Test of Professional Skills

Assurance and Data: Retake Material

2022

INTRODUCTION

This retake course pack is designed for students sitting the TPS examinations in 2022 for a second or subsequent attempt. It should be used in conjunction with the most recent exam papers, suggested solutions and Examiner's Report which can be found on the retake resource areas of icas.com: https://www.icas.com/students/test-of-professional-skills-tps/tps-retake-classes-and-materials. Debriefs of recent examinations can also be found on icas.com.

The retake pack includes examination style questions from across the syllabus, with solutions. You should attempt these questions under exam conditions. You may wish to review the relevant topics before you attempt the question. You will find a mapping of questions to modules on the next page.

You should also remind yourself of the Study and Exam Technique module relevant for 2022 which is available on myCABLE.

Students that originally attended TPS AD classes in 2021

The additional material pack for AD in 2022 has been updated to include new questions compared to 2021. Therefore, if you attended TPS AD classes in 2021 and have previously used the 2021 Additional Material Pack you can also include the following questions from the 2022 Additional Material Pack as part of your revision.

Question No.	Topic covered	Module coverage
Question 32	Substantive procedures for trade receivables circularisation	14
Question 33	Data integrity risk evaluation	3,4
Question 43	Evaluate group instructions	17
Question 44	Prepare and explain Summary of Audit Misstatement	14,16
Question 45	Quality management responsibilities	9

The 2022 Additional Material Pack is available on myCABLE.

QUESTIONS SUMMARY

Question No.	Topic covered	Module coverage
Question 1	Impact of matters on the audit opinion and report	16
Question 2	Analyse cashflow forecasts and explain further evidence required	15
Question 3	Identifying the weaknesses in the HR department's current processes, explaining the implications and recommending improvements	2
Question 4	Materiality calculation and evaluation of fraud risk factors	6,17
Question 5	Evaluate outstanding points, design further actions/ additional evidence required and prepare a Summary of Audit Misstatements	14
Question 6	Relevance of KPIs and recommended improvements	3
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Question 8	Evaluate outstanding points and subsequent events, considering additional evidence required and evaluate impact on the audit opinion and audit report	14, 15, 16
Question 9	Audit risk and additional audit evidence required	6,17
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Question 11	Design further substantive tests to complete the trade receivables circularisation testing	13,14
Question 12	Identify the weaknesses, explain the implications and recommend improvements in the CASS management and reporting processes for Frazier.	17
Question 13	Substantive analytical procedures, CASS breaches and materiality calculation	6,12,17
Question 14	Identifying the weaknesses, analysing the implications and recommending improvements in the payroll system and recommending controls if payroll is outsourced	2
Question 15	Elements of an assurance engagement and most suitable type of work to perform	18
Question 16	Planning analytical review and audit approach, Additional audit risk and audit approach	6,7,8
Question 17	Identifying the weaknesses in the sales system, evaluating the implications and recommending improvements.	2
Question 18	Design test of controls, analyse methods of implementation and explain types of engagement your firm could undertake	2,11,18
Question 19	Design test of controls	11
Question 20	Integrity and reliability of data and design substantive procedures for share capital and reserves	4,12,13

Question 1 (15 marks)

Lemon Home Appliances Limited

It is March 2X21. You are the audit manager on the audit of Lemon Home Appliances Limited ('Lemon') for the year ended 31 December 2X20. This is your firm's first year of appointment. The audit fieldwork is complete and you are reviewing a number of outstanding matters as reported to you by your audit senior, which includes limited responses from management (Appendix).

Lemon is a manufacturer, specialising in the manufacture and sale of advanced, state-of-the-art, energy efficient home appliances.

You have noted from the audit file that materially is set at £100,000. Lemon has net assets of £900,000 and profit before tax of £1m. Your audit partner has asked you to evaluate, for each matter, the impact on the audit report and opinion, if any, in the event that the further substantive procedures do not resolve the issue satisfactorily.

Required:

Analyse each matter and evaluate the impact on the audit report and opinion, if any, in the event that the further substantive procedures do not resolve the issue satisfactorily.

(15 marks)

APPENDIX (QUESTION 1) – Outstanding matters

New product

Lemon has manufactured a new, highly efficient washing machine that was due to launch on 1 May 2X21. However, the company is still negotiating a long-term supply contract with a major high street and internet retailer. The directors are confident that the agreement will be signed within the next month. At the year-end £120,000 of the new products were included in finished goods inventory.

From your discussions with management and review of post year end management accounts, you noted that the company has continued significant production of this new washing machine. The contract will be key to Lemon's ability to sell the product. The board is not currently considering any other supply contracts and the audit team has concluded that it is unlikely that this will have any impact on Lemon's status as a going concern.

Inventory Count

Due to the late appointment of our firm as auditors of Lemon, we were unable to observe the year end physical inventory count. Inventory was valued at £800,000 at the year end.

During the audit we carried out additional testing on accuracy, valuation and allocation, classification, and rights and obligations with no issues noted. In addition we provided client staff with a list of inventory items as counted by our staff at the monthly inventory count on 28 February 2X21 and asked for evidence of despatches and receipts from December to the end of February so we could rollback inventory to confirm existence and completeness at the year end. This information remains outstanding.

