Answers
1  (a)  

(i) Importance of reporting to those charged with governance

In accordance with ISA 260 *Communication with Those Charged with Governance*, it is important for the auditors to report to those charged with governance as it helps in the following ways:

1. It assists the auditor and those charged with governance in understanding matters related to the audit, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor’s independence and objectivity.

2. It helps the auditor in obtaining, from those charged with governance, information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence and in providing information about specific transactions or events.

3. It helps those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

(ii) Matters to be communicated to those charged with governance

- The auditor’s responsibilities with regards to providing an opinion on the financial statements and that they have carried out their work in accordance with International Standards on Auditing.
- The auditor should explain the planned approach to the audit as well as the audit timetable.
- Any key audit risks identified during the planning stage should be communicated.
- In addition, any significant difficulties encountered during the audit should be communicated.
- Also significant matters arising during the audit, as well as significant accounting adjustments.
- During the audit any significant deficiencies in the internal control system identified should be communicated in writing or verbally.
- Those charged with governance should be notified of any written representations required by the auditor.
- Other matters arising from the audit that are significant to the oversight of the financial reporting process.
- If any suspected frauds are identified during the audit, these must be communicated.
- If the auditors are intending to make any modifications to the audit opinion, these should be communicated to those charged with governance.
- For listed entities, a confirmation that the auditors have complied with ethical standards and appropriate safeguards have been put in place for any ethical threats identified.

(b) Report to management

Dear Sirs,

Audit of Fox Industries Co (Fox) for the year ended 30 April 2013

Please find enclosed the report to management on deficiencies in internal controls identified during the audit for the year ended 30 April 2013. The appendix to this report considers deficiencies in the purchasing and payments system, the implications of those deficiencies and recommendations to address those deficiencies.

Please note that this report only addresses the deficiencies identified during the audit and if further testing had been performed, then more deficiencies may have been reported.

This report is solely for the use of management and if you have any further questions, then please do not hesitate to contact us.

Yours faithfully

An audit firm
<table>
<thead>
<tr>
<th>Deficiency</th>
<th>Implication</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>When raising purchase orders, the clerks choose whichever supplier can despatch the goods the fastest.</td>
<td>This could result in Fox ordering goods at a much higher price or a lower quality than they would like, as the only factor considered was speed of delivery.</td>
<td>An approved supplier list should be compiled; this should take into account the price of goods, their quality and also the speed of delivery.</td>
</tr>
<tr>
<td>Purchase orders are not sequentially numbered.</td>
<td>Failing to sequentially number the orders means that Fox's ordering team are unable to monitor if all orders are being fulfilled in a timely manner; this could result in stock outs.</td>
<td>All purchase orders should be sequentially numbered and on a regular basis a sequence check of unfulfilled orders should be performed.</td>
</tr>
<tr>
<td>Purchase orders below $5,000 are not authorised and are processed solely by an order clerk.</td>
<td>This can result in goods being purchased which are not required by Fox. In addition, there is an increased fraud risk as an order clerk could place orders for personal goods up to the value of $5,000, which is significant.</td>
<td>All purchase orders should be authorised by a responsible official. Authorised signatories should be established with varying levels of purchase order authorisation.</td>
</tr>
<tr>
<td>Purchase invoices are input daily by the purchase ledger clerk and due to his experience, he does not utilise any application controls.</td>
<td>Without application controls there is a risk that invoices could be input into the system with inaccuracies or they may be missed out entirely.</td>
<td>The purchase ledger clerk should input the invoices in batches and apply application controls, such as control totals, to ensure completeness and accuracy over the input of purchase invoices.</td>
</tr>
<tr>
<td>The purchase day book automatically updates with the purchase ledger but this ledger is manually posted to the general ledger.</td>
<td>Manually posting the amounts to the general ledger increases the risk of errors occurring. This could result in the payables balance in the financial statements being under or overstated.</td>
<td>The process should be updated so that on a regular basis the purchase ledger automatically updates the general ledger. A responsible official should then confirm through purchase ledger control account reconciliations that the update has occurred correctly.</td>
</tr>
<tr>
<td>Fox's saving (deposit) bank accounts are only reconciled every two months.</td>
<td>If these accounts are only reconciled periodically, there is the risk that errors will not be spotted promptly. Also, this increases the risk of employees committing fraud. If they are aware that these accounts are not regularly reviewed, then they could use these cash sums fraudulently.</td>
<td>All bank accounts should be reconciled on a regular basis, and at least monthly, to identify any unusual or missing items. The reconciliations should be reviewed by a responsible official and they should evidence their review.</td>
</tr>
<tr>
<td>Fox has a policy of delaying payments to their suppliers for as long as possible.</td>
<td>Whilst this maximises Fox's bank balance, there is the risk that Fox is missing out on early settlement discounts. Also, this can lead to a loss of supplier goodwill as well as the risk that suppliers may refuse to supply goods to Fox.</td>
<td>Fox should undertake cash flow forecasting/budgeting to maximise bank balances. The policy of delaying payment should be reviewed, and suppliers should be paid in a systematic way, such that supplier goodwill is not lost.</td>
</tr>
</tbody>
</table>


