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# Answers

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- 1 (a) Audit planning is addressed by ISA 300 (Redrafted) *Planning an Audit of Financial Statements*. The standard notes that an audit plan will be developed after the overall audit strategy has been established and then states that adequate planning benefits the audit of financial statements in several ways, including the following:
- Helping the auditor to devote appropriate attention to important areas of the audit.
  - Helping the auditor identify and resolve potential problems on a timely basis.
  - Helping the auditor 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.

The following are examples of matters that would be included in the audit plan:

- (i) A description of the nature, timing and extent of planned risk assessment procedures sufficient to assess the risks of material misstatement.
- (ii) This would include assessment of inherent risk and control risk at both the entity and assertion level. An important element of the plan would be the understanding and assessment of the control environment of the organisation.
- (iii) A description of the nature, timing and extent of planned further procedures at the assertion level for each material class of transactions, account balance, and disclosure.
- (iv) This would include an explanation of the decision
  - whether to test the operating effectiveness of controls (an important decision is whether reliance is to be placed on controls).
  - on the nature, timing and extent of planned substantive procedures (this would depend on the decision as to the level of control risk).
- (v) Audit procedures required to be carried out for the engagement in order to comply with ISAs, for example, the use of external confirmations to obtain sufficient appropriate evidence at the assertion level.

*(Tutorial note: Marks would also be available for additional points such as:*

- *Materiality*
- *Timetable of detailed audit work*
- *Allocation of work to team members.*)

- (b) Appropriate procedures would include:

- Reconcile the sales statistics to the recorded sales in the accounting records. *(Tutorial note: Other audit procedures should already have proven the validity of the recorded sales.)*
- Compare trends this year to those of prior years to ensure they are reasonable.
- In this connection consider any changes in client circumstances and exercise professional scepticism as these statistics are produced internally.
- Discuss with management the analyses they have made and the actions they have taken as a result of the statistical information available to them. They would probably use them, for example, in deciding whether reprints of books are necessary.
- On a test basis check that the customer codes on the customer master file are properly entered to ensure that the type of customer is properly identified.
- Review reports from sales staff to ensure that information on college take-up of books is accurate.

*(Tutorial note: As a general rule statistics that are kept on a day-to-day basis for the company's own purposes, will be much more reliable than those prepared especially for the auditor. However, the auditor should carry out procedures to ensure that they are accurate enough for audit purposes.)*

(c) Appropriate substantive tests to satisfy the auditor that the royalties charge is accurate and complete include:

<b>Test</b>	<b>Objective</b>
(i) Compare the royalties charge with stated sales income and obtain explanations from management if the figures do not appear reasonable.	To satisfy the auditor that the royalties charge in the income statement is reasonable in relation to stated sales income.
(ii) Compare budgeted royalties figure with actual figures. If variations are significant, obtain explanations from management.	To satisfy the auditor that the actual figures had been anticipated by management, thus providing evidence as to their reliability.
(iii) Review the sales statistics (proven in (b) above) to ascertain those despatches that attract royalties.	This would be evidence that the royalties charge was soundly based.
(iv) Take a sample of recorded sales entries and check: <ul style="list-style-type: none"> <li>– whether royalties are due in respect of the customer.</li> <li>– if they are, that the entry in the computerised royalties file has been calculated at 10% according to the contracts agreed with the published poets.</li> </ul>	These are detailed tests to prove that royalties were due on despatches and that the calculation of the royalty was accurate.
(v) Take a sample of royalty payments and agree to supporting despatch and sales documentation, checking in particular that all despatches are to individuals and organisations attracting royalties.	This is a test to prove that recorded royalty payments have resulted from despatches and sales attracting royalties.
(vi) Select sales for 15 days before the year end and 15 days afterwards and compare with the dates of despatch notes.	This is to check that cut-off is accurate. The royalties charge should only include royalties on sales up to the cut-off date.
(vii) Calculate the expected level of royalty payments based on monthly trend information for type of customer. Obtain sales figures and multiply by 10%. Compare expectation to actual royalties and obtain explanations from management for any significant variations.	This test should provide the auditor with evidence as to the completeness and accuracy of royalties paid.

