Answers

1 (a) Pear International's (Pear) internal control

Deficiency	Control	Test of control
Currently the website is not integrated into inventory system. This can result in Pear accepting customer orders when they do not have the goods in inventory. This can cause them to lose sales and customer goodwill.	The website should be updated to include an interface into the inventory system; this should check inventory levels and only process orders if adequate inventory is held. If inventory is out of stock, this should appear on the website with an approximate waiting time.	Test data could be used to attempt to process orders via the website for items which are not currently held in inventory. The orders should be flagged as being out of stock and indicate an approximate waiting time.
For goods despatched by local couriers, customer signatures are not always obtained. This can lead to customers falsely claiming that they have not received their goods. Pear would not be able to prove that they had in fact despatched the goods and may result in goods being despatched twice.	Pear should remind all local couriers that customer signatures must be obtained as proof of despatch and payment will not be made for any despatches with missing signatures.	Select a sample of despatches by couriers and ask Pear for proof of despatch by viewing customer signatures.
There have been a number of situations where the sales orders have not been fulfilled in a timely manner. This can lead to a loss of customer goodwill and if it persists will damage the reputation of Pear as a reliable supplier.	Once goods are despatched they should be matched to sales orders and flagged as fulfilled. The system should automatically flag any outstanding sales orders past a predetermined period, such as five days. This report should be reviewed by a responsible official.	Review the report of outstanding sales orders. If significant, discuss with a responsible official to understand why there is still a significant time period between sales order and despatch date. Select a sample of sales orders and compare the date of order to the goods despatch date to ascertain whether this is within the acceptable predetermined period.
Customer credit limits are set by sales ledger clerks. Sales ledger clerks are not sufficiently senior and so may set limits too high, leading to irrecoverable debts, or too low, leading to a loss of sales.	Credit limits should be set by a senior member of the sales ledger department and not by sales ledger clerks. These limits should be regularly reviewed by a responsible official.	For a sample of new customers accepted in the year, review the authorisation of the credit limit, and ensure that this was performed by a responsible official. Enquire of sales ledger clerks as to who can set credit limits.
Sales discounts are set by Pear's sales team. In order to boost their sales, members of the sales team may set the discounts too high, leading to a loss of revenue.	All members of the sales team should be given authority to grant sales discounts up to a set limit. Any sales discounts above these limits should be authorised by sales area managers or the sales director. Regular review of sales discount levels should be undertaken by the sales director, and this review should be evidenced.	Discuss with members of the sales team the process for setting sales discounts. Review the sales discount report for evidence of review by the sales director.
Supplier statement reconciliations are no longer performed. This may result in errors in the recording of purchases and payables not being identified in a timely manner.	Supplier statement reconciliations should be performed on a monthly basis for all suppliers and these should be reviewed by a responsible official.	Review the file of reconciliations to ensure that they are being performed on a regular basis and that they have been reviewed by a responsible official.

Deficiency	Control	Test of control
Changes to supplier details in the purchase ledger master file can be undertaken by purchase ledger clerks. This could lead to key supplier data being accidently amended or fictious suppliers being set up, which can increase the risk of fraud.	Only purchase ledger supervisors should have the authority to make changes to master file data. This should be controlled via passwords. Regular review of any changes to master file data by a responsible official and this review should be evidenced.	Request a purchase ledger clerk to attempt to access the master file and to make an amendment, the system should not allow this. Review a report of master data changes and review the authority of those making amendments.
Pear has considerable levels of surplus plant and equipment. Surplus unused plant is at risk of theft. In addition, if the surplus plant is not disposed of then the company could lose sundry income.	Regular review of the plant and equipment on the factory floor by senior factory personnel to identify any old or surplus equipment. As part of the capital expenditure process there should be a requirement to confirm the treatment of the equipment being replaced.	Observe the review process by senior factory personnel, identifying the treatment of any old equipment. Review processed capital expenditure forms to ascertain if the treatment of replaced equipment is stated.
Purchase requisitions are authorised by production supervisors. Production supervisors are not sufficiently independent or senior to authorise capital expenditure.	Capital expenditure authorisation levels to be established. Production supervisors should only be able to authorise low value items, any high value items should be authorised by the board.	Review a sample of authorised capital expenditure forms and identify if the correct signatory has authorised them.