Cash and Bank

The bank balance is overstated by £4,000 as a result of a supplier payment incorrectly posted to the next financial year. Management has not adjusted Lemon's accounts for this matter.

Holiday payments

Lemon has been using an incorrect hourly rate to pay their 100 employees holiday pay. It has been paying holiday pay at the employees' standard hourly rates, but should also have included weekend premium pay, where worked. During the audit we estimated that Lemon would be required to pay employees a total of £102,000 to rectify this shortfall.

Update from management March 2X21: The board of directors engaged a payroll consultant to investigate this issue and to arrive at its own estimate of the understatement of payroll costs. The result of the investigation is outstanding, but management understand that the payroll consultant's calculations indicate a liability in line with our estimate.

Relocation loan

During the year Lemon recruited a new innovation director. As part of her remuneration package, a £15,000 interest free loan was granted in November 2X20 to assist with the costs of her relocating to a property near Lemon's production facilities. This loan will be repaid when the innovation director has completed her move. There is no mention of this transaction within the financial statements.

Question 2 (20 marks)

Bespoke Bolts Ltd

It is December 20X4. You are the audit manager on the audit of the financial statements of Bespoke Bolts Ltd. ('Bolts') for the year ended 31 August 20X4. Bolts manufactures nuts and screws to customers' specific requirements and has been a client of your firm for a number of years. The year-end audit fieldwork and audit of subsequent events have been completed.

The company has experienced cash flow problems recently, and during your fieldwork you have identified concerns over the ability of the company to continue as a going concern.

To support the directors' assumption that Bolts is a going concern, Robert Wright, Bolts' finance director, has sent you detailed quarterly cash flow projections for the 12 months to 31 August 20X5, prepared as part of Bolt's annual business planning process (Appendix). These include actual figures for the 12 months ended 31 August 20X4 and details of business developments and assumptions included in the cash flow forecast.

Your audit partner has asked you to analyse the cash flow projections and evaluate the reasonableness of the assumptions and information provided. They would also like you to explain any further evidence needed regarding the going concern assumption.

Required:

(i) Analyse the cashflow forecasts provided and evaluate the reasonableness of the assumptions and information provided.

(ii) Draft notes for your audit senior explaining the further audit evidence needed regarding the going concern assumption.

(20 marks)

APPENDIX (QUESTION 2) - Cash flow assumptions and forecasts prepared by Robert Wright

All figures £'000

	Actual Year ended 31 Aug X4	*Forecast Qtr 1 ended 30 Nov X4*	*Forecast Qtr 2 ended 28 Feb X5*	*Forecast Qtr 3 ended 31 May X5*	*Forecast Qtr 4 ended 31 Aug X5*	*Forecast Year ended 31 Aug X5*
Revenue receipts	20,627	5,163	5,227	5,235	5,833	21,458
Payments to suppliers	(12,377)	(2,891)	(2,920)	(3,215)	(3,287)	(12,313)
Other operating expenses	(8,080)	(2,065)	(2,090)	(2,095)	(2,127)	(8,377)
Net cash in/(out) flows	170	207	217	(75)	419	768
Loan repayment	(400)	-	-	(400)	-	(400)
Opening cash	70	(160)	47	264	(211)	(160)
Closing cash	(160)	47	264	(211)	208	208

The cash flow projections for the year ending 31 August 20X5 have been prepared using the following key assumptions:

- A new contract to supply a car manufacturer with high value nuts and screws has been signed. This contract is for three years and will increase our revenue by 10% per annum by the end of the third year. Bolts will begin supplying these in March 20X5. The contract to supply an oil company with screws has been extended for a further 12 months from 1 January 20X5. This contract accounted for 15% of our revenue to 31 August 20X4.
- These contracts have increased our buying power and we have negotiated extended payment terms with key suppliers. Payment terms are now 45 days. (20X4: 35 days)
- The company's overdraft will be renewed in February 20X5 with an unchanged limit of £200,000, (the actual overdraft per the bank statement at 30 November 20X4 was £17,000).
- The final instalment of our term loan, £400,000, will be paid in March 20X5.

Question 3 (18 marks)

Masters Sports Shops Ltd

You are a consultant engaged by the board of Masters Sports Shops Ltd (‘Masters’) to review the Human Resources (‘HR’) department. Masters employs over 200 staff in its UK stores. At a recent meeting with the directors, it was explained to you that they are aware that controls within the HR department are not as robust as they could be, indeed a recent review had uncovered significant errors and even fraud in the HR system.

You have been asked to prepare paragraphs suitable for a report to the board identifying the weaknesses, explaining the implications and recommending improvements to the HR department’s current processes. At your meeting you made notes regarding the functions of the HR department (Appendix).

Required:

Prepare information in a format suitable for inclusion in a report to the board identifying the weaknesses in the HR department’s current processes, explaining the implications and recommending improvements.

(18 marks)

APPENDIX (QUESTION 3) – Notes of Masters' payroll system

General
Masters operates its own bespoke payroll system that is processed by the HR department.

The department comprises the HR Manager, Frank Smith ('Frank'), and two clerks who spend 50% of their time performing HR tasks of updating master files for new starts, leavers, changes to wages rates or employee personal details. The remainder of their time is spent processing payroll. Access to the master file is restricted with a password known to the three members of HR. The HR department falls under the remit of the finance director, Rob Morris.

