
Answers

1 (a) Identification of risk

Smoothbrush supplies 60% of its goods to Homewares at a significantly reduced selling price, hence inventory may be overvalued.

Recoverability of receivable balances as credit period extended.

Valuation of plant and equipment.

Cut-off of purchases and inventory may not be accurate.

New inventory system introduced in the year. This could result in inventory balances being misstated.

Inventory may be overstated as Smoothbrush no longer has a slow moving provision.

Provisions/contingent liability disclosures may not be complete.

Explanation of risk

Per IAS 2 *Inventories*, inventory should be stated at the lower of cost and net realisable value (NRV). Therefore, as selling prices are much lower for goods sold to Homewares, there is a risk that the NRV of some inventory items may be lower than cost and hence that inventory could be overvalued.

Smoothbrush has extended its credit terms to Homewares from one month to four months. Hence there is an increased risk as balances outstanding become older, that they may become irrecoverable.

The production facility has a large amount of unused plant and equipment. As per IAS 16 *Property, Plant and Equipment* and IAS 36 *Impairment of Assets*, this plant and equipment should be stated at the lower of its carrying value and recoverable amount, which may be at scrap value depending on its age and condition.

Smoothbrush imports goods from South Asia and the paint can be in transit for up to two months. The company accounts for goods when they receive them. Therefore at the year end only goods that have been received into the warehouse should be included in the inventory balance and a respective payables balance recognised.

Smoothbrush has introduced a continuous/perpetual inventory counting system in the year. These records will be used for recording inventory at the year end. If the records and new system have not initially been set up correctly then there is a risk that the year end balances may not be fairly stated.

Previously Smoothbrush maintained an inventory provision of 1%, however, this year it has decided to remove this. Unless all slow moving/obsolete items are identified at the year end and their value adjusted, there is a risk that the overall value of inventory may be overstated.

The company's finance director (FD) has left and is intending to sue Smoothbrush for unfair dismissal. However, the company does not intend to make any provision/disclosures for sums due to the FD.

Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, if there is a present obligation, a probable outflow of resources to settle the obligation and a reliable estimate can be made of the obligation then a provision should be recognised.

If the obligation is only possible, or if there is a present obligation but it is not recognised as there is not a probable outflow of resources, or the amount of the obligation cannot be measured with sufficient reliability then a contingent liability should be disclosed, unless the likelihood of payment is remote.

Identification of risk

Inherent risk is higher due to the changes in the finance department.

Inventory may be over or understated if the perpetual inventory counts are not complete and accurate.

Explanation of risk

The financial controller has been appointed as temporary FD and this lack of experience could result in an increased risk of errors arising in the financial statements. In addition the previous FD is not available to help the finance or audit team.

The inventory counts are to cover all of the inventory lines. If any areas of the warehouse are not counted then this will need to be done at the year end.

In addition inventory adjustments arising from the counts must be verified and updated by an appropriate member of the finance team to ensure that the records are accurate.

- (b) ISA 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, requires auditors 'to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels'.

It is vitally important for auditors to assess engagement risks at the planning stage, this will ensure that attention is focused early on the areas most likely to cause material misstatements.

A thorough risk assessment will also help the auditor to fully understand the entity, which is vital for an effective audit.

Any unusual transactions or balances would also be identified early, so that these could be addressed in a timely manner.

In addition, as most auditors adopt a risks based audit approach then these risks need to be assessed early in order for the audit strategy and detailed work programmes to be developed.

Assessing risks early should also result in an efficient audit. The team will only focus their time and effort on key areas as opposed to balances or transactions that might be immaterial or unlikely to contain errors.

In addition assessing risk early should ensure that the most appropriate team is selected with more experienced staff allocated to higher risk audits and high risk balances.

A thorough risk analysis should ultimately reduce the risk of an inappropriate audit opinion being given. The audit would have focused on the main risk areas and hence all material misstatements should have been identified, resulting in the correct opinion being given.

It should enable the auditor to have a good understanding of the risks of fraud, money laundering, etc.

Assessing risk should enable the auditor to assess whether the client is a going concern.

- (c) Controls over the perpetual/continuous inventory system.

Control

The inventory count team should be independent of the warehouse team.

Timetable of counts should be regularly reviewed to ensure that all areas are counted.

Movements of inventory should be stopped from the designated areas during continuous/perpetual inventory counts.

Inventory counting sheets should be pre-printed with a description or item code of the goods, but the quantities per the records should not be pre-recorded.