(b) Substantive procedures – Additions and disposals

Additions

- Obtain a breakdown of additions, cast the list and agree to the non-current asset register to confirm completeness of plant & equipment (P&E).
- Select a sample of additions and agree cost to supplier invoice to confirm valuation.
- Verify rights and obligations by agreeing the addition of plant and equipment to a supplier invoice in the name of Pear.
- Review the list of additions and confirm that they relate to capital expenditure items rather than repairs and maintenance.
- Review board minutes to ensure that significant capital expenditure purchases have been authorised by the board.
- For a sample of additions recorded in P&E physically verify them on the factory floor to confirm existence.

Disposals

- Obtain a breakdown of disposals, cast the list and agree all assets removed from the non-current asset register to confirm existence.
- Select a sample of disposals and agree sale proceeds to supporting documentation such as sundry sales invoices.
- Recalculate the profit/loss on disposal and agree to the income statement.

(c) Levels of assurance

The level of assurance provided by audit and other review engagements is as follows:

Audit
External Audit – A high but not absolute level of assurance is provided, this is known as reasonable assurance. This provides comfort that the financial statements are true and fair and are free of material misstatements.

Other review engagements
Other review engagements where an opinion is being provided, the practitioner gathers sufficient evidence to be satisfied that the subject matter is plausible; in this case negative assurance is given whereby the practitioner confirms that nothing has come to his attention which indicates that the subject matter contains material misstatements.

(d) Differences between internal and external audit

	External Audit	Internal Audit
Objective	The main objective of the external auditor is to express an opinion on the truth and fairness of the financial statements.	The main objective of internal audit is to improve a company's operations, by reviewing the efficiency and effectiveness of the company's internal controls.
Reporting	External auditors report to the shareholders or members of the company. External audit reports are contained within the financial statements and hence are publicly available.	Internal auditors normally report to management or those charged with governance. Internal audit reports not publicly available and are only intended to be seen by the addressee of the report. The reports are normally provided to the board of directors and those charged with governance such as the audit committee.

	External Audit	Internal Audit
Scope of work	The external auditor's work is limited to verifying the truth and fairness of the financial statements of the company.	The internal auditor can have a wide scope of work and it is determined by the requirements of management or those charged with governance. Commonly internal audit focus on the company's internal control environment, but any other area of a company's operations can be reviewed.
Relationship with company	External auditors are appointed by the company's shareholders. They are independent of the company.	Internal auditors are appointed by management. As internal auditors are normally employees of the company they lack independence. However, the internal audit department can be outsourced and this can increase their independence.

(e) Impact on interim and final audit

Interim audit

Apple & Co could look to rely on any internal control documentation produced by internal audit (IA) as they would need to assess whether the control environment has changed during the year.

If the IA department has performed testing during the year on internal control systems, such as the payroll, sales and purchase systems, then Apple & Co could review and possibly place reliance on this work. This may result in the workload reducing and possibly a decrease in the external audit fee.

During the interim audit, Apple & Co would need to perform a risk assessment to assist in the planning process. It is possible that the IA department may have conducted a risk assessment and so Apple could use this as part of their initial planning process.

Apple & Co would need to consider the risk of fraud and error and non-compliance with law and regulations resulting in misstatements in the financial statements. This is also an area for IA to consider, hence there is scope for Apple & Co to review the work and testing performed by IA to assist in this risk assessment.

Final audit

It is possible that the IA department may assist with year-end inventory counting and controls and so Apple & Co can place some reliance on the work performed by them, however, they would still need to attend the count and perform their own reduced testing.

2 (a) Benefits of audit planning

Audit planning is addressed by ISA 300 *Planning an Audit of Financial Statements*. It states that adequate planning benefits the audit of financial statements in several ways:

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor to identify and resolve potential problems on a timely basis.
- Helping the auditor to properly organise and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by experts.

(b) Sampling methods

Methods of sampling in accordance with ISA 530 *Audit Sampling*:

Random selection – Ensures each item in a population has an equal chance of selection, for example, by using random number generators or tables.