(c) Application controls

Document counts – the number of invoices to be input are counted, the invoices are then entered one by one, at the end the number of invoices input is checked against the document count. This helps to ensure completeness of input.

Control totals – here the total of all the invoices, such as the gross value, is manually calculated. The invoices are input, the system aggregates the total of the input invoices’ gross value and this is compared to the control total. This helps to ensure completeness and accuracy of input.

One for one checking – the invoices entered into the system are manually agreed back one by one to the original purchase invoices. This helps to ensure completeness and accuracy of input.

Review of output to expected value – an independent assessment is made of the value of purchase invoices to be input, this is the expected value. The invoices are input and the total value of invoices is compared to the expected value. This helps to ensure completeness of input.

Check digits – this control helps to reduce the risk of transposition errors. Mathematical calculations are performed by the system on a particular data field, such as supplier number, a mathematical formula is run by the system, this checks that the data entered into the system is accurate. This helps to ensure accuracy of input.

Range checks – a pre-determined maximum is input into the system for gross invoice value, for example, $10,000; when invoices are input if the amount keyed in is incorrectly entered as being above $10,000, the system will reject the invoice. This helps to ensure accuracy of input.

Existence checks – the system is set up so that certain key data must be entered, such as supplier name, otherwise the invoice is rejected. This helps to ensure accuracy of input.

Tutorial note: Marks will be awarded for any other relevant application controls.

(d) Substantive procedures over bank and cash balance of Fox Industries Co (Fox)

– Obtain Fox’s current bank account reconciliation and check the additions to ensure arithmetical accuracy.
– Obtain a bank confirmation letter from Fox’s bankers for all of its accounts.
– For the current account, agree the balance per the bank statement to an original year-end bank statement and also to the bank confirmation letter.
– Agree the reconciliation’s balance per the cash book to the year-end cash book.
– Trace all of the outstanding lodgements to the pre year-end cash book, post year-end bank statement and also to paying-in-book pre year end.
– Trace all unpresented cheques through to a pre year-end cash book and post year-end statement. For any unusual amounts or significant delays obtain explanations from management.
– Examine any old unpresented cheques to assess if they need to be written back into the purchase ledger as they are no longer valid to be presented.
– Agree all balances listed on the bank confirmation letter to Fox’s bank reconciliations or the trial balance to ensure completeness of bank balances.
– Review the cash book and bank statements for any unusual items or large transfers around the year end, as this could be evidence of window dressing.
– Examine the bank confirmation letter for details of any security provided by Fox or any legal right of set-off as this may require disclosure.
– For the saving (deposit) bank accounts, review any reconciling items on the year-end bank reconciliations and agree to supporting documentation.
– In respect of material cash balances, count cash balances at the year end and agree to petty cash records, such as the petty cash book.
– Review the financial statements to ensure that the disclosure of cash and bank balances are complete and accurate.

Tutorial note: Marks will be awarded for any other relevant bank and cash tests.
2 (a) Ethical threats

The five categories of threats as per the ACCA Code of Ethics and Conduct along with an example of each threat are:

(i) Self-interest

- Undue dependence on fee income from one client.
- Close personal or business relationships.
- Direct financial interest in a client.
- Concern over loss of significant client.
- Contingent fee arrangements.
- Member of audit team entering into employment negotiations with client.
- The discovery of a significant error during a re-evaluation of the work undertaken by the member.