This list is not exhaustive and other procedures may be appropriate.

(d) There are many inherent risks that may affect the inventory of books and some of these are set out below, together with controls that would mitigate each risk.

<b>Inherent risks</b>	<b>Mitigating controls</b>
Risk of deterioration.	Books should be stored in a location with air conditioning to keep them in saleable state.
Some books may not be saleable because of lack of demand.	Maintenance of movement records to identify slow-moving items.
Books may be defective and therefore not saleable.	Inspection of books returned from customers to identify those that are not in good condition. Identification of defective items at interim or period-end inventory counts.
Books may be attractive and easily transportable, making attempted theft likely.	Books to be kept in a secure location with restriction of entry to authorised personnel.
Poor counting of inventory at the period end.	The use of independent and experienced inventory counters. The use of teams to cover specific areas of the locations where inventory is held. The use of pre-numbered inventory count sheets. And other inventory count procedures.
Poor cut-off as there may be movements of goods during the inventory count.	Movement of books out stopped during the count or only allowed by permission of authorised official in charge of the count. Book returns received during count held in separate area. Identification of last movements in and out.
Goods on sale or return are held by customers but should be included within inventory until the return period is passed.	Detailed records should be maintained of goods on sale or return and this should be reviewed at the year end to ensure that any goods within the return period have been included in inventory.

- (e) (i) Net realisable value is defined in IAS 2 *Inventories* as: ‘the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.’
- (ii) Appropriate procedures to determine that net realisable value of book inventory is above cost would include:
- (1) Assessment of estimated proceeds from the sale of items of inventory. Sales price in the period following the year-end is one important element of net realisable value. Procedures to determine sales prices include:
    - Obtain actual sales prices by reference to invoices issued after the year-end and determine that the sales were genuine by vouching sales invoices to orders, despatch notes and subsequent receipt of cash.
    - If actual sales prices are not available, the auditor should obtain estimated sales prices from management. It would be necessary to assess how reasonable these estimated prices were. The auditor might be aided in this respect by reviewing the reports from sales staff backed up by discussions with management.
    - Particular attention should be paid to sales prices of books identified as slow-moving. (*Tutorial note: Slow-moving books might be identified by obtaining lists of sales made in the preceding (say) six months and reviewing reports from sales staff. The sales statistics would also be useful in this respect.*)
    - For damaged books disposal price may be nil or very low and the auditor should examine records of disposal of such books in the past. (*Tutorial note: Damaged books should have been identified during the inventory count.*)
  - (2) Determine estimated costs to completion. These costs represent another important element of net realisable value. Relevant procedures include:
    - Some books may still be in production and will initially be included in inventory at cost to date; for example, they may have been printed but not bound. The auditor should examine production budgets and actual costs (for binding, for example) to determine actual costs to completion. (*Tutorial note: It is not uncommon for publishers to print books but leave them unbound until sales in the immediate future are expected.*)
    - Books returned may incur extra costs before they can be made ready for resale and the auditor should examine cost records to obtain a reasonable estimate of such costs.
  - (3) Determine costs to be incurred in marketing, selling and distributing directly related to the items in question.
    - In general terms the auditor may determine the percentage relationship between sales and selling and distribution expenses.
    - However, the distribution costs of heavy books are likely to be higher than for (say) light paperback books and the auditor should assess whether the cost weighting is reasonable.
  - (4) All of the above matters should be discussed with management bearing in mind that, although they represent an internal source of evidence, they are the most informed people regarding the saleability of books on hand and regarding determination of the various elements of net realisable value.
  - (5) Discuss with management the need for an inventory provision for slow moving and/or obsolete books.

2 (a) The following five factors that influence the reliability of audit evidence are taken from ISA 500 *Audit Evidence*:

- (i) Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- (ii) Audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective.
- (iii) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- (iv) Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium. (For example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed.)
- (v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles.

Other examples are:

- (vi) Evidence created in the normal course of business is better than evidence specially created to satisfy the auditor.
- (vii) The best-informed source of audit evidence will normally be management of the company (although management's lack of independence may reduce its value as a source of such evidence).
- (viii) Evidence about the future is particularly difficult to obtain and is less reliable than evidence about past events.