New starts
New employees are sent two copies of their contract of employment both of which they sign, returning one copy directly to HR and retaining the other for their own records.

On their first day, employees complete a standard employee details form containing their personal details which is forwarded to HR for processing. The HR clerk matches the employee details form with the employee contract and creates the employee master file record in the HR system. The HR clerk signs the standard employee details form as evidence of processing and files the matched contract and employee details form alphabetically in cabinets. These cabinets are kept locked and can only be accessed by members of the HR department.

On a weekly basis, a system generated report is automatically sent to Frank listing all new starts that week. He downloads and securely files a copy of this for his own records.

Leavers
All leavers submit their resignation in writing to their line manager and complete a standard leaver's form which is sent to Frank. He matches the resignation letter and leaver's form with the employee's contract details and completes a standard termination form on screen. The form automatically changes the status of the employee to 'leaver' within, the payroll system with effect from the leaving date. Frank signs the standard leaver's form as evidence of processing through the master file. A clerk then uses the leaving date to calculate the final salary payment due.

On a weekly basis, a system generated report is automatically sent to Frank listing leavers that week. He prints and reviews it to ensure that all leavers are listed. He signs this report as evidence of his review.

Changes to Employees Standing Data
Amendments to employees standing data such as hourly rate, annual salary or pension deductions are recorded using a standard amendment form which is reviewed and signed by Rob Morris. The HR clerks use this form to update the master file and file it with the employee's contract.

On a weekly basis, the HR system automatically prints a report – 'changes to employees standing data'. This report is reviewed by Frank and any standing data amendments are agreed to the standard amendment form.

APPENDIX (QUESTION 3) (continued)

Employee driven changes, such as changes to bank details, home address, etc., are completed by the employee using a separate standard form. This form is signed by the employee and passed to the HR department where the changes are processed by one of the HR clerks. Once processed the form is then shredded. These changes are not picked up by the ‘changes to employee standing data’ report.

Recent review

Two months ago, Masters’ IT team alerted the directors that there had been an unsuccessful attempt, which they described as ‘clumsy’, to access the HR master file remotely. The directors commissioned a counter-fraud specialist to review the file. The specialist found that a more sophisticated attack successfully added a ‘ghost employee’ six months ago by remotely accessing Masters’ server. There were also two casual employees, who left Masters 12 and 18 months ago, who were never removed from the file and have continued to be paid small amounts throughout this period.

This caused shock among Masters’ IT team and the directors, and considerable anger among store managers. One store manager has pointed out in a heated email that costs relating to two of the false employees were charged against her store’s budget, affecting her own performance-related pay, yet there was no way that she could have spotted that the store was being overcharged for non-existent workers.

The specialist also noted that there were some instances where legitimate overtime payments to employees had been paid to the wrong employee due to human error when manually inputting staff reference numbers. The specialist advised that, although improved controls over data entry may be required, changes to the HR master file could also help to prevent future recurrences.

Question 4 (15 marks)

Animal Park

You are an audit manager working for Smith & Right LLP (‘Smith & Right’) a firm of registered auditors. You are planning the audit of Animal Park (‘Park’), a company limited by guarantee. Park is an established “not for profit” charitable organisation which runs a network of animal sanctuaries. The public can visit these and the largest site, which is also the location of the head office, has a shop and cafe. During your planning meeting, the finance director informed you that the company has had a difficult year and has seen a downturn in the level of legacies and donations being pledged in the year. However, the trustee directors expect this position to improve by the year end.

You have been involved in the audit for a number of years and have just commenced the planning work for the year ending 30 September 20X4. As part of this planning exercise, you need to calculate and set planning materiality. You have obtained the current period and prior year results and most recent and prior period financial positions from the March 20X4 management accounts (Appendix 1).

You are also concerned about potential fraud risks after attending a recent training webinar on fraud risks in the not-for-profit sector. You think that revenue and associated cash holdings are a key risk in this regard and have asked an audit junior to discuss Park’s revenue/ cash streams and processes with staff, and to summarise their findings in a note (Appendix 2).

Required:

1. Recommend a level of overall materiality suitable for Park, explaining your reasoning.

(5 marks)

2. Prepare a note, suitable for inclusion in your audit planning file in which you evaluate the fraud risk factors in relation to Park’s revenue and associated cash holdings.

(10 marks)

(15 marks)

APPENDIX 1 (QUESTION 4) – Extracts from management accounts

Extracts from management accounts
For the period ended 31 March 20X4

	Period to 31/03/X4 Unrestricted funds £'000	Year to 30/09/X3 Unrestricted funds £'000
Incoming resources		
Voluntary income:		
Legacies	2,169	4,994
Donations	1,583	3,652
Activities for generating funds:		
Trading activities	70	140
Fundraising	464	982
Total incoming resources	4,286	9,768
Balance Sheet highlights		
Total assets less current liabilities	11,423	12,368
Net assets/total unrestricted funds	8,554	9,300

APPENDIX 2 (QUESTION 4) – Notes on revenues and cash

Donations and Fundraising

Donations continue to be collected via monthly standing orders and ad hoc, by post and through the Park website. These amounts are paid direct to Park's bank by donors' banks, card issuers and various online payment services. Fundraising includes a range of high-profile sponsored events.