Explanation

Currently the team includes a warehouse staff member and an internal auditor. There should be segregation of roles between those who have day-to-day responsibility for inventory and those who are checking it. If the same team are responsible for maintaining and checking inventory, then errors and fraud could be hidden.

The warehouse has been divided into 12 areas that are each due to be counted once over the year. All inventory is required to be counted once a year, hence if the timetable is not monitored then some areas could be missed out.

Goods will continue to move in and out of the warehouse during the counts. Inventory records could be under/over stated if product lines are missed or double counted due to movements in the warehouse.

The inventory sheets produced for the count have the quantities pre-printed, therefore a risk arises that the counting team could just agree with the record quantities, making under counting more likely, rather than counting the inventory lines correctly.

Control

A second independent team should check the counts performed by the inventory count team.

Inventory checks should be performed from inventory physically present in the warehouse to the records.

Any damaged or obsolete goods should be moved to a designated area, where a responsible official then inspects it, it should not be removed from the sheets.

After the count, the inventory count sheets should be compared to the inventory records, any adjustments should be investigated and if appropriate the records updated in a prompt manner by an authorised person.

Explanation

By counting the lines twice this should help to ensure completeness and accuracy of the counts, and hence that any inventory adjustments are appropriate.

Currently the team is comparing the records to the inventory in the warehouse. If the count is performed from the records to the warehouse then this will only ensure existence or overstatement of the records. To ensure completeness is addressed the inventory in the warehouse must be compared to the records as this will identify any goods physically present but not included in the records.

Damaged or obsolete goods should be written down or provided against to ensure that they are stated at the lower of cost and NRV. This may not involve fully writing off the inventory item as is currently occurring. This is an assessment that should only be performed by a suitably trained member of the finance team, as opposed to the inventory count team.

At the year end the inventory of Smoothbrush will be based on the records maintained. Hence the records must be complete, accurate and valid. It is important that only individuals authorised to do so can amend records.

Senior members of the finance team should regularly review the types and levels of adjustments, as recurring inventory adjustments could indicate possible fraud.

(d) Substantive procedures to confirm valuation of inventory

- Select a representative 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 NRV is above cost or if an adjustment is required.
- For a sample of manufactured items obtain cost sheets and confirm:
 - raw material costs to recent purchase invoices
 - labour costs to time sheets or wage records
 - overheads allocated are of a production nature.
- Review aged inventory reports and identify any slow moving goods, discuss with management why these items have not been written down.
- Compare the level/value of aged product lines to the total inventory value to assess whether the provision for slow moving goods of 1% should be reinstated.
- Review the inventory records to identify the level of adjustments made throughout the year for damaged/obsolete items. If significant consider whether the year end records require further adjustments and discuss with management whether any further write downs/provision may be required.
- Follow up any damaged/obsolete items noted by the auditor at the inventory counts attended, to ensure that the inventory records have been updated correctly.
- Perform a review of the average inventory days for the current year and compare to prior year inventory days. Discuss any significant variations with management.
- Compare the gross margin for current year with prior year. Fluctuations in gross margin could be due to inventory valuation issues. Discuss significant variations in the margin with management.

Substantive procedures to confirm completeness of provisions or contingent liability

- Discuss with management the nature of the dispute between Smoothbrush and the former finance director (FD), to ensure that a full understanding of the issue is obtained and to assess whether an obligation exists.
- Review any correspondence with the former FD to assess if a reliable estimate of any potential payments can be made.
- Write to the company's lawyers to obtain their views as to the probability of the FD's claim being successful.
- Review board minutes and any company correspondence to assess whether there is any evidence to support the former FD's claims of unfair dismissal.
- Obtain a written representation from the directors of Smoothbrush confirming their view that the former FD's chances of a successful claim are remote, and hence no provision or contingent liability is required.

Credit will be awarded for any substantive procedures which test for additional provisions or contingent liabilities of Smoothbrush.

- 2 (a)** 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.

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)** Materiality is defined 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. Firstly 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.

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.

The assessment of what is material is ultimately a matter of the auditors’ professional judgement, and it is affected by the auditor’s perception of the financial information needs of users of the financial statements.

In calculating materiality the auditor should also consider setting the performance materiality level. This is the amount set by the auditor, it is below materiality, and is used for particular transactions, account balances and disclosures.

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

- 3 (a) (i)** Tests of control test the operating effectiveness of controls in preventing, detecting or correcting material misstatements.

Substantive procedures are aimed at detecting material misstatements at the assertion level. They include tests of detail of transactions, balances, disclosures and substantive analytical procedures.

