Management has not yet decided how many stores will be retained for business use, with the remainder to be sold.

   Refurbishment will take place between November 2025 and January 2026.

2. **Trade receivables:**

   While most sales are for cash, an increasing number of customers now have credit accounts with Innovation Co.

   Customers are offered 60 days' credit terms, and receivables are expected to reach £42m

(2024: £22m) by year-end.

Due to this growth, credit control was outsourced to Trust Ltd in December 2024.

3. **Goods in transit:**

   In June 2025, Innovation Co purchased pet food supplies worth £12m from an overseas supplier under a contract transferring ownership on shipment.

   The vessel carrying the goods was involved in an accident, and the shipment was completely destroyed.

   Management had insurance coverage for 80% of the goods' value.

4. **Employee leave obligations:**

   Internal audit identified duplicate employee records following the merger of two HR systems in October 2024.

   The system can record leave taken but is not always used; manual records are also maintained.

   Employees can carry forward up to 3 days of unused leave.

   Management estimates leave obligations using prior year balances adjusted for pay rises and staff changes.

Exhibit 4 – Meeting Notes with the Finance Director

- The company launched its own-brand product line, the "Innovation Range", offering premium pet food and accessories.
- These products are manufactured overseas; purchases expected to reach £7m in FY2025.
- The range was launched in June 2025 and heavily marketed.
- Sales in FY2025 will be immaterial, but expected to represent 30% of total revenue by FY2026.
- The company obtained additional bank financing to support cash flow, marketing, and store refurbishments related to the Lake Co acquisition.

SECTION (B)

Answer only two questions

QUESTION ONE

Seas Co

Date: 1 July 2025

You are the audit manager responsible for the audit of Seas Co, a listed retail company.

You are currently finalising the audit for the year ended 31 March 2025.

Exhibit 1 – Audit Issues

The draft financial statements show:

- Total assets: £118 million
- Profit before tax: £11.5 million
- Audit materiality: £1.1 million

Lease of new property:

Seas Co expanded its operations and entered a new property lease on 1 April 2024.

- Lease term: 7 years, with a 12-month rent-free period, followed by six annual rental payments.
- The lease is accounted for in accordance with IFRS 16 Leases, and correctly recognised as a lease.
- A right-of-use asset of £28.9m and a corresponding lease liability were recognised, calculated using the implicit interest rate in the lease.
- However, no depreciation has been charged on the right-of-use asset; management argues that the rent-free period should not give rise to an expense.
- Management intends to start depreciating the asset next year, over six years (the payment period).
- The finance cost on the lease liability has been correctly recognised.

Inventory:

Seas Co recently signed contracts with a new supplier, which allow:

- The supplier to request returns of unsold goods at any time, and
- Seas Co to return unsold items within a specific period.

Inventory purchased from this supplier totals £8.1m, recognised at cost, which is below NRV.

Required:

a) **Evaluate the matters to consider when finalising the audit, and identify the audit evidence expected in the working papers:**

   (i) **Lease** **(9 marks)**

   (ii) **Inventory** **(7 marks)**

(Total: 16 marks)

b) **Evaluate the implications for the auditor's report, assuming the inventory issue is satisfactorily resolved, but no adjustments or disclosures are made for the lease issue.**

(4 marks)

Professional marks (5) will be awarded for demonstrating:
Analytical and evaluative skill, Professional scepticism and judgement, Commercial acumen

Total (25 Marks)

QUESTION TWO

Prince & Co

Date: 1 July 2025

You are a manager in the forensic audit department of Prince & Co, which provides audit and assurance services as well as other advisory work.

You have received a request from Bakkar Co to carry out an agreed-upon procedures engagement relating to an insurance claim following a fraud discovered in the payroll system.

Bakkar Co is not listed and not an existing audit client. It manufactures and sells medical supplies to hospitals.
It is wholly owned by a foreign trust, whose beneficiaries are the company's directors.