Park now employs a Revenue Growth Leader (RGL) who is personally responsible for driving both donation and fundraising income. A significant proportion of the RGL's pay is performance-related and tied to the income generated, including gift aid generated. Gift aid can be claimed from the government on eligible donations. Conditions include a declaration from donors that certain eligibility criteria have been met. The RGL has launched a drive to improve the rate of gift aid collection and the RGL receives and inputs all paper-based gift aid forms into Park's finance system.

Legacies

These relate to sums left to Park in the wills of deceased supporters. The value of legacies in the first 6 months of the financial year is low but management are unconcerned as legacy cash flow is inherently 'lumpy' no major income from this source had been anticipated. Procedures are largely unchanged from prior years. Money is normally paid direct from the deceased's lawyers to Park's bank at the end of the probate process.

Park's trustees have a policy of not accepting any legacies or donations with conditions attached as they feel that this impairs Park's independence and strategic flexibility.

Cash

Cash handling from trading activities (shop and café) has fallen due to card and device payments, but is still significant, as are cash donations at all locations.

Cash collected at all sites is banked locally by site managers and a daily banking report emailed to Park's bookkeeper, who saves all such reports on Park's cloud drive. Prior to banking, cash at head office is stored in a safe. Only the bookkeeper and site manager are meant to have access, but there seems to be an 'in joke' around the office that that the bookkeeper is an avid football fan and that the safe code was bound to be the year that their football team was founded.

I did ask to see inside the safe and noticed that, as well as the cash and related paperwork collected by Park, there were two large envelopes containing money collected from staff for a lottery syndicate and the office Christmas lunch. Neither enveloped contained an accounting record of the money inside.

The bookkeeper seemed very irritable and mentioned to me that Park had previously employed a part-time financial controller but due to a need for efficiencies, that post had been made redundant. The bookkeeper took on the controller's responsibilities but has had no pay rise to reflect this. One of their colleagues mentioned that the bookkeeper had been so busy that they had not taken a single day of leave since taking on these additional responsibilities.

Question 5 (18 marks)

Top Tubs Ltd

It is February 20X2 and you are the audit manager on the audit of the financial statements of Top Tubs Ltd ('Tubs') for the year ended 31 October 20X1. Tubs has been client of your firm for a number of years.

Tubs buys luxury hot tubs from North America, ships them over to the UK and sells them to UK customers. Tubs has a large showroom for customer viewing, based in Liverpool. It also has a warehouse next to the showroom where all the tubs shipped in are quality checked before being distributed to customers. The ownership of all Tubs' despatched goods transfer to the customer upon customer receipt.

Your audit partner Giovanni McKenzie recently had a meeting with the finance director of Tubs, Katie Christian, to discuss a number of points following completion of the audit fieldwork. Giovanni has asked you to review the notes of the meeting (Appendix) and evaluate each of the points, explaining any potential impact on the financial statements. They would also like you to consider further actions or additional evidence required in response to the findings from your review and to prepare a Summary of Audit Misstatements ('SAM') noting, where applicable, any potential adjustments. They wish you to conclude on which items may require adjustment.

You note that overall materiality for this year's audit has been set at £100,000 with a trivial threshold of £5,000.

For the purpose of this question you should ignore VAT.

Required:

1. Prepare information suitable for inclusion in the audit file where you:

   (a) Evaluate each of the outstanding points explaining any potential impact on the financial statements.

   (6 marks)

   (b) Design, for each outstanding point, any further actions or additional evidence required as a result of your findings (note: you are **not** required to evaluate any impact on the audit report or audit opinion).

   (6 marks)

   (c) Prepare a SAM noting, where applicable, any potential adjustments arising from the matters noted and conclude on which items may require adjustment.

   (6 marks)

(18 marks)

APPENDIX (QUESTION 5) - Notes from outstanding audit points meeting with Giovanni McKenzie

Points for discussion	Notes from discussion
During our attendance at the year end inventory count, it was noted that 15 hot tubs were sitting in the packing area that were not included in the final inventory listing. During the audit fieldwork in January 20X2 it was noted that these had been invoiced and were ready to be delivered. However, the customer, Lodges UK, had had some construction delays and was not ready for them yet. It had been agreed that Lodges UK would pay upon delivery estimated to be in three months' time. The recording of the sale had been verified to the invoice, debtors ledger and trade receivable balance within the nominal ledger. The cost of the inventory was also confirmed as having been recognised within cost of sales.	Lodge UK tubs took delivery of the tubs on 3 February 20X2. Upon delivery it had paid the invoice of £150,000 immediately. The cost of the inventory concerned is £120,000.
In July 20X1 the pension payment payable to the company's pension provider, per the payroll listing, of £51,836 (employee and employer) did not agree to the bank statement which showed £15,836. The payroll clerk was on holiday during the audit fieldwork, so the query was still outstanding. At year end, it remained as an unreconciled item on the bank reconciliation.	The payroll clerk had looked into this matter and it appeared to be a transposition error. The correct figure is £15,836. The payroll clerk posted the following journal: Dr Bank and cash 36,000 Cr Suspense account (Statement of financial position) 36,000
It was flagged during the audit that there was an aged trade receivables balance that had been outstanding for >180 days. This was for a holiday park company and the balance outstanding is £81,000. The customer had failed to respond to the trade receivables circularisation. Tubs had provided for 50% of the balance in the allowance for receivables at the year-end.	Katie had mentioned at the meeting that she had seen on the news that the holiday park company was experiencing financial difficulties and had entered administration.