Systematic selection – This involves having a constant sampling interval, such as every 40th item being selected, the starting point for testing is determined randomly.

Monetary Unit Sampling – This is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

Haphazard selection – Here the auditor selects the sample without following a structured technique. The auditor must ensure that no conscious bias or predictability arises and this method is not appropriate when using statistical sampling.

Block selection – This involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

(c) Audit report modifications

As per ISA 705 *Modifications to the Opinion in the Independent Auditor's Report* identifies three types of modifications which result in the opinion being modified:

Qualified opinion – Arises where the auditor concludes, having obtained sufficient evidence, that material BUT NOT pervasive misstatements are present in the financial statements.

A qualified opinion also arises where the auditor is unable to obtain sufficient evidence on which to base an opinion and the possible effect on the financial statements is material BUT NOT pervasive.

Adverse opinion – Where the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are BOTH material and pervasive to the financial statements.

Disclaimer of opinion – When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements could be BOTH material and pervasive.

3 (a) Responsibilities of auditor in relation to fraud and error

An auditor conducting an audit in accordance with ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

In order to fulfil this responsibility auditors are required to identify and assess the risks of material misstatement of the financial statements due to fraud.

The auditor will need to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses.

In addition, the auditor must respond appropriately to fraud or suspected fraud identified during the audit.

When obtaining reasonable assurance, the auditor is responsible for maintaining professional scepticism throughout the audit, considering the potential for management override of controls and recognising the fact that audit procedures that are effective in detecting error may not be effective in detecting fraud.

To ensure that the whole engagement team is aware of the risks and responsibilities for fraud and error, ISAs require that a discussion is held within the team. For members not present at the meeting the engagement partner should determine which matters are to be communicated to them.

(b) Ethical threats and managing these risks

Ethical Threat	Managing Risk
Orange Financials Co (Orange) has asked the engagement partner of Currant & Co to attend meetings with potential investors. This represents an advocacy threat as the audit firm may be perceived as promoting investment in Orange and this threatens objectivity.	The engagement partner should politely decline this request from Orange, as it represents too great a threat to independence.
Due to the stock exchange listing, Orange has requested that Currant & Co produce the financial statements. This represents a self-review threat. As Orange is currently not a listed company then Currant & Co are permitted to produce the financial statements and also audit them. However, Orange is seeking a listing and therefore these financial statements will be critical to the potential investors and this increases audit risk.	Ideally, Currant & Co should not undertake the preparation of the financial statements. Due to the imminent listing, this would probably represent too high a risk. If Currant & Co choose to produce the financial statements then separate teams should undertake each assignment and the audit team should not be part of the accounts preparation process.
The assistant finance director of Orange has joined Currant & Co as a partner and has been proposed as the review partner. This represents a self-review threat, as he was in a position to influence the financial statements whilst working at Orange; if he is the review partner there could be a risk of him reviewing his own work.	This partner must not be involved in the audit of Orange for a period of at least two years. An alternative review partner should be appointed.

Ethical Threat	Managing Risk
Orange has several potential assurance assignments available and Currant & Co wish to be appointed to these. There is a potential self-interest threat as these assurance fees along with the external audit fee could represent a significant proportion of Currant & Co's fee income.	The firm should assess whether these assignments along with the audit fee would represent more than 15% of gross practice income for two consecutive years. These assurance assignments will only arise if the company obtains its listing and hence will be a public interest company. If the recurring fees are likely to exceed 15% of annual practice income then additional consideration should be given as to whether these assignments should be sought by the firm.
Orange has implied to Currant & Co that they must complete the audit quickly and with minimal questions/issues if they wish to obtain the assurance assignments. This creates an intimidation threat on the team as they may feel pressure to cut corners and not raise issues, and this could compromise the objectivity of the audit team.	The engagement partner should politely inform the finance director that the team will undertake the audit in accordance with all relevant ISAs and their own quality control procedures. This means that the audit will take as long as is necessary to obtain sufficient, appropriate evidence to form an opinion. If any residual concerns remain or the intimidation threat continues then Currant & Co may need to considering resigning from the engagement.
The finance director has offered the team a free weekend away at a luxury hotel. This represents a self-interest threat as the acceptance of goods and services, unless insignificant in value, is not permitted.	As it is unlikely that a weekend at a luxury hotel for the whole team has an insignificant value, then this offer should be politely declined.
The finance director has offered a senior team member a loan at discounted interest rates. Orange does provide loans and hence the provision of a loan is within the normal course of business. However, if the loan is on preferential rates, as this is, then it would represent a self-interest threat.	This loan must not be accepted by the audit senior due to the preferential terms. However, if the terms of the loan are amended so that the interest rate charged is in line with Orange's normal levels, then the provision of the loan is acceptable.