(b) (i) Those charged with governance are responsible for overseeing:

- the strategic direction of the entity
- obligations related to the accountability of the entity. This includes overseeing the financial reporting process.
- promotion of good corporate governance
- risk assessment processes
- the establishment and monitoring of internal controls
- compliance with applicable law and regulations
- implementation of controls to prevent and detect fraud and errors.

(ii) General audit matters that might be communicated to those charged with governance are addressed in ISA 260:

(1) *The auditor's responsibilities in relation to financial statement audit.*

This would include:

- A statement that the auditor is responsible for forming and expressing an opinion on the financial statements.
- That the auditor's work is carried out in accordance with ISAs and in accordance with local laws and regulations.

(2) *Planned scope and timing of the audit.*

This would include

- The audit approach to assessing the risk of serious misstatement, whether arising from fraud or error.
- The audit approach to the internal control system and whether reliance will be placed on it.
- The timing of interim and final audits, including reporting deadlines.

(3) *Significant findings from the audit.*

This heading could include:

- Significant difficulties encountered during the audit, including delays in obtaining information from management.
- Material weaknesses in internal control and recommendations for improvement.
- Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on the entity's financial statements. For example, the bankruptcy of a material receivable shortly after the year-end that should result in an adjusting entry.

(4) *A statement on independence issues affecting the audit.*

This would include:

- That the audit firm has ensured that all members of the audit team have complied with the ethical standards of ACCA.
- That appropriate safeguards are in place where a potential threat to independence has been identified.

*(Tutorial note: The lists of examples listed under the above headings are not exhaustive and in practice many more specific matters would be communicated to those charged with governance such as:*

- *Modifications to the audit report.*
- *Any management representation points requested.*
- *Cases of suspected/actual fraud.)*

3 (a) The auditor obtains an understanding of the entity, its control environment and its detailed internal controls:

- to identify and assess the risks of material misstatements, whether due to fraud or error, at the financial statement and assertion levels. Risks would include inherent risk and control risk. An important objective would be to determine the extent to which the auditor would rely on the internal control system.
- to provide a basis for designing and implementing responses to the assessed risks of material misstatement in the financial statements. This would involve the design and performance of the audit procedures required to form an opinion on the truth and fairness of the financial statements. An important objective would be to determine the extent and nature of audit procedures to reduce detection risk, and therefore audit risk, to an acceptable level.
- to set the scene for identifying assertions and collecting sufficient appropriate evidence to prove that the assertions are reasonable.

*(Tutorial note: Marks would also be available for additional points such as:*

- *To assess the adequacy of the accounting system as a basis for preparing financial statements*
- *To assess whether competent to perform the audit*
- *To understand relevant law and regulations impacting the entity*
- *To consider the reliability of various evidence sources.)*

(b) Strong points in the control environment of Letham Co in respect of non-current assets are set out below, together with explanations as to their impact on control risk:

<b>Strengths</b>	<b>Impact on control risk</b>
(i) Approval of the five-year and annual budgets by the board of directors.	The annual budget is the 'trigger' for placing orders for equipment. Its approval by the board will ensure that only authorised non-current assets are purchased.
(ii) The budget is updated when the order for new equipment is placed.	The company can use the updated budget at any time to anticipate cash outflows. It will also ensure that there is no duplication of assets purchased.

### Strengths

- (iii) Pre-numbered goods received notes and operational certificates are available to the accounting department for comparison with the purchase invoice.
- (iv) Informed people in the production department carefully assess the proper operation of the equipment.
- (v) The accounting department, independent of the production facility, updates the non-tangible assets register and only the accounting department has access to it.
- (vi) Accounting department personnel, independent of production, perform rolling tests to ensure that the non-current assets register and non-current assets on hand are in agreement with each other.
- (vii) The internal audit department tests on a sample basis that recorded non-current assets are in existence, but see (c) below.
- (viii) Internal audit test the operation of the entire non-current assets recording system.  
*(Tutorial note: Marks would also be available for additional strengths:*
  - *Pre-numbered goods received notes used to update the budget*
  - *Permanent identification numbers recorded on assets*
  - *Purchase invoice automatically updates the non-current assets register.*)