APPENDIX (QUESTION 5) (continued)

Points for discussion	**Notes from discussion**
A shipment of tubs had arrived on 31 October 20X1 and only part of the delivery had been quality checked and processed by year end. One tub with a value of £4,900 had not yet been processed or included in inventory until the following day at which point the value of the goods processed had been correctly included within the goods received not invoiced accrual.	Katie had mentioned that Tubs was ordering larger shipments of hot tubs and this matter had occurred a few times now. The audit team were made aware of this and she was in discussions with the inventory manager about how to address this. Giovanni verified the inventory listing for 31 October 20X1 and confirmed the items were not listed. It was noted that the audit team had not found any further errors during testing and had extended the sample following management's comment regarding errors during the year.

Question 6 (10 marks)

Swipenfly Ltd

You are the head of internal audit at Swipenfly Ltd (‘Swipenfly’). The company offers business class flights from Edinburgh and Glasgow to three destinations in the USA using leased aircraft. The destinations are New York (3,600 miles), Los Angeles (5,100 miles) and Honolulu (6,900 miles).

Customers are offered a premium flying experience, comprising airport lounge access (where available), flat bed seats, a five-course meal, use of a tablet for entertainment, and unlimited Wi-Fi access during the flight. Tickets for all destinations currently cost £1,500 one way. Tickets are transferable to other flights at a cost or may be refunded if the customer misses the flight, subject to a no show penalty.

Each aircraft carries 80 passengers, but, as last-minute cancellations are common, the company will sell up to 85 tickets for each flight. Where a flight is undersold, standby tickets are routinely offered at £500. If a flight is oversold, customers will be booked on to the next day’s flight and offered a total refund. The Honolulu flight is frequently undersold and the New York flight is often oversold.

Customers are offered the chance of offsetting carbon emissions on payment of an additional £20 and this money is invested in carbon emission projects in South America.

The industry is highly regulated from a safety perspective and all accidents and certain incidents (such as hard landings or bird strikes) must be reported to the Aviation Authority.

The running costs of the airline are fairly constant with the only exception being any changes in duties or fuel costs payable for running flights. However, these have not fluctuated greatly in the last 12 months and the company does not anticipate any significant changes in the near future.

The directors have asked you to consider how relevant the data is to monitoring the state business objective. Where appropriate, they also wish you to suggest improvements to the relevance and reliability of the data.

The objectives, KPIs, and supporting commentary from Swipenfly’s management, are set out in the Appendix.

Required:

For each of Swipenfly’s stated business objectives:

a) evaluate whether data used to calculate the KPI would provide relevant information to monitor achievement of the objective; and

b) if applicable, recommend appropriate actions to be taken to improve the relevance of the data gathered to monitor the KPI

(10 marks)

APPENDIX (QUESTION 6) – Swipenfly KPIs and supporting commentary

Business Objective	KPI	Source of data
Maximisation of profitability	Seat utilisation (total seats used as a percentage of total seats on flight)	Passenger booking records for seats booked in advance. Data for each flight is extracted on date prior to the flight. Reported monthly.
Maximisation of profitability	Operating profit margin (operating profit as a percentage of revenue)	Automatically generated by Swipenfly's accounting software on a monthly basis as part of the management accounting process.
Maximisation of customer satisfaction	Number of complaints received	Manually extracted from complaints department's email records and reported monthly on an excel spreadsheet – each complaint is copied and pasted from the customer email and the total number of complaints reported to management.
Optimisation of safety record	Number of staff and passenger fatalities	No process for data extraction as the board monitors the press and are confident that there have been no fatalities to date.
Optimisation of safety record	Management attendance at monthly Safety Committee meetings	Extracted from a sample of Safety Committee minutes on an annual basis.

Question 7 (15 marks)

Scorpion Exploration Ltd

You are an audit manager at a large global firm of Chartered Accountants and Registered Auditors. Your audit partner has recently met with Frankie Summers, the finance director of a potential new client, Scorpion Exploration Ltd ('Scorpion'), a company headquartered in London which undertakes oil and gas exploration activities. Frankie would like to engage your firm to perform the audit of the financial statements for the year ended 31 March 2X21.

Your audit partner has provided you with notes from the meeting (Appendix 1) and would like you to prepare information for inclusion in a briefing note in which you evaluate the acceptance risks at Scorpion. You have also reviewed the prior year audited statutory financial statements and noted any important points (Appendix 2).

Required:

Prepare information in a suitable format for inclusion in a briefing note in which you evaluate the acceptance risks at Scorpion.