(ii) Self-review

- Member of assurance team being or recently having been employed by the client in a position to influence the subject matter being reviewed.
- Involvement in implementation of financial system and subsequently reporting on the operation of said system.
- Firm having prepared the original data used to generate records that are the subject matter of the assurance engagement, for example, preparing clients’ financial statements.
- Performing a service for a client that directly affects the subject matter of an assurance engagement.

(iii) Advocacy

- Acting as an advocate on behalf of a client in litigation or disputes.
- Promoting shares in a listed audit client.

(iv) Familiarity

- Long association with a client.
- Acceptance of gifts or preferential treatment (significant value).
- Former partner of firm being employed by client.
- A person in a position to influence financial or non-financial reporting or business decisions having an immediate or close family member who is in a position to benefit from that influence.

(v) Intimidation

- Threat of litigation.
- Threat of removal as assurance firm.
- Threat of not being awarded non-audit engagements if disagree with directors’ accounting treatment.
- Accountant threatened by audit partner of not being promoted within the firm if disagree with client.
- Dominant personality of client director attempting to influence decisions.
- Pressure to reduce inappropriately the extent of work performed in order to reduce fees.

Tutorial note: Only one example per threat is required, credit will be awarded for other relevant examples of threats.

(b) Going concern

Management have a responsibility under IAS 1 Presentation of Financial Statements to undertake an assessment of the company’s ability to continue as a going concern and to make appropriate disclosures with regards to going concern.

In accordance with ISA 570 Going Concern, the auditor’s responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements by undertaking appropriate substantive procedures.

The auditor should consider whether the period of management’s going concern assessment is adequate. The assessment needs to cover a period of no less than 12 months from the date of the financial statements.

In addition, the auditor should conclude whether there is a material uncertainty about the entity’s ability to continue as a going concern and consider the reporting implications.

(c) Emphasis of matter paragraph

ISA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report identifies situations where the audit report is modified, by the inclusion of additional paragraphs, but result in an unmodified opinion. An emphasis of matter paragraph is one such example. These are commonly used in raising awareness of issues such as going concern.

Emphasis of matter paragraph – A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgement, is of such importance that it is fundamental to users’ understanding of the financial statements. The paragraph must state that the auditor’s opinion is not modified in respect of the matter emphasised.
3 (a) Materiality and performance materiality

Materiality and performance materiality are dealt with under ISA 320 Materiality in Planning and Performing an Audit. Auditors need to establish the materiality level for the financial statements as a whole, as well as assess performance materiality levels, which are lower than the overall materiality.

Materiality is defined in ISA 320 as follows:

‘Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.’

In assessing the level of materiality, there are a number of areas that should be considered. First the auditor must consider both the amount (quantity) and the nature (quality) of any misstatements, or a combination of both. The quantity of the misstatement refers to the relative size of it and the quality refers to an amount that might be low in value but due to its prominence could influence the user’s decision, for example, directors’ transactions.

As per ISA 320, materiality is often calculated using benchmarks such as 5% of profit before tax or 1% of total revenue or total expenses. These values are useful as a starting point for assessing materiality.

The assessment of what is material is ultimately a matter of the auditor’s professional judgement, and it is affected by the auditor’s perception of the financial information needs of users of the financial statements and the perceived level of risk; the higher the risk, the lower the level of overall materiality.

In assessing materiality, the auditor must consider that a number of errors each with a low value may, when aggregated, amount to a material misstatement.

In calculating materiality, the auditor should also set the performance materiality level. Performance materiality is normally set at a level lower than overall materiality. It is used for testing individual transactions, account balances and disclosures. The aim of performance materiality is to reduce the risk that the total of errors in balances, transactions and disclosures does not in total exceed overall materiality.

Tutorial note: Award marks for ISA 320 definition of performance materiality below:

‘Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.’