- (ii) Example tests of control over sales invoicing**

- Inspect numerical sequence of sales invoices, if any breaks in the sequence noted, enquire of management as to missing invoices.
- Review a sample of sales invoices for evidence of authorisation by a responsible official of any discounts allowed.
- Inspect customer statements for evidence of regular preparation.

Example substantive procedures over sales invoicing

- Select a sample of pre and post year end goods despatch notes and follow through to pre or post year end sales invoices, to ensure the sales cut-off has been correctly applied.
- Perform an analytical review of monthly sales, compare any trends to prior years and discuss significant fluctuations with management.
- Review post year end credit notes to identify if any pre year end sales should be removed.

- (b) Deficiency**

A junior clerk opens the post unsupervised. This could result in cash being misappropriated.

Cash and cheques are secured in a small locked box and only banked every few days. A small locked box is not adequate for security of considerable cash receipts, as it can easily be stolen.

Control

A second member of the accounts team or staff independent of the accounts team should assist with the mail, one should open the post and the second should record cash received in the cash log.

Cash and cheques should be ideally banked daily, if not then it should be stored in a fire proof safe, and access to this safe should be restricted to supervised individuals.

Test of Control

Observe the mail opening process, to assess if the control is operating effectively.

Enquire of management where the cash receipts not banked are stored. Inspect the location to ensure cash is suitably secure.

Deficiency

Cash and cheques are only banked every few days and any member of the finance team performs this.

Cash should ideally not be held over-night as it is not secure. Also if any member of the team banks cash, then this could result in very junior clerks having access to significant amounts of money.

The cashier updates both the cash book and the sales ledger. This is weak segregation of duties, as the cashier could incorrectly enter a receipt and this would impact both the cash book and the sales ledger. In addition weak segregation of duties could increase the risk of a 'teeming and lading' fraud.

Bank reconciliations are not performed every month and they do not appear to be reviewed by a senior member of the finance department. Errors in the cash cycle may not be promptly identified if reconciliations are performed infrequently.

Control

Cash and cheques should be banked every day.

The cashier should prepare the paying-in-book from the cash received log. Then a separate responsible individual should have responsibility for banking this cash.

The cashier should update the cash book from the cash received log. A member of the sales ledger team should update the sales ledger.

Bank reconciliations should be performed monthly. A responsible individual should then review them.

Test of Control

Inspect the paying-in-books to see if cash and cheques have been banked daily or less frequently.

Review bank statements against the cash received log to confirm all amounts were banked promptly.

Enquire of staff as to who performs the banking process and confirm this person is suitably responsible.

Observe the process for recording cash received into the relevant ledgers and note if the segregation of duties is occurring.

Review the file of reconciliations for evidence of regular performance and review by senior finance team members.

(c) Substantive procedures over bank balance:

- Obtain the company's bank reconciliation and check the additions to ensure arithmetical accuracy.
- Obtain a bank confirmation letter from the company's bankers.
- Verify the balance per the bank statement to an original year end bank statement and also to the bank confirmation letter.
- Verify 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.
- Examine any old unrepresented cheques to assess if they need to be written back into the purchase ledger as they are no longer valid to be presented.
- Trace all unrepresented 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.
- Agree all balances listed on the bank confirmation letter to the company'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 the company or any legal right of set-off as this may require disclosure.

4 (a) Compliance with ACCA's *Code of Ethics and Conduct* fundamental principles can be threatened by a number of areas. The five categories of threats, which may impact on ethical risk, are:

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation.

Examples for each category (Only one example required per threat):

Self-interest

- Undue dependence on fee income from one client
- Close personal or business relationships
- Financial interest in a client

- Incentive fee arrangements
- Concern over employment security
- Commercial pressure from outside the employing organisation
- Inappropriate personal use of corporate assets.

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
- Same person reviewing decisions or data that prepared them
- An analyst, or member of a board, audit committee or audit firm being in a position to exert a direct or significant influence over the financial reports
- The discovery of a significant error during a re-evaluation of the work undertaken by the member
- Performing a service for a client that directly affects the subject matter of an assurance engagement.

Advocacy

- Acting as an advocate on behalf of a client in litigation or disputes
- Promoting shares in a listed audit client
- Commenting publicly on future events in particular circumstances
- Where information is incomplete or advocating an argument which is unlawful.

Familiarity

- Long association with a client
- Acceptance of gifts or preferential treatment (significant value)
- Over familiarity with management
- 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.