### Impact on control risk

- Only goods that have been received and are operating effectively will be paid for.
- This will help to ensure the operational effectiveness of plant and equipment.
- The potential for fraudulent entries to cover theft/ unauthorised purchases will be reduced and the non-current assets register, an important non-current assets control document, cannot be manipulated by the people who hold the assets.
- The risk of theft and loss of plant and equipment is reduced and the likelihood that all items in the register existing increased.
- The internal auditing department will be more independent than the accounting department and hence will provide further comfort that the non-current assets register is not overstated.
- Any controls which are not operating effectively are likely to be identified and rectified before significant errors can occur.

- (c) (i) Great care must be taken in selecting the starting point for audit testing. The test that the internal auditors performed, namely, selecting a representative sample of purchase invoices for testing to the non-current assets register and to the updating movements on the annual budget, proves merely that register and budget are in agreement with the purchase invoices issued. It is therefore not a good test to prove the completeness of purchase invoices and therefore of the entries in the register and budget. In addition, the purchase invoices are issued by many different suppliers and there is no common serial number to enable the company to ensure that all purchases are accounted for.
- (ii) A more appropriate test would be to make the selection from goods received notes (GRNs), as the issue of a GRN is normally the point at which liability is accepted and is in any event the document used to update the non-current assets budget. In other words, it is important to identify your audit objective and then to decide on what sample will be the most appropriate to aid you in meeting that objective. The GRNs would be traced to the recorded purchase invoices to ensure that the latter were complete and then to the entries in the non-current assets register and to the updating entries in the budget to ensure that these too were complete.

An additional appropriate test would be to select a sample of plant and equipment visible on the shop floor and trace them to the non-current assets register to identify whether they have been:

- included in the register
- noted against the budget as purchased
- paid for by tracing purchase invoice through to payment.

*(Tutorial note: The auditor would of course wish to prove that the GRNs are complete and might select a sample of purchase orders and trace them to the GRNs to ensure GRNs have been prepared in each case or the order rejected for good reason. Another appropriate test on the GRNs would be to prove that the numbering sequence was complete. This list is not exhaustive and other completeness procedures may be appropriate.)*

- 4 (a) The interim audit, as its name suggests, is that part of the whole audit that takes place before the year-end. The auditor uses the interim audit to carry out procedures that would be difficult to perform at the year-end because of time pressure. The final audit, on the other hand, will take place after the year-end and concludes with the auditor forming and expressing an opinion on the financial statements for the whole year subject to audit. It is important to note that the final opinion takes account of conclusions formed at both the interim and final audit.

Typical work carried out at the interim audit includes:

- consideration of inherent risks facing the company. *(Tutorial note: risk would be initially considered at the planning stage, but is, in fact, reassessed at all audit stages.)*
- recording the system of internal control.

- carrying out tests of control on the company's internal control system and evaluating its effectiveness to determine the level of control risk.
- performing sufficient substantive testing of transactions and balances to be satisfied that the books and records are a reliable basis for the preparation of financial statements.
- identification of potential problems that may affect the final audit work. A basic aim is to ensure as far as possible that there are no undetected problems at the year-end.

Typical work carried out at the final examination includes:

- Follow up of items noted at the inventory count.
- Obtaining confirmations from third parties, such as bankers and lawyers.
- Analytical reviews of figures in the financial statements.
- Reviews of events after the reporting period.
- Consideration of the going concern status of the organisation.

*(Tutorial note: At the final audit the auditor would carry out tests to ensure that the conclusions formed at the interim audit were still valid.)*

**(b)** The external auditors would normally be able to use the work of the internal auditors provided that:

- they are independent (in this case, of the accounting department and finance director to whom the accounting department reports). It appears that they have reported to the whole board, which would be a factor increasing their independence. It would be even better if they had strong links with the audit committee (if applicable).
- they are competent. Your firm would have formed a view in past years of their reliability by considering the background (including qualifications and experience, particularly as regards forecasting) of the internal audit staff and by examining their reports and working papers. You may also have reviewed some aspects of their work in the current year to the same end.
- effective communication, whether there is likely to be effective communication between the internal auditors and the external auditor.
- they have exercised due professional care, the work would need to have been properly planned including detailed work programmes, supervised, documented and reviewed.
- the company is experiencing difficulties due to the economic down turn and it requires the loan in order to expand. Management might place pressure upon the internal auditors to present the cash flow forecast in a more favourable light. This would impact the independence of the internal auditors.