Bakkar Co has a good reputation in the healthcare sector and donates 5% of annual profits to international medical charities.

Exhibit 1 – Summary of the Payroll Fraud:

The fraud was discovered during an upgrade of the management information system (MIS) in June 2025.

At the head office, analysis revealed anomalies in staff costs and profit margins.
Upon review, the Finance Director found two employees still listed on the payroll, even though they left in 2013.
Both continued to receive monthly salary payments to the same bank account, though the beneficiary's identity is still unknown.

Over the past two years, the total amount paid is estimated at £30,000.
The Finance Director is unsure whether this is the full extent of the fraud or if there are other cases within payroll.

Bakkar Co expects the insurance company to reimburse the losses but needs an independent assessment to determine the exact amount for the claim.

The company wishes to submit the insurance claim within three weeks, before the shareholders' meeting on 1 August 2025.

Required:

a) **With reference to Exhibit 1:**

(i) Evaluate the quality management matters Prince & Co should consider before accepting the engagement. **(10 marks)**

(ii) Explain the specific elements that must be agreed in the engagement terms. **(4 marks)**

Note: Do not discuss any police or criminal investigation issues in (a)(i).

Now assume it is 10 July 2025, and your firm has accepted the engagement.

b) **Recommend the procedures to be performed to estimate the loss amount for the insurance claim.** **(6 marks)**

Professional marks (5) will be awarded for demonstrating:

Analytical and evaluative skill, Professional scepticism and judgement, Commercial awareness

Total (25 Marks)

QUESTION THREE

Fora Group

Date: 1 July 2025

You are an audit manager at Mango & Co, currently performing an Engagement Quality Review (EQR) of the audit of Fora Group, a listed group.

Your firm was engaged to audit both the consolidated financial statements and the individual financial statements of each group company.

Exhibit 1 – Summary of Issues Identified During Review

The audit of Fora Group for the year ended 31 March 2025 is nearing completion, and the auditor's report is scheduled for next week.

The group operates mainly in manufacturing, but also in agriculture and other sectors.

Extracts from draft consolidated financial statements:

- Revenue: £129m (2024: £113m)
- Profit before tax: £18.6m (2024: £23.2m)
- Total assets: £465m (2024: £460m)

A junior audit team member made the following comments about planning and audit execution:

- On 10 June 2025, the group acquired a new subsidiary (Robin Co) expected to increase group revenue by ~20%.
- The CFO was too busy to discuss audit matters due to the acquisition.
- The acquisition was not included in the original audit plan (January 2025).
- The audit partner decided no audit work was needed on the acquisition because the CFO stated it would be consolidated next year.
- To reduce costs, the audit manager arranged for audit procedures on revenue for several key subsidiaries (including one agricultural entity) to be performed by Camelia Co, an unrelated accounting firm.
- The audit manager stated that the team could rely on Camelia's evidence because it is a qualified accounting firm.

Further comments:

- No review was performed by the audit manager or partner on Camelia's audit work.
- No additional audit evidence was obtained for capitalised development costs (£1.2m).
- No discussion occurred with management regarding technical feasibility or commercial viability; instead, assumptions were matched to the business plan, deemed "consistent."
- This is the first year such development costs were capitalised as an intangible asset.

Vegetable Co, an agricultural subsidiary, had the following figures:

- Assets: £60.5m (2024: £83m)
- Revenue: £6.5m (2024: £6.4m)

The audit strategy initially required a technical specialist for agricultural matters, but this was dropped due to cost constraints, and all related instructions were removed from the audit file.

Required:

a) **Evaluate the quality management and other professional issues identified during your review relating to the planning and execution of the audit of Fora Group, and recommend appropriate actions to be taken. (20 marks)**

b) **Professional marks (5) will be awarded for demonstrating:**
Analytical and evaluative skill, Professional scepticism and judgement, Commercial awareness

Total (25 Marks)