Intimidation

- Threat of litigation
- Threat of removal as assurance firm
- Dominant personality of client director attempting to influence decisions
- Pressure to reduce inappropriately the extent of work performed in order to reduce fees.

(b) Ethical threat

The audit team has in previous years been offered a staff discount of 10% on purchasing luxury mobile phones.

This is a familiarity threat. It would need to be confirmed if this discount is to be offered to this year's team as well, as only goods of an insignificant value are allowed to be accepted. A discount of 10% may not appear to be significant, but as these are luxury mobile phones then this may still be a significant value.

An audit senior of Jones & Co has been on secondment as the financial controller of LV Fones and is currently part of the audit team.

There is a self-review threat if the senior has prepared records or schedules that support the year end financial statements and he then audits these same documents.

The total fee income from LV Fones is 16% of the total fees for the audit firm. If the fees for audit and recurring work exceed 15% then there is a self-interest threat.

The fees for LV Fones include tax and audit that are assumed to be recurring, however the secondment fees would not recur each year.

Managing risk

The audit firm should ascertain whether the discount is to be offered to staff this year.

If it is then the discount should be reviewed for significance. If it is deemed to be of significant value then the offer of discount should be declined.

The firm should clarify exactly what areas the senior assisted the client on. If he worked on areas not related to the financial statements then he may be able to remain in the audit team.

However, it is likely that he has worked on some related schedules and therefore he should be removed from the audit team to ensure that independence is not threatened.

The firm should assess if the recurring fees will exceed 15%. If this is the case then it might need to consider whether the appearance of independence will still be met if the tax and audit work is retained.

No further work should be accepted in the current year from the client, and it might be advisable to perform external quality control reviews. It may also become necessary to consider resigning from either the tax or the audit engagement.

Ethical threat

The partner and the finance director know each other socially and have holidayed together. Personal relationships between the client and members of the audit team can create a familiarity or self-interest threat.

ACCA's *Code of Ethics and Conduct* does not specifically prohibit friendships between the audit client and the team. However, due to the senior positions held by both parties then there is a risk that independence may be perceived to have been threatened.

Last year's audit fee is still outstanding. This amounts to 20% of the total fee and is likely to be a significant value.

A self-interest threat can arise if the fees remain outstanding, as Jones & Co may feel pressure to agree to certain accounting adjustments in order to have the previous year and the current year fee paid.

In addition outstanding fees could be perceived as a loan to a client, this is strictly prohibited.

Managing risk

The personal relationship should be reviewed in line with Jones's ethical policies.

Consideration should be given to rotating the partner off this engagement and replacing with an alternative partner.

Jones & Co should chase the outstanding fees.

If they remain outstanding, the firm should discuss with those charged with governance the reasons for the continued non-payment, and ideally agree a payment schedule which will result in the fees being settled before much more work is performed for the current year audit.

(c) Prior to accepting

Prior to accepting an audit engagement the firm should consider any issues which might arise which could threaten compliance with *ACCA's Code of Ethics and Conduct* or any local legislation. If issues arise then their significance must be considered.

The firm should consider whether they are competent to perform the work and whether they would have appropriate resources available, as well as any specialist skills or knowledge.

The prospective firm must communicate with the outgoing auditor to assess if there are any ethical or professional reasons why they should not accept appointment.

The prospective firm must obtain permission from the client to contact the existing auditor, if this is not given then the engagement should be refused.

The existing auditor must obtain permission from the client to respond, if not given then the prospective auditor should refuse the engagement.

If given permission to respond, then the existing auditor should reply to the prospective auditor, who should then carefully review the response for any issues that could affect acceptance.

In addition the audit firm should undertake client screening procedures such as considering management integrity and assessing whether any conflict of interest with existing clients would arise.

Further client screening procedures would include assessing the level of audit risk of the client and whether the expected engagement fee would be sufficient for the level of anticipated risk.

- 5 (a)** The going concern assumption means that management believes the company will continue in business for the foreseeable future. Foreseeable future is not defined in *ISA 570 Going Concern*. However under *IAS 1 Presentation of Financial Statements*, this period is a minimum of 12 months after the year end.

IAS 1 Presentation of Financial Statements requires that management automatically prepare financial statements on a going concern basis unless they believe that the company will soon cease trading.

(b) Indicator

Medimade has seen a significant decline in demand for its products.

Medimade generates 90% of its revenue through sales of just two products, and this market has now become very competitive.