(15 marks)

APPENDIX 1 (QUESTION 7) - Extracts of the meeting with Frankie Summers

During the year, the Angolan branch commenced a contract to perform hydraulic fracturing (‘fracking’) operations. This is the first fracking contract that Scorpion has secured and the company’s main gas exploration activities have not involved this relatively new process. In previous years the branch has undertaken small exploration projects and discussions indicated that these were not significant to the results of the company. Following the commencement of the fracking contract, Frankie expects the profit from this to be significant to the overall results of Scorpion for the current year.

The Angolan contract is profitable, though there has been some bad publicity locally regarding small earthquakes caused by the fracking and the impact it has had on local communities.

The Angolan branch has a local finance team and that the finance manager reports directly to Frankie. Scorpion’s internal audit department has visited the branch and reported no significant weaknesses in operational controls.

The UK operations have had a difficult year with a significant write-off of previously capitalised development costs due to technical difficulties encountered with one of their oil exploration sites. As a result, the company is expected to make a small loss for the year.

Frankie explained that there are four directors of Scorpion, with three based in the UK and the Chief Technical Officer (‘CTO’). Frankie stated that the CTO does not reside in the UK and rarely visits the London office and is “a quiet person who keeps themself to themself, particularly regarding their personal background and other business activities”.

Frankie approached your firm as you also audit Scorpion’s main non-fracking competitor. Frankie believes that getting your firm in as auditors will provide confidence to investors and other external stakeholders. Frankie noted that ideally the audit would be completed by 30 April 2X21 to allow Scorpion to bid for further European fracking contracts. The competitor is the firm’s only other client in the oil and gas industry.

APPENDIX 1 (QUESTION 7) - Points extracted from prior year audited statutory financial statements

The strategic report discussed reduced competition within the fracking market due to the corporate failure of a number of competitors resulting from a difficultly to overcome technical risks.

Scorpion has been loss making in the previous two financial years with significant asset impairments contributing to the result.

Question 8 (25 marks)

Domtherm Ltd

You are the audit manager on the audit of the financial statements of Domtherm Ltd ('Domtherm') for the year ended 30 September 20X3. You are reviewing the final outstanding points and subsequent events from the audit.

Domtherm is an Edinburgh-based company that supplies and installs fuel efficient gas central heating systems to industrial and domestic customers. In recent years, the company's turnover and profit have grown substantially. The board of Domtherm is seeking to borrow £500,000 from the bank to fund the next phase of growth and the audited 20X3 accounts will be used to support the loan application.

The finance director of Domtherm, David Wallaby, has already supplied profit and cash flow forecasts for 20X3-20X5 to the bank and has given the bank an indication that the profit shown in the draft accounts is in line with the 20X3 forecast. He is, therefore, reluctant to make any further adjustments to the draft financial statements prior to their finalisation.

Your audit senior has prepared a list of outstanding points from the audit, (Appendix 1), and also obtained a list of subsequent events from David (Appendix 2).

To prepare for the final audit clearance meeting with David, your audit partner, Sheila Miller, has reviewed these points and made some notes regarding the accounting treatment that she believes should be applied. She has asked you to prepare notes evaluating each of the outstanding points from the audit and subsequent events, considering what additional audit evidence, if any, is required to reach a conclusion on their impact on the financial statements.

To facilitate her discussions with David, Sheila would also like you to analyse the impact, if any, of the outstanding points and subsequent events on the audit opinion and recommend appropriate audit report wording.

Sheila has reminded you that overall materiality was set at £30,000 and that this is still deemed appropriate.

Required:

1. Prepare notes for the meeting in which you:

   (a) evaluate each of the outstanding points from the audit and list of subsequent events, considering what, if any, additional audit evidence would be required;

   (14 marks)

   (b) analyse the impact of each of the outstanding points and subsequent events on the audit opinion and audit report to be issued.

   (11 marks)

(25 marks)

APPENDIX 1 (QUESTION 8) - Outstanding audit points

The following outstanding matters have been identified by the audit team for discussion between Sheila and David at the forthcoming audit clearance meeting.

1. From 1 March 20X3, Domtherm started selling a new type of Combi boiler to domestic customers and provides a one-year warranty on this product. During the seven months to 30 September 20X3, revenue for this product totalled £300,000.

   There have been problems with these systems since installation and parts have needed replaced, sometimes more than once. Domtherm's technical director believes the problem can be solved but none of these models have been sold since the year end. During the period to 30 September 20X3, the company spent £10,000 on repairs but the directors estimate that, based on complaints received to date, the additional costs of repairs under warranty could be in excess of 15% of revenue. No provision has been made at 30 September 20X3.

   Sheila's comment: Based on this information, this liability arose from work during the year and, therefore, we should consider whether this needs to be provided for in the financial statements to 30 September 20X3. Please summarise what additional evidence we will need to assess the likely impact of this on the audit opinion.

2. In May 20X3, Domtherm supplied and installed a gas boiler at the factory of Venicones Ltd ('Venicones'), a major industrial customer. Two months later, the boiler exploded, seriously injuring two employees and causing substantial damage to the customer's building and inventories. Venicones is suing Domtherm for £1.3m for damage caused by faulty installation. Domtherm's engineers have inspected the boiler and report that it had been moved by the customer after installation, contrary to the sales agreement. This has been denied by Venicones. The matter is going to arbitration in July 20X4 which is well after the financial statements for 20X3 will have been issued.