(b) (i) Ratios

Ratios to assist the audit supervisor in planning the audit:

<table>
<thead>
<tr>
<th>2013</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross margin</td>
<td>5/12·5 = 44%</td>
</tr>
<tr>
<td>Operating margin</td>
<td>0/5·12·5 = 4%</td>
</tr>
<tr>
<td>Inventory days</td>
<td>1·9/7 * 365 = 99 days</td>
</tr>
<tr>
<td>Inventory turnover</td>
<td>7/1·9 = 3·7</td>
</tr>
<tr>
<td>Receivable days</td>
<td>3·1/2·6 = 91 days</td>
</tr>
<tr>
<td>Payable days</td>
<td>1·6/7 * 365 = 83 days</td>
</tr>
<tr>
<td>Current ratio</td>
<td>5·8/1·9 = 3·7</td>
</tr>
<tr>
<td>Quick ratio</td>
<td>(5·8 – 1·9)/1·9 = 1·5</td>
</tr>
</tbody>
</table>

(ii) Audit risks and responses

Audit risk

Receivable days have increased from 49 to 91 days and management has significantly extended the credit terms given to customers. This leads to an increased risk of recoverability of receivables as they may be overvalued.

Due to the fall in demand for Kangaroo Construction Co’s (Kangaroo) houses, there are some houses where the selling price may be below cost. IAS 2 Inventories requires that inventory should be stated at the lower of cost and NRV.

In addition, inventory days have increased from 64 to 99 days and inventory turnover has fallen from 5·7 in 2012 to 3·7 in the current year. There is a risk that inventory is overvalued.

Audit response

Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation.

Detailed cost and net realisable value (NVR) testing to be performed and the aged inventory report to be reviewed to assess whether inventory requires writing down.
4 (a) Procedures to obtain evidence and an audit test relevant to property, plant and equipment:

(i) Inspection
Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

(ii) – Inspect a sample of capital items at the client site to ensure they exist, are in use and in good condition, and agree included in the non-current assets register to confirm completeness of assets.
– Inspect capital expenditure forms for evidence of authorisation by a responsible official.

(i) Observation
Observation consists of looking at a process or procedure being performed by others.

(ii) – Observe the process for logging property, plant and equipment invoices into the system to ensure that all invoices are entered completely and accurately.
– Observe the process of physical confirmation of non-current assets undertaken by internal audit/finance department.
(i) Analytical procedures
Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

(ii) Undertake a proof in total calculation for depreciation, taking into account additions and disposals, compare it to the actual charge and investigate any significant differences.
– Review monthly depreciation charges to identify any significant fluctuations and discuss with management.

(i) Inquiry
Inquiry consists of seeking information from knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

(ii) Discuss with management whether there have been any changes in useful lives or residual values of assets as this will impact the depreciation calculation.
– Inquire of department heads the process they follow in authorising capital expenditure orders to ensure that it follows the specified company authorisation process.

(i) Recalculation
Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

(ii) Recalculate the depreciation charge for a sample of assets and agree the charge to the non-current assets register.
– Recalculate the profit or loss on disposal for a sample of assets disposed of in the year to ensure accuracy.

(i) External confirmation
An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party, in paper form, electronic form or by other medium.

(ii) Obtain a confirmation from the company’s bank or lawyers of any non-current assets held as security for loans, as this will require disclosure in the financial statements.
– Write to the firm who have undertaken the valuation of property, plant and equipment for the year and obtain a copy of their report in order to undertake testing of the assumptions and calculations.

(i) Reperformance
Reperformance involves the auditor’s independent execution of procedures or controls that were originally performed as part of the entity’s internal control.

(ii) Reperform the non-current asset register reconciliation to the general ledger to ensure accuracy.
– Select a sample of authorised capital expenditure orders; match to the invoice and to inclusion in the non-current assets register to ensure completeness of the capital expenditure cycle.

Tutorial note: Marks will be awarded for any other relevant property, plant and equipment tests.

(b) Preventing and detecting fraud and error
The directors of Bush-Baby Hotels Co (Bush-Baby) are responsible for the prevention and detection of fraud and error. However, the new internal audit department can help the directors by assessing the main areas of fraud risk, assessing the adequacy and effectiveness of control systems and helping to develop controls to mitigate key risks.

Having developed the controls, they can undertake regular reviews of compliance by each hotel of these controls. Where non-compliance is identified, they can instigate further training if necessary or report suspected frauds to senior management.