Lack of investment in future product development

Why could impact going concern

If the company is not able to increase demand for its products then it will struggle to generate sufficient operating cash flows leading to going concern difficulties.

As the market is very competitive and Medimade has only two products then it is very dependent on these and must ensure that it makes sufficient sales as otherwise it may face difficulties in meeting all expenses.

As current products reach the end of their life-cycle they will bring in diminishing cash flows. Without new products to generate future income operating cash flows will be strained.

Indicator

The company is struggling to recruit suitably trained scientific staff to develop new products.

Why could impact going concern

The company has decided that it needs to develop new products, however, this is a highly specialised area and therefore it needs sufficiently trained staff. If it cannot recruit enough staff then it could hold up the product development and stop the company from increasing revenue.

Medimade was unable to obtain suitable funding for its \$2m investment in plant and machinery.

If Medimade was unable to obtain finance for its investment, then this could indicate that the banks deem the company to be too risky to lend money to. They may be concerned that Medimade is unable to meet its loan payments, suggesting cash flow problems.

Some trade payables have been paid much later than their due dates.

Failing to make payments to suppliers on time could ultimately lead to some of them refusing to supply Medimade. Therefore the company may need to find alternative suppliers and they could be more expensive which will decrease operating cash flows and profits.

Some suppliers have withdrawn credit terms from Medimade resulting in cash on delivery payments.

As Medimade must now make cash on delivery payments, then it puts additional pressure on the company's overdraft, which has already grown substantially. This is because the company has to pay for goods in advance but it may not receive cash from its receivables for some time later.

The overdraft facility has increased substantially and is due for renewal next month.

Medimade's overdraft has grown significantly and it is heavily dependent on it to pay its expenses. If the bank does not renew the overdraft and the company is unable to obtain alternative finance then it may not be able to continue to trade.

The cash flow forecast has shown a significantly worsening position.

The future cash outflows are greater than the inflows and this position is worsening rather than improving. If Medimade cannot start to reverse this position, then it may have difficulties in funding its operating activities.

- (c) 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.

Review any current agreements with the bank to determine whether any key ratios have been breached.

Review any bank correspondence to assess the likelihood of the bank renewing the overdraft facility.

Discuss with the directors whether they have contacted any alternative banks for finance to assess whether they have any other means of repaying the bank overdraft.

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 post year end correspondence with suppliers to identify if any further restrictions in credit have arisen, and if so ensure that the cash flow forecast reflects an immediate payment for trade payables.

Inquire of the lawyers of Medimade as to the existence of litigation and claims, if any exist then consider their materiality and impact on the going concern basis.

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 financial difficulties for the company.

Review post year end management accounts to assess if in line with cash flow forecast.

Consider whether any additional disclosures as required by IAS 1 *Presentation of Financial Statements* in relation to material uncertainties over going concern should be made in the financial statements.

Obtain a written representation confirming the director's view that Medimade is a going concern.

- (d) The directors of Medimade have agreed to make going concern disclosures, however, the impact on the audit report will be dependent on the adequacy of these disclosures. If the disclosures are adequate, then the audit report will be unmodified. However, an emphasis of matter paragraph would be required.

This will state that the audit report is not modified, identify that there is a material uncertainty and will cross reference to the disclosure note made by management, this paragraph would be included after the opinion paragraph.

If the disclosures made by management are not adequate the audit report will need to be modified. A material misstatement modification will be required, depending on the materiality of the issue this will be either qualified or an adverse opinion.

A paragraph describing the matter giving rise to the modification will be included just before the opinion paragraph and this will clearly identify the going concern uncertainty. The opinion paragraph will be amended to state 'except for' or the accounts are not fairly presented.

	Marks
<p>1 (a) $\frac{1}{2}$ mark for each identification of risk and up to 1 per description of the risk</p> <ul style="list-style-type: none">– Sole supplier to Homewares, NRV of inventory– Recoverability of receivable as credit period extended– Valuation of plant and equipment– Cut-off– New system– Inventory provision– Provision/contingent liability– Inherent risk increased– Perpetual inventory counts	<hr/> <u>10</u>
<p>(b) Up to 1 mark per valid point</p> <ul style="list-style-type: none">– ISA 315 requirement ($\frac{1}{2}$ mark only for ISA ref)– Early identification of material errors– Understand entity– Identification of unusual transactions/balances– Develop strategy– Efficient audit– Most appropriate team– Reduce risk incorrect opinion– Understanding fraud, money laundering– Assess risk going concern	<hr/> <u>4</u>
<p>(c) $\frac{1}{2}$ mark for each identification of a control and up to 1 mark per well explained description of the control</p> <ul style="list-style-type: none">– Team independent of warehouse– Timetable of counts– Inventory movements stopped– No pre-printed quantities on count sheets– Second independent team– Direction of counting floor to records– Damaged/obsolete goods to specific area– Records updated by authorised person	<hr/> <u>10</u>