(c) Benefits of audit committee for Orange Financials Co

Appointing an audit committee will benefit Orange in the following ways:

– It will help to improve the quality of the financial reporting of Orange; whilst the company already has a finance director, the audit committee will assist by reviewing the financial statements.
– The establishment of an audit committee can help to improve the internal control environment of the company. The audit committee is able to devote more time and attention to areas such as internal controls.
– Orange does not currently have any non-executive directors, hence once appointed, they will bring considerable outside experience to the executive directors as well as challenging their decisions and contributing to an independent judgement.
– The finance director will benefit in that he will be able to raise concerns and discuss accounting issues with the audit committee.
– The audit committee will be responsible for appointing the external auditors and this will strengthen the auditors' independence and contribute to a channel of communication and forum of issues.
– If Orange has an internal audit (IA) department, then establishing an audit committee will also improve the independence of IA.
– The audit committee can also provide advice on risk management to the executive directors. They can create a climate of discipline and control and reduce the opportunity for fraud, and increase the public confidence in the credibility and objectivity of the financial statements.

4 (a) Financial statement assertions and inventory substantive procedures for balances at the year end.

(i) **Existence**
Assets, liabilities and equity interests exist.

Substantive procedures
During the inventory count select a sample of assets recorded in the inventory records and agree to the warehouse to confirm the assets exist.

Obtain a sample of pre year-end goods despatch notes and agree that these finished goods are excluded from the inventory records.

(ii) **Rights and obligations**
The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

Substantive procedures
Confirm during the inventory count that any goods belonging to third parties are excluded from the inventory records and count.

For year-end raw materials and finished goods confirm title belongs to the company by agreeing goods to a recent purchase invoice in the company name.

(iii) Completeness
All assets, liabilities and equity interests that should have been recorded have been recorded.

Substantive procedures
Obtain a copy of the inventory listing and agree the total to the general ledger and the financial statements.

During the inventory count select a sample of goods physically present in the warehouse and confirm recorded in the inventory records.

(iv) Valuation and allocation
Assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Substantive procedures
Select a sample of goods in inventory at the year end, agree the cost per the records to a recent purchase invoice and ensure that the cost is correctly stated.

Select a sample of year-end goods and review post year-end sales invoices to ascertain if net realisable value is above cost or if an adjustment is required.

(b) Substantive procedures

Depreciation

– Review the reasonableness of the depreciation rates applied to the new leisure facilities and compare to industry averages.
– Review the capital expenditure budgets for the next few years to assess whether there are any plans to replace any of the new leisure equipment, as this would indicate that the useful life is less than 10 years.
– Review profits and losses on disposal of assets disposed of in the year, to assess the reasonableness of the depreciation policies.
– Select a sample of leisure equipment and recalculate the depreciation charge to ensure that the non-current asset register is correct.
– Perform a proof in total calculation for the depreciation charged on the equipment, discuss with management if significant fluctuations arise.
– Review the disclosure of the depreciation charges and policies in the draft financial statements.

Food poisoning

– Review the correspondence from the customers claiming food poisoning to assess whether Pineapple has a present obligation as a result of a past event.
– Send an enquiry letter to the lawyers of Pineapple to obtain their view as to the probability of the claim being successful.
– Review board minutes to understand whether the directors believe that the claim will be successful or not.
– Review the post year-end period to assess whether any payments have been made to any of the claimants.
– Discuss with management as to whether they propose to include a contingent liability disclosure or not, consider the reasonableness of this.
– Obtain a written management representation confirming management's view that the lawsuit is unlikely to be successful and hence no provision is required.
– Review the adequacy of any disclosures made in the financial statements.