Where fraud is suspected, the internal audit department can undertake a detailed fraud investigation to identify who is involved, likely sums stolen and gather evidence for any subsequent police investigation.

In addition, the presence of an internal audit department can itself act as a fraud deterrent, as the risk of being discovered means individuals are less likely to undertake fraudulent activities.

(c) Limitations of establishing and maintaining an internal audit department
The internal auditors of Bush-Baby will be employees of the company and so this can impair their independence, as they may not report issues to those charged with governance for fear of losing their job.

Although some internal auditors are professionally qualified, there is no requirement to be qualified, as there is for external auditors. Hence, there may be gaps in the experience and technical knowledge of the internal audit department.

The cost of establishing an internal audit department can be significant; hence prior to recruiting a team, the management of Bush-Baby should consider carefully the roles the team can perform and whether this will generate sufficient value for money.

As Bush-Baby has not previously had any form of internal audit, there may be some resistance from employees of the company. They may be uncomfortable with the idea of their work being reviewed, especially if the first role of the department is to undertake fraud investigations.
Additional functions for Bush-Baby’s internal audit department

Monitoring asset levels
The internal audit department could undertake inventory counts at the restaurants of the 18 hotels. There is likely to be a significant level of goods held at each hotel. Internal audit could count actual levels of goods held and compare them to the hotels’ records. If consistent negative differences occur for a hotel, then this may be an early indicator of fraud. If positive differences are highlighted, then it could be because employees have not been adequately trained on how to record inventory.

Cash controls at hotels
Bush-Baby’s internal auditors could undertake controls testing over cash receipts and cash counts. It is likely that cash at each hotel will be significant as there would be cash at the reception, restaurant and leisure club. Each hotel should have tight controls over the cash receipts process. These controls should be tested at each location as well as performance of a cash count to reduce the level of errors.

Customer satisfaction levels
In order to improve the overall guest experience in the hotel, members of the internal audit department could undertake ‘mystery guest’ reviews, where they enter the hotel as a guest, stay the night, eat and drink in the restaurant and visit the leisure club. They then rate the overall hotel experience. This is fed back to each hotel to improve customer service and can provide the basis for further training, if necessary.

Overall review of financial/operational controls
The department could undertake reviews of controls at head office, as well as individual hotels and make recommendations to management over such areas as the purchasing process as well as the payroll cycle.

IT system reviews
Bush-Baby is likely to have a relatively complex computer system linking all of the tills in the hotels to head office. The internal audit department could be asked to perform a review over the computer environment and controls.

Value for money review
The internal audit department could be asked to assess whether Bush-Baby is obtaining value for money in areas such as capital expenditure.

Regulatory compliance
Bush-Baby’s operations include leisure clubs, restaurants and hotel rooms. There will be various laws and regulations such as health and safety, food hygiene and fire prevention that impact Bush-Baby. The internal audit department could help to monitor compliance with these regulations.

5 (a) Elements of an assurance engagement
In accordance with ISAE 3000 Assurance Engagements other than Audits or Reviews of Historical Financial Information, an assurance engagement will involve three separate parties:

– The intended user who is the person who requires the assurance report.
– The responsible party, which is the organisation responsible for preparing the subject matter to be reviewed.
– The practitioner (i.e. an accountant) who is the professional who will review the subject matter and provide the assurance.

A second element is a suitable subject matter. The subject matter is the data that the responsible party has prepared and which requires verification.

Suitable criteria are required in an assurance engagement. The subject matter is compared to the criteria in order for it to be assessed and an opinion provided.

Sufficient appropriate evidence has to be obtained by the practitioner in order to give the required level of assurance.

An assurance report is the opinion that is given by the practitioner to the intended user and the responsible party.

(b) Subsequent events
Event 1 – Defective chemicals
Panda Co’s (Panda) quality control procedures have identified that inventory with a cost of $0·85 million is defective; the scrap value of this inventory is $0·1 million. This information was obtained after the year end but provides further evidence of the net realisable value of inventory at the year end and hence is an adjusting event.

IAS 2 Inventories requires that inventory is valued at the lower of cost and net realisable value. The inventory of $0·85 million must be written down to its net realisable value of $0·1 million. The write down of $0·75 million (0·85 – 0·1) is material as it represents 13·4% (0·75/5·6) of profit before tax and 1·4% (0·75/55) of revenue. Hence, the directors should amend the financial statements by writing down the inventory to $0·1 million.