You would still take full responsibility for any report that you issue.

**(c)** Audit procedures adopted in the examination of the cash flow forecast would include:

- (1) Check that the opening balance of the cash forecast is in agreement with the closing balance of the cash book, to ensure the opening balance of the forecast is accurate.
- (2) Consider how accurate company forecasts have been in the past by comparing past forecasts with actual outcomes. If forecasts have been reasonably accurate in the past, this would make it more likely that the current forecast is reliable.
- (3) Determine the assumptions that have been made in the preparation of the cash flow forecast. For example, the company is experiencing a poor economic climate, so you would not expect cash flows from sales and realisation of receivables to increase, but either to decrease or remain stable. You are also aware that costs are rising so you would expect cost increases to be reflected in the cash forecasts.
- (4) Examine the sales department detailed budgets for the two years ahead and, in particular, discuss with them the outlets that they will be targeting. This would help the auditor determine whether the cash derived from sales is soundly based.
- (5) Examine the production department's assessment of the non-current assets required to increase the production of white bread to the level required by the sales projections. Obtain an assessment of estimated cost of non-current assets, reviewing bids from suppliers, if available. This would provide evidence on material cash outflows.
- (6) Consider the adequacy of the increased working capital that will be required as a result of the expansion. Increased working capital would result in cash outflows and it would be important to establish its adequacy.
- (7) If relevant review the post year end period to compare the actual performance against the forecast figures.
- (8) Recalculate and cast the cash flow forecast balances.
- (9) Review board minutes for any other relevant issues which should be included within the forecast.
- (10) Review the work of the internal audit department in preparing the cash flow forecast.

**(d)** You would inform management that it would not be possible to give a report on the accuracy of the cash flow forecast. The forecast is an assessment of cash flows in the future which is uncertain, particularly in the second year.

The bank should be informed that the kind of report that you could give is a limited assurance or negative assurance report. You would be able to state in your report the kind of work you had carried out, the assumptions that management had made

and then to give a negative form of assurance in which you would state, among other things, that nothing had come to your attention that would cause you to believe that the assumptions do not provide a reasonable basis for the cash forecast. You could then go on to say that the forecast has been properly prepared on the basis of the assumptions.

This is assuming that this kind of opinion is appropriate in the light of the work you have performed.

5 (a) As regards accounts payable there are many different assertions that have to be addressed. Some relevant assertions are set out below:

- (i) Rights and obligations – Accounts payable represent amounts actually due by the company, that is, there is an obligation, taking into account:
  - the actual performance of services for the company; or
  - transfer of title in goods transferred to the company; and
  - cash payments or other genuine debit entry.
- (ii) Valuation and allocation – Accounts payable have been correctly valued taking into account original transaction amounts and such matters as trade discounts and local sales tax.
- (iii) Existence – The original transaction amounts are valid and the liability exists.
- (iv) Completeness – All accounts payable are recorded in the accounting records.

*(Tutorial note: The importance of assertions lies in the fact that they provide objectives for the auditor and enable the evidence search to be carried out in a logical fashion. The auditor will determine the assertions that are made about a particular figure appearing in the financial statements. This provides a series of objectives about that audit area and then the auditor searches for evidence to prove that each objective is met and that the assertion is valid or invalid.)*

(b) Controls that the company has in place to reduce the risk associated with purchases of food and its preparation in the kitchen, together with relevant audit procedures on controls testing, would include the following: *(Tutorial note: For a restaurant it is important that food quality is good and in particular that it does not present any danger to the customer arising from deterioration or poor practices in its preparation.)*