(c) Working papers

– Name of client – identifies the client being audited.
– Year-end date – identifies the year end to which the audit working papers relate.
– Subject – identifies the area of the financial statements that is being audited, the topic area of the working paper, such as receivables circularisation.
– Working paper reference – provides a clear reference to identify the number of the working paper, for example, R12 being the 12th working paper in the audit of receivables.
– Preparer – identifies the name of the audit team member who prepared the working paper, so any queries can be directed to the relevant person.
– Date prepared – the date that the audit work was performed by the team member; this helps to identify what was known at the time and what issues may have occurred subsequently.
– Reviewer – the name of the audit team member who reviewed the working paper; this provides evidence that the audit work was reviewed by an appropriate member of the team.
– Date of review – the date the audit work was reviewed by the senior member of the team; this should be prior to the date that the audit report was signed.

– Objective of work/test – the aim of the work being performed, could be the related financial statement assertion; this provides the context for why the audit procedure is being performed.
– Details of work performed – the audit tests performed along with sufficient detail of items selected for testing.
– Results of work performed – whether any exceptions arose in the audit work and if any further work is required.
– Conclusion – the overall conclusion on the audit work performed, whether the area is true and fair.

5 (a) Analytical procedures

Analytical procedures can be used at all stages of an audit; however, ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and ISA 520 *Analytical Procedures* identify three particular stages.

During the planning stage analytical procedures must be used as risk assessment procedures in order to help the auditor to obtain an understanding of the entity and assess the risk of material misstatement.

During the final audit analytical procedures can be used to obtain sufficient appropriate evidence. Substantive procedures can either be tests of detail or substantive analytical procedures.

At the final review stage the auditor must design and perform analytical procedures that assist him when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

(b) Going concern indicators

(i) A major customer of Strawberry Kitchen Designs Co (Strawberry) has ceased trading owing them $0·6m. This will result in a significant loss of future revenues and profit, and unless this customer can be replaced then there will be a reduction of future cash flows.

(ii) The sales director has recently left the company and has yet to be replaced. Loss of a key director will impact on the company's sales, as Strawberry has already lost a major customer, then without an experienced sales director to generate new sales the company will face significantly reduced sales and cash flows.

(iii) Strawberry is experiencing negative monthly cash flows and this is expected to continue. If the company continues to have cash outflows then it will increase its overdraft further and will start to run out of available cash.

(iv) The company has been late paying some of its suppliers. If suppliers are being paid late then they may refuse to supply Strawberry with goods or impose 'cash on delivery' terms which will disrupt service or sales to customers.

(v) A number of the suppliers are threatening legal action. If this occurs then Strawberry will have legal costs on top of the amounts owed already and this will further increase the pressure on cash flows. In addition, other suppliers may hear about the legal action and, as a result, stop supplying goods to Strawberry.

(vi) Strawberry has missed a loan repayment which is a breach in the loan covenant and hence the loan of $4·8m is now all repayable. The company only has six months to raise $4·8m; as it currently stands they do not have this level of cash available and unless they are able to raise alternative finance or sell non-current assets, it is difficult to see how they will be able to raise this amount.

(vii) In order to conserve cash Strawberry has decided not to pay a final dividend for 2012. This may result in shareholders losing faith in the company and they may attempt to sell their shares; in addition, they are highly unlikely to invest further equity, and Strawberry urgently needs to raise finance to repay their loans.

(viii) The current ratio has significantly declined from 4·55 (1·6 + 2·2 + 1·2/0·9 + 0·2) in 2011 to 0·64 (3·4 + 1·4/1·9 + 0·8 + 4·8) in 2012. The current ratio is showing that the current assets are not sufficient to pay the current liabilities. This is another indication of the worsening liquidity position of the company, which has mainly occurred due to the loan becoming repayable.