The following audit procedures should be applied to form a conclusion on the adjustment:

– Review the board minutes/quality control reports to assess whether this event was the only case of defective inventory as there could potentially be other inventory which requires writing down.
– Discuss the matter with the directors, checking whether the company has sufficient inventory to continue trading in the short term.
– Obtain a written representation confirming that the company’s going concern status is not impacted.
– Obtain a schedule showing the defective inventory and agree to supporting production documentation that it was produced prior to 30 April, as otherwise it would not require a write down at the year end.
– Discuss with management how they have assessed the scrap value of $0.1 million and agree this amount to any supporting documentation to confirm the value.

Event 2 – Explosion

An explosion has occurred in one of the offsite storage locations and property, plant and equipment and inventory valued at $0.9 million have been damaged and now have no scrap value. The directors do not believe they are likely to be able to claim insurance for the damaged assets. This event occurred after the year end and the explosion would not have been in existence at 30 April, and hence this event indicates a non-adjusting event.

The damaged assets of $0.9 million are material as they represent 16.1% (0.9/5.6) of profit before tax and 1.6% (0.9/55) of revenue. As a material non-adjusting event, the assets should not be written down to zero; however, the directors should consider including a disclosure note detailing the explosion and the value of assets impacted.

The following audit procedures should be applied to form a conclusion on any amendment:
– Obtain a schedule showing the damaged property, plant and equipment and agree the net book value to the non-current assets register to confirm what the value of damaged assets was.
– Obtain the latest inventory records for this storage location to ascertain the likely level of inventory at the time of the explosion.
– Discuss with the directors whether they will disclose the effect of the explosion in the financial statements.
– Discuss with the directors why they do not believe that they are able to claim on their insurance; if a claim was to be made, then only uninsured losses would require disclosure, and this may be an immaterial amount.

(c) Audit report

The explosion is a non-adjusting post year-end event and the level of damaged assets are material. Hence a disclosure note should be included in the 2013 financial statements and the write down of assets would be included in the 2014 financial statements.

If the directors refuse to make the subsequent event disclosures, then the financial statements are materially misstated and as the lack of disclosure is material but not pervasive, the audit report will be modified and a qualified opinion will be necessary.

A basis for qualified opinion paragraph would need to be included before the opinion paragraph. This would explain the misstatement in relation to the lack of subsequent events disclosure and the effect on the financial statements. The opinion paragraph would be qualified ‘except for’.
1 (a) (i) Up to 1 mark per well explained point
- Assists the auditor and those charged with governance in understanding matters related to the audit
- Obtains information relevant to the audit
- Helps those charged with governance in fulfilling their responsibility to oversee the financial reporting process

(ii) Up to 1 mark for each example matter to be communicated to those charged with governance

(b) Up to 1 mark per well explained deficiency, implication and recommendation. If not well explained then just give \( \frac{1}{2} \) mark for each. Overall maximum of 4 marks each for deficiencies, implications and recommendations.
2 marks for presentation: 1 for address and intro and 1 for conclusion.
- No approved suppliers list
- Purchase orders not sequentially numbered
- Orders below $5,000 are not authorised by a responsible official
- No application controls over input of purchase invoices
- Purchase ledger manually posted to general ledger
- Saving (deposit) bank accounts only reconciled every two months
- Payments to suppliers delayed
- Finance director only reviews the total of the payment list prior to payment authorising

(c) Up to 1 mark per well explained application control
- Document counts
- Control totals
- One for one checking
- Review of output to expected value
- Check digits
- Range checks
- Existence checks

(d) Up to 1 mark per substantive procedure
- Check additions of bank reconciliation
- Obtain bank confirmation letter
- Bank balance to statement/bank confirmation
- Cash book balance to cash book
- Outstanding lodgements
- Unpresented cheques review
- Old cheques write back
- Agree all balances on bank confirmation
- Unusual items/window dressing
- Security/legal right set-off
- Review reconciliations for saving (deposit) accounts
- Cash counts for significant cash balances
- Review disclosure of bank and cash in financial statements
2. **(a)** ½ mark for each threat and ½ mark per example of a threat:
   - Self-interest
   - Self-review
   - Advocacy
   - Familiarity
   - Intimidation
   - Marks: 5