**Controls**

**Audit Procedures**

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| <ul style="list-style-type: none"> <li>(i) Overall authority for food purchasing should be in the hands of a designated person to ensure that the food purchased is of the desired quality. This is often in the hands of the head chef.</li> <li>(ii) There should be a list of approved suppliers to ensure that the food comes from sources known for their quality.</li> <li>(iii) On receipt of food, whether meat, fish, or vegetables and fruit, it should be carefully inspected by informed people, including those responsible for food preparation. This would be to ensure that it was of the desired quality (as well as quantity). A goods received note (GRN) should be signed to provide evidence of receipt and inspection.</li> <li>(iv) Food purchased should be kept in a clean place and refrigerated, if necessary. This would be to ensure that it has kept its quality.</li> <li>(v) Strict adherence to use-by dates to ensure that no poor quality food is prepared. <i>(Tutorial note: Marks would also be available for additional controls such as:</i> <ul style="list-style-type: none"> <li>– <i>Staff training on basic food hygiene.</i></li> <li>– <i>Rotation of inventory.</i></li> <li>– <i>Recording temperatures of cooked/reheated food.)</i></li> </ul> </li> </ul> | <p>Review the company's organisation chart and identify the person with overall responsibility for food purchasing. Discuss with management his or her background and expertise.</p> <p>Examine the list of approved suppliers of food and check that there are no purchases of food from other parties.</p> <p>Examine a sample of GRNs to ensure that all bear an approved signature indicating that food has been inspected for quality on receipt.</p> <p>Examine the food storage areas, including refrigerators, on a surprise basis to ensure they are clean and tidy. Ensure that the refrigerators are maintained at the correct temperature. Another test in this area might be to examine reports of local authority and other inspectors to ensure they were happy that the food was being properly stored.</p> <p>Check that there is no food on the premises which is past its use-by date. Discuss with management what happens to food which is past its use-by date, that is, how it is disposed of.</p> |
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- (c) Evidence collected by the auditor to enable a conclusion to be formed on the likelihood of the claim being successful (that is, whether a provision would be necessary according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) includes:

<b>Evidence</b>	<b>Explanation</b>
(i) Obtain the written claim by the customer.	This would tell you the reason why the claim was being made and provide other relevant details, such as whether the customer dined in the restaurant or purchased carry-out food, and the date when the alleged food poisoning took place.
(ii) Review the controls in force over purchases and food preparation (see (b) above).	This would be to ensure that the company controls appeared to be effective.
(iii) Obtain written reports concerning any inspections that had been carried out by company staff or third parties in the food store and food preparation areas.	This would provide evidence about any problems that had arisen affecting food quality. Discuss with management the actions that were taken to correct any problems that had arisen.
(iv) Discuss the matter with the company's lawyers to obtain their view on the likelihood of the claim being successful.	This would provide evidence from a professional third party as to the likelihood of the claim succeeding and the reasons why the lawyers had reached their conclusion.
(v) Obtain management representations regarding the likelihood of the claim succeeding. ( <i>Tutorial note: Marks would also be available for additional points such as:</i> <ul style="list-style-type: none"> <li>– <i>Review of board minutes to assess management's view of the likelihood of the claim succeeding</i></li> <li>– <i>Discussions with management about any previous claims and their outcome.</i></li> </ul>	This is internal evidence and should be approached with professional scepticism, but it would provide the auditor with the views of an informed group of people.
(d) As you have concluded that the likelihood of the claim being successful is only possible, it would be appropriate for the company to explain the contingent liability by way of note as required by IAS 37, giving a description of the nature of the contingent liability, an estimate of its financial effect, an indication of the uncertainties relating to the amount and timing and the possibility of any reimbursement.	