(c) Going concern procedures

– Obtain the company's cash flow forecast and review the cash in and out flows. Assess the assumptions for reasonableness and discuss the findings with management to understand if the company will have sufficient cash flows.
– Perform a sensitivity analysis on the cash flows to understand the margin of safety the company has in terms of its net cash in/out flow.
– Discuss with the finance director whether the sales director has yet been replaced and whether any new customers have been obtained to replace the one lost.
– Review the company's post year-end sales and order book to assess if the levels of trade are likely to increase and if the revenue figures in the cash flow forecast are reasonable.
– Review the loan agreement and recalculate the covenant which has been breached. Confirm the timing and amount of the loan repayment.
– Review any agreements with the bank to determine whether any other covenants have been breached, especially in relation to the overdraft.
– Discuss with the directors whether they have contacted any alternative banks for finance to assess whether they have any other means of repaying the loan of $4·8m.

- Review any correspondence with shareholders to assess whether any of these are likely to increase their equity investment in the company.
- Review post year-end correspondence with suppliers to identify if any others have threatened legal action or refused to supply goods.
- Enquire of the lawyers of Strawberry as to the existence of any additional litigation and request their assessment of the likely amounts payable to the suppliers.
- Perform audit tests in relation to subsequent events to identify any items that might indicate or mitigate the risk of going concern not being appropriate.
- Review the post year-end board minutes to identify any other issues that might indicate further financial difficulties for the company.
- Review post year-end management accounts to assess if in line with cash flow forecast.
- Consider whether the going concern basis is appropriate for the preparation of the financial statements.
- Obtain a written representation confirming the director's view that Strawberry is a going concern.

(d) (i) Reporting in relation to going concern to the directors of Strawberry Kitchen Designs Co

Kiwi & Co has a responsibility to report to the directors in relation to any events or conditions which may cast doubt on Strawberry's ability to continue as a going concern. These include:

- Whether the events or conditions constitute a material uncertainty;
- Whether the use of the going concern assumption is appropriate in the preparation of the financial statements; and
- The adequacy of related disclosures in the financial statements.

(ii) Audit report

The directors do not wish to make any amendments to the financial statements. However, if we believe that Strawberry is not a going concern then the audit report will need to be modified. An adverse opinion will be required regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern assumption as the financial statements are materially misstated, and the misstatements are material and pervasive to the financial statements.

The basis for adverse opinion paragraph will require an explanation that the use of the going concern basis is inappropriate. The opinion paragraph will state that the financial statements do not present fairly or are not true and fair.

			Marks
1	(a)	Up to 1 mark per deficiency, up to 1 mark per well explained control and up to 1 mark for each well explained test of control, max of 5 for deficiencies, max of 5 for controls and max of 5 for tests of control.	
		Website not integrated into inventory system Customer signatures Unfulfilled sales orders Customer credit limits Sales discounts Supplier statement reconciliations Purchase ledger master file Surplus plant and equipment Authorisation of capital expenditure	15
	(b)	Up to 1 mark per substantive procedure, max of 2 for additions and max of 2 for disposals.	
		Additions Cast list of additions and agree to non-current asset register Vouch cost to recent supplier invoice Agree addition to a supplier invoice in the name of Pear to confirm rights and obligations Review additions and confirm capital expenditure items rather than repairs and maintenance Review board minutes to ensure authorised by the board Physically verify them on the factory floor to confirm existence	
		Disposals Cast list of disposals and agree removed from non-current asset register Vouch sale proceeds to supporting documentation such as sundry sales invoices Recalculate the profit/loss on disposal	4
	(c)	Up to 1½ marks per well explained point	
		External audit – Reasonable assurance Other review engagements – Negative assurance	3
	(d)	Up to 1 mark per well explained point	
		Objective Whom they report to Reports – publicly available or not Scope of work Appointed by Independence of company	4
	(e)	Up to 1 mark per well explained point	
		Interim audit Systems documentation Testing of systems such as payroll, sales, purchases Risk assessment Fraud and error, non-compliance with law and regulations	
		Final audit Inventory count procedures	4
			30