   **(b)** Up to 1 mark per well explained responsibility
   - Management assessment of the company’s ability to continue as a going concern and to make appropriate disclosures
   - Auditor’s responsibility to obtain evidence about the appropriateness of management’s going concern assumption
   - Auditor consider whether the period of management’s going concern assessment is adequate; no less than 12 months from the date of the financial statements
   - Auditor should conclude whether there is a material uncertainty about going concern and consider the reporting implications
   - Marks: 3

   **(c)** Up to 1 mark per well described point
   - Emphasis of matter
   - Marks: 2

3. **(a)** Up to 1 mark per well explained point:
   - Materiality for financial statements as a whole and also performance materiality levels
   - Definition of materiality
   - Amount or nature of misstatements, or both
   - 5% profit before tax or 1% revenue or total expenses
   - Judgement, needs of users and level of risk
   - Small errors aggregated
   - Performance materiality
   - Marks: 5

   **(b) (i)** ½ mark per ratio calculation per year.
   - Gross margin
   - Operating margin
   - Inventory days
   - Inventory turnover
   - Receivable days
   - Payable days
   - Current ratio
   - Quick ratio
   - Marks: 5

   **(ii)** Up to 1 mark per well described audit risk and up to 1 mark per well explained audit response
   - Receivables valuation
   - Inventory valuation
   - Depreciation of plant and machinery
   - Management manipulation of profit to reach bonus targets
   - Completeness of warranty provision
   - Disclosure of bank loan of $1 million
   - Going concern risk
   - Marks: 10

   Total Marks: 20
4 (a) Up to 1 mark per well described procedure and up to 1 mark for a valid audit test, overall maximum of 2 marks per type of procedure and test, maximum of 5 marks for procedures and maximum of 5 marks for tests.
   - Inspection
   - Observation
   - Analytical procedures
   - Inquiry
   - Recalculation
   - External confirmation
   - Reperformance

(b) Up to 1 mark per well explained point
   - Internal audit (IA) can assess fraud risk and develop controls to mitigate fraud
   - Regular reviews of compliance with these controls
   - Where fraud suspected, IA can undertake detailed fraud investigation
   - Existence of IA department acts as a fraud deterrent

(c) Up to 1 mark per well described limitation
   - Lack of independence as employees of the company
   - No requirement to be professionally qualified
   - Cost of establishing department
   - Possible resistance from existing employees to idea of being audited

(d) Up to 1 mark per well described point
   - Monitoring asset levels
   - Cash controls testing
   - Customer satisfaction levels
   - Financial/operational controls
   - IT system review
   - Value for money review
   - Regulatory compliance

Marks

10

3

2

5

20
5 (a) Up to 1 mark per well explained element
   – Intended user, responsible party, practitioner
   – Subject matter
   – Suitable criteria
   – Appropriate evidence
   – Assurance report

(b) Up to 1 mark per valid point, overall maximum of 6 marks per event

   Event 1 – Defective chemicals
   – Provides evidence of conditions at the year end
   – Inventory to be adjusted to lower of cost and net realisable value
   – Calculation of materiality
   – Review board minutes/quality control reports
   – Discuss with the directors, adequate inventory to continue to trade
   – Obtain written representation re going concern
   – Obtain schedule of defective inventory, agree to supporting documentation
   – Discuss with directors basis of the scrap value

   Event 2 – Explosion
   – Provides evidence of conditions that arose subsequent to the year end
   – Non-adjusting event, requires disclosure if material
   – Calculation of materiality
   – Obtain schedule of damaged property, plant and equipment and agree values to asset register
   – Obtain latest inventory records to confirm damaged inventory levels
   – Discuss with the directors if they will make disclosures
   – Discuss with directors why no insurance claim will be made

(c) Up to 1 mark per well explained valid point

   Disclosure required in 2013 financial statements and adjustment to the assets in 2014 financial statements
   – Material but not pervasive misstatement, modified audit report, qualified opinion
   – Basis for qualified opinion paragraph required
   – Opinion paragraph – except for

Marks

5

6

6