   Sheila's comment: At the reporting date it is not clear what the outcome of this will be, but it would appear that there could be a contingent liability of £1.3m. Again, please summarise what audit evidence we will need to assess this and the effect it could have on the audit report.

3. Around 18 months ago, the company's sales manager was given a loan of £3,000 by the company, with very flexible repayment terms, to assist him in the purchase of a new car. At the end of July 20X3, he left the company and emigrated to Australia still owing £3,000. Domtherm's cashier did not ask him to pay back the loan before he left. The loan is still included in the statement of financial position as at 30 September 20X3.

   Sheila's comment: This one looks easy enough; I will leave this with you.

APPENDIX 1 (QUESTION 8) (continued)

4. A venture capitalist (‘VC’) holds 20% of the company’s shares. At the VC’s request, the directors always produce a Management Commentary as a supplementary report within the Annual Report. This is in addition to the Directors’ Report. The Management Commentary for the year ended 30 September was written earlier in the year and was based on expected results. The commentary states that the profits have grown by a record 40% and that net assets have increased by 10%.

   Following agreed audit adjustments, we have calculated that, as the accounts stand at present, the gross profit has increased by 29% and net assets by 5.6%. Increases in overhead levels have meant that the pre-tax profit has gone up by only 16%. David stated that he had no intention of changing the Management Commentary.

   Sheila’s comment: You will need to consider what our responsibilities are in relation to this extra document – ‘Management Commentary’. Please consider this and set out what additional work we will need to perform, along with any effect it may have on our report.

APPENDIX 2 (QUESTION 8) - Subsequent events provided by David Wallaby, finance director of Domtherm

The following subsequent events have been identified:

1. A customer, Epidii Ltd ('Epidii'), owed us £52,000 at 30 September 20X3. The balance at that time was three months old and, despite knowing that the company was experiencing financial difficulties, we were confident that the debt would be recoverable and no allowance for doubtful debt was made. On 18 November 20X3 Domtherm received a letter from a firm of accountants informing us that Epidii was now in receivership. The letter is not optimistic about the chances of any payments being made.

   David's comment: I believe that a provision should be made against this balance but as the appointment of a receiver took place after the year end, any provision should be made in the new financial year and not be adjusted in the 20X3 financial statements.

   Sheila's comment: Based on this information I would consider this to be an adjusting event as there were concerns about the recoverability of the balance at the year end. This letter simply confirms that concern. Please set out the additional procedures we will need to carry out to confirm this and details of potential effect on audit opinion.

2. On 20 October 20X3, a lorry belonging to a road haulage company, was transporting boilers to industrial customers in the West Midlands, when it hit a patch of oil spilled on the motorway and overturned, destroying all four boilers.

   A dispute has arisen as to who should bear the loss and it appears very likely that Domtherm will not be able to recover anything from either the haulage company or the private motorist who caused the spillage. The boilers were included in inventories at 30 September at a value of £50,000. The selling prices of the boilers totalled £66,000.

   David's comment: As this event relates wholly to the new financial year the boilers should still be carried in the 30 September statement of financial position at full value.

   Sheila's comment: To my mind this is a non-adjusting event as there was no indication of this at the year end. However, we will still need to consider if it has any impact on the accounts and audit opinion.

QUESTION 9 (23 marks)

Chuff

You are the audit senior on the audit of Chuff (‘CC’), a company limited by guarantee and a registered charity, CC produces a Statement of Financial Activities (similar to a Profit and Loss Account) and a Balance Sheet, together with accompanying notes. You are currently planning the audit of Income for the year ended 31 December 20X1. Your audit firm makes use, where possible, of Audit Data Analytics (‘ADA’).

CC is planning to fully reopen a stretch of disused railway between Creagan and Ballachulish. A start has been made on construction and one a half miles of rail track is now open to passenger traffic. The railway receives income from passenger fares, an on-site shop and cafe, membership subscriptions, an annual lottery plus grant from the Scottish Government, donations and legacies (from deceased benefactors). Donations and membership subscriptions (but not legacies) attract gift aid from the UK Government (25% of each subscription or donation made by UK taxpayers). A small amount of investment income is also received.

CC has reasonably good IT general controls, but its financial analysis reports are not sufficient for audit purposes. Therefore, the audit team plan to utilise your firm’s ADA tools to perform analysis of the income for the purpose of assessing audit risk and carrying out audit testing.

A download from CC’s ledger for the year has been provided by CC’s director of finance and IT. The data download was cleansed and relevant data integrity checks, including a limited amount of testing of a number of underlying transactions to source documentation, were carried out by an audit assistant. A number of outputs were produced (Appendix 1).

Your audit manager has asked you to analyse the results in order to identify and evaluate any audit risks in relation to income. Your audit manager would also like you, if applicable, to describe any further evidence that may be required in order to address each risk identified.

To aid with this analysis the audit manager has provided you with extracts from relevant information discussed at the audit planning meeting with the director of finance and IT (Appendix 2). You have also been provided with a copy of the Gift Aid Claim for the final quarter of the year (Appendix 3).