			Marks
2	**(a)**	Up to 1 mark per well explained point Important areas of the audit Potential problems Effective and efficient audit Selection of engagement team members and assignment of work Direction, supervision and review Coordination of work	4
	(b)	Up to 1 mark per well explained point, if the method is identified but not explained then maximum of ½ mark. Random selection Systematic selection Monetary unit sampling Haphazard selection Block selection	3
	(c)	Up to 1 mark per well explained point Qualified opinion – misstatements which are material but not pervasive Qualified opinion – cannot obtain sufficient evidence, possible misstatements which are material but not pervasive Adverse opinion Disclaimer of opinion	3
			10
3	**(a)**	Up to 1 mark per well explained point Per ISA 240 – obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error Identify and assess the risks of material misstatement due to fraud Obtain sufficient appropriate audit evidence Respond appropriately to fraud or suspected fraud identified during the audit Maintain professional scepticism throughout the audit Discussion within the engagement team	4
	(b)	Up to 1 mark per ethical threat and up to 1 mark per managing method, max of 6 for threats and max 6 for methods Engagement partner attending listing meeting Preparation of financial statements Assistant finance director as review partner on audit Total fee income Pressure to complete audit quickly and with minimal issues Weekend away at luxury hotel Provision of loan at preferential rates	12
	(c)	Up to 1 mark per well explained point Improve the quality of the financial reporting Improve the internal control environment of the company Non-executives will bring outside experience to the executive directors The finance director will be able to raise concerns with the audit committee The audit committee will be responsible for appointing the external auditors Establishing an audit committee will improve the independence of IA Provide advice on risk management to the executive directors	4
			20

			Marks
4	**(a)**	Up to 1 mark per assertion, ½ mark for stating assertion and ½ mark for explanation, max of 4 marks; up to 1 mark per relevant inventory substantive procedure, max of 4 marks. Existence – explanation and relevant substantive procedure Rights and obligations – explanation and relevant substantive procedure Completeness – explanation and relevant substantive procedure Valuation and allocation – explanation and relevant substantive procedure	8
	(b)	Up to 1 mark per relevant substantive procedure, max of 4 marks for each issue. **Depreciation** Review the reasonableness of the depreciation rates and compare to industry averages Review the capital expenditure budgets Review profits and losses on disposal for assets disposed of in year Recalculate the depreciation charge for a sample of assets Perform a proof in total calculation for the depreciation charged on the equipment Review the disclosure of depreciation in the draft financial statements **Food poisoning** Review the correspondence from the customers Send an enquiry to the lawyers as to the probability of the claim being successful Review board minutes Review the post year-end period to assess whether any payments have been made Discuss with management as to whether they propose to include a contingent liability disclosure Obtain a written management representation Review any disclosures made in the financial statements	8
	(c)	Up to 1 mark per well explained point, ½ mark only if just identifies item to be included, max of 4 points. Name of client Year-end date Subject Working paper reference Preparer Date prepared Reviewer Date of review Objective of work/test Details of work performed Results of work performed Conclusion	4
			20

			Marks
5	**(a)**	Up to 1 mark per well explained point	
		Planning stage – risk assessment procedures During the final audit – substantive procedures Review stage – form overall conclusion	3
	(b)	Up to 1 mark per explanation of why this could indicate going concern problems, if just identify indicator then max of ½ mark.	
		Loss of major customer Loss of sales director Negative monthly cash flows Slow payment to suppliers Potential legal action Breach of covenants and loan now repayable No final dividend Low current ratio	6
	(c)	Up to 1 mark per well explained point	
		Review cash flow forecasts Sensitivity analysis Discuss if sales director replaced and new customers obtained Review post year-end sales and order book Review the loan agreement and recalculate the covenant breached to confirm timing and amount of the loan repayment Review bank agreements, breach of covenants Review bank correspondence Discuss if alternative finance obtained Review shareholders' correspondence Review suppliers' correspondence Enquire of lawyers any further litigation by suppliers Subsequent events Board minutes Management accounts Consider going concern basis appropriate Written representation	6
	(d)	**(i)** Up to 1 mark per well explained point	
		Events or conditions constitute a material uncertainty Use of the going concern assumption is appropriate Adequacy of disclosures in the financial statements	2
		(ii) Up to 1 mark per well explained point	
		Not going concern therefore modified opinion Adverse opinion Basis for adverse opinion paragraph, going concern basis not appropriate Opinion paragraph, financial statements not true and fair	3
			20