If the company includes a note of this nature, there would be no need to modify your audit opinion, however if the litigation is viewed to be exceptional then an emphasis of matter paragraph might be appropriate. However, if the contingency is not disclosed, the auditor would modify the audit opinion on the grounds of an 'except for' disagreement and include in the report the required details of the contingent liability. The auditor should try to persuade management to include the disclosure before issuing the modified opinion. (*Tutorial note: An 'except for' qualification would be appropriate as the contingent loss is material only, that is, the uncertainty is not major.*)

		Marks
<b>1</b>	<b>(a)</b> Audit planning	
	Up to 1 mark for any of the following, but maximum 4.	
	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
	Two matters	
	Up to 1 mark for relevant matters, but maximum 2.	
	Risk assessment generally	
	Assessment of control environment	
	Decision to test controls	
	Scope of substantive testing	
	Procedures to comply with ISAs	
	Materiality	
	Timetable of detailed audit work	
	Allocation of work to team members	2
	Maximum marks	<hr style="width: 100%; border: 0; border-top: 1px solid black; margin-bottom: 2px;"/> 6
	<b>(b)</b> Sales statistics	
	1 mark each for each relevant procedure and up to 1 for each explanation of how the procedure operates, but maximum 4.	
	Reconcile to recorded sales	
	Compare trends	
	Discuss with management	
	Customer codes	
	Reports from sales staff	
	Maximum marks	<hr style="width: 100%; border: 0; border-top: 1px solid black; margin-bottom: 2px;"/> 4
	<b>(c)</b> Substantive tests on royalties	
	Up to 1½ marks for description of test and ½ mark for stating objective, but maximum 6.	
	Compare royalties with sales income	
	Compare budgeted and actual royalties	
	Review sales statistics	
	Check whether royalties due and correctly calculated	
	Agree royalty payments to supporting documentation	
	Check cut-off	
	Compare expected and actual royalties	
	Maximum marks	<hr style="width: 100%; border: 0; border-top: 1px solid black; margin-bottom: 2px;"/> 6
	<b>(d)</b> Inventory risks	
	Up to 1 mark for each identified risk and up to 1 mark for mitigating control, but maximum 4.	
	Deterioration	
	Unsaleable – lack of demand	
	Unsaleable – defective	
	Theft likely	
	Poor inventory counting	
	Poor cut-off	
	Sale or return	
	Maximum marks	<hr style="width: 100%; border: 0; border-top: 1px solid black; margin-bottom: 2px;"/> 4

<p><b>(e) (i)</b> Define net realisable value</p> <p>1 mark for each element of definition.</p> <p>Selling price Less estimated costs to completion, marketing, selling and distribution costs</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">2</p>
<p><b>(ii)</b> Four procedures</p> <p>Up to 1 mark for stating procedure and up to 1 further mark for explanation, but maximum 8.</p> <p>On sales price On costs to completion On selling and distribution cost Discussion with management Inventory provision</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">8</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;"><b>30</b></p>
<b>2</b>	
<p><b>(a)</b> Reliability of audit evidence</p> <p>Up to 1 mark for identification of factors, but maximum 4.</p> <p>Independent source Effective controls Evidence obtained directly by auditor Written evidence Original documents Normal course of business Informed management Evidence about the future</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">4</p>
<p><b>(b) (i)</b> Responsibilities of those charged with governance</p> <p><math>\frac{1}{2}</math> mark for identification of responsibility and a further <math>\frac{1}{2}</math> if adequately described, but maximum 2.</p> <p>Strategic direction Accountability obligations Financial reporting process Promotion of good corporate governance Risk assessment processes Establishment and monitoring of internal controls Compliance with law and regulations Implementation of controls to prevent and detect fraud and errors</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">2</p>
<p><b>(ii)</b> Matters to be communicated</p> <p><math>\frac{1}{2}</math> mark for identification of matter and a further <math>\frac{1}{2}</math> mark if explanation is adequate, but maximum 4.</p> <p>Matters under the following headings</p> <ul style="list-style-type: none"> <li>– Auditor’s responsibilities</li> <li>– Planned scope and timing</li> <li>– Significant findings from audit</li> <li>– Independence issues</li> <li>– Modifications to the audit report</li> <li>– Management representation points</li> <li>– Cases of suspected/actual fraud</li> </ul> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">4</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;"><b>10</b></p>

3 (a) Understanding entity and environment

1 mark for each explanation of reason, but maximum 4.