(d) Up to 1 mark per substantive procedure

Inventory:

- Cost to purchase invoice
- NRV to sales invoice
- Manufactured items to invoices/time sheets/production overheads
- Review aged inventory reports
- Compare aged items to 1% prov
- Total level of adjustment over year
- Follow up items noted at inventory count
- Inventory days
- Gross margin

Max 3

Provisions:

- Discuss with management
- Review correspondence with FD
- Write to lawyers
- Review board minutes
- Obtain written representation

Marks awarded for tests for additional provisions and contingent liabilities of Smoothbrush

Max 3

30

2 (a) Up to 1 mark per description of element:

- Intended user
- Responsible party
- Practitioner
- Suitable criteria
- Subject matter
- Appropriate evidence
- Assurance report

5

(b) Up to 1 mark per valid point:

- ISA 320 (1/2 mark only for ISA ref)
- Definition
- Amount
- Nature, or both
- Small errors aggregated
- Judgement, needs of users
- Performance materiality
- 5% profit before tax or 1% revenue

5

10

<p>3 (a) Up to 1 mark each for definition of test of control and substantive procedures and up to 1 mark each for example test given</p> <ul style="list-style-type: none"> - Definition of test of control (toc) - Definition of substantive test 	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">2</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>
<ul style="list-style-type: none"> - Example toc - Example substantive test 	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">2</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>
<p>(b) Up to 1 mark for each deficiency identified and explained, up to 1 mark for each suitable control and up to 1 mark per test of control.</p> <ul style="list-style-type: none"> - Junior clerk opens post - Small locked box - Cash not banked daily - Cashier updates cash book and sales ledger - Bank reconciliation not performed monthly 	<p>Max 3 for deficiencies Max 3 for controls Max 3 for test of controls</p>
<p>(c) Up to 1 mark per substantive procedure</p> <ul style="list-style-type: none"> - Check additions 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 	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">7</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">20</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>

4 (a) $\frac{1}{2}$ mark for each threat and $\frac{1}{2}$ per example of a threat

- Self-interest
- Self-review
- Advocacy
- Familiarity
- Intimidation

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5

(b) Up to 1 mark per ethical threat and up to 1 mark per managing method

- Staff discount
- Secondment
- Total fee income
- Finance director and partner good friends
- Outstanding fees

Max 5 for threats
Max 5 for methods

(c) Up to 1 mark per step

- Compliance with ACCA's Code of Ethics and Conduct
- Competent
- Write outgoing auditor
- Permission to contact old auditor
- Old auditor permission to respond
- Review response
- Client screening procedures

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- 5 (a)** Up to 1 mark per point
- Continue to trade for foreseeable future
 - Foreseeable future not defined ISA 570, but IAS 1 states minimum 12 months after year end
 - IAS 1 Accounts automatically on going concern basis
- 2
- (b)** $\frac{1}{2}$ mark per indicator and up to 1 mark per description of why this could indicate going concern problems for Medimade:
- Decline in demand
 - Dependent on two products
 - Lack of investment in future product development
 - Unable to recruit staff
 - Inability to obtain funding
 - Failing to pay payables on time
 - Withdrawal of credit terms
 - Overdraft facility due for renewal
 - Cash flow forecast shows worsening position
- 8
- (c)** Up to 1 mark per well explained point – If the procedure does not clearly explain how this will help the auditor to consider going concern then a $\frac{1}{2}$ mark only should be awarded:
- Review cash flow forecasts
 - Sensitivity analysis
 - Review bank agreements, breach of key ratios
 - Review bank correspondence
 - Discuss if alternative finance obtained
 - Review post year end sales and order book
 - Review suppliers correspondence
 - Inquire lawyers any litigation
 - Subsequent events
 - Board minutes
 - Management accounts
 - Consider additional disclosures under IAS 1
 - Written representation
- 6
- (d)** Up to 1 mark per point
- Depends on adequacy of disclosures
 - Adequately disclosed – unmodified
 - Emphasis of matter para – after opinion
 - Not adequately disclosed – modified
 - Material misstatement
 - Add paragraph before opinion and impact on opinion paragraph
- 4

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