Required:

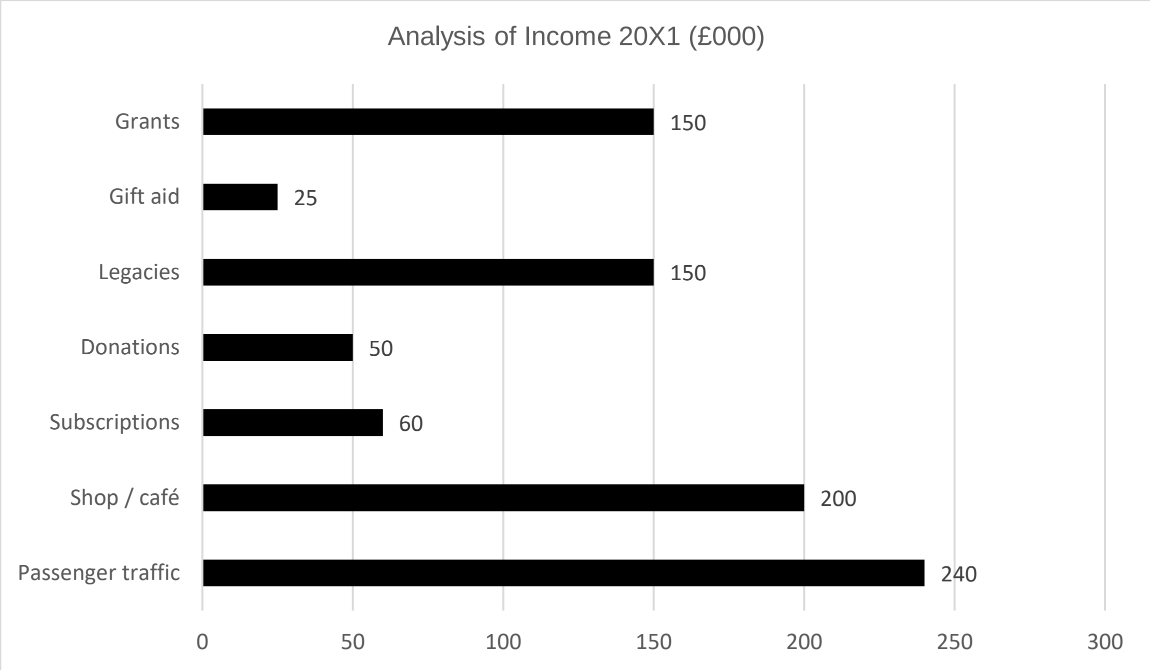
Using the information provided within Appendices 1 to 3:

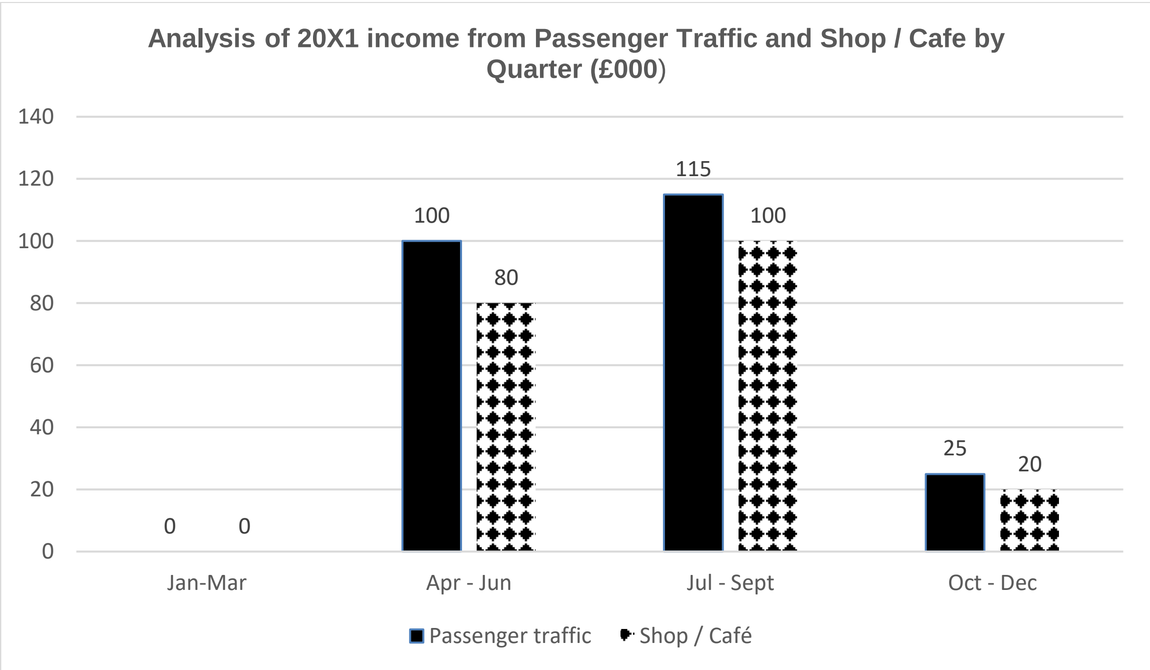
(a) analyse the results of the outputs of the audit data analytics exercise to identify and evaluate any audit risks in relation to income; and

(b) describe, where applicable, any further audit evidence that is required in order to address any identified audit risks.

(23 marks)

APPENDIX 1 (QUESTION 9) – Audit data analytics outputs produced by audit assistant