- Risks of material misstatement
- Design and performance of audit procedures
- Identification of assertions
- Adequacy of accounting system as a basis for preparing financial statements
- Assessment of competence to perform the audit
- Understanding relevant law and regulations
- Consider the reliability of evidence sources

Maximum marks

4

(b) Strengths in control environment

Up to 1 mark for identification of strength and a further 1 mark for impact on control risk, but maximum 12.

- Approval of budgets
- Updating of budget
- Matching operation adequate
- Assessment of operation of equipment
- Independent updating and holding of non-current assets register
- Independent tests on non-current assets register
- Internal audit tests on existence
- Internal audit review of whole system
- Pre numbered goods received notes update budget
- Permanent identification on assets
- Automatic update of register with purchase invoice

Maximum marks

12

(c) Test for completeness

Up to 1 mark for what the current test does and a further 1 mark for an adequate explanation.  
1 mark for identification of a more appropriate test and a further 1 mark for an explanation why it is more appropriate.

- What the test does
- Why it is inadequate
- More appropriate test
- Why more appropriate

Maximum marks

4

**20**

**4 (a)** Difference between interim audit and final audit

Up to 1 mark for each relevant explanation and maximum of 2 marks for examples of procedures at interim and final audit, but overall maximum 4.

- Interim audit and final audit parts of whole audit
- Interim audit performed during year but final audit at or after the year-end
- Interim audit performs procedures that cannot be performed at the final audit
- Interim audit forms interim conclusion, but final audit results in audit opinion
- Typical work at interim audit
- Typical work at final audit

Maximum marks

4

**(b)** Work of internal audit

$\frac{1}{2}$  mark for identification of each factor and up to 1 mark for full explanation, but maximum 6.

- Independence – to whom report; links to audit committee
- Competence – qualifications and experience
- Effective communication – between internal and external auditors
- Professional care – properly planned and performed
- Management pressure to present favourable cash flow forecast

Maximum marks

6

**(c)** Examination of forecast

Up to 1 mark for identification of a relevant procedure and a further 1 mark if adequately described, but maximum 6.

- Opening balance
- Accuracy of past forecasts
- Assumptions
- Sales budgets
- Non-current assets required
- Increased working capital required
- Review post year end period
- Recalculate and cast the cash flow forecast
- Review board minutes
- Review the work of the internal audit department

Maximum marks

6

**(d)** Kind of assurance

1 mark for each relevant point, but maximum 4.

- Not possible to give a report on accuracy and why
- Limited assurance or negative assurance
- What this kind of assurance means
- Testing assumptions and reporting on validity
- Forecast properly prepared on basis of assumptions

Maximum marks

4

**20**

<p><b>5 (a)</b> Accounts payable assertions</p> <p><math>\frac{1}{2}</math> mark for identification of assertion and up to 1 mark for each explanation of assertion, maximum 6.</p> <p>Rights and obligation Valuation and allocation Existence Completeness</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">6</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>
<p><b>(b)</b> Control risk and audit procedures</p> <p>Up to 1 mark for each control identified, but maximum 2. Up to 1 mark for each audit procedure, but maximum 2.</p> <p>Overall authority Approved suppliers Inspection on receipt Storage of food Use-by dates Basic food hygiene training Rotation of inventory Recording temperatures of cooked/reheated food</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">4</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>
<p><b>(c)</b> Evidence on claim</p> <p>1 mark for identification of each item of evidence and up to a further 1 mark for explanation.</p> <p>Written claim Review controls Inspection reports View of lawyer Management representations Review of board minutes Discussions with management about previous claims</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">6</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>
<p><b>(d)</b> Reporting in financial statements</p> <p>Up to 1 mark for assessing meaning of probable and possible and a further mark for showing how the matter should be disclosed, but maximum 2.</p> <p>Meaning of possibility Therefore contingent liability Note disclosure Audit reporting</p> <p>Up to 1 mark for each relevant point, but maximum 2.</p> <p>If contingent liability correctly included then unqualified opinion Emphasis of matter paragraph if litigation exceptional Material matter if not disclosed Therefore 'except for' disagreement Disclosures in audit report</p> <p>Maximum marks</p>	<hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;">4</p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/> <p style="text-align: right;"><b>20</b></p> <hr style="width: 20px; margin-left: auto; margin-right: 0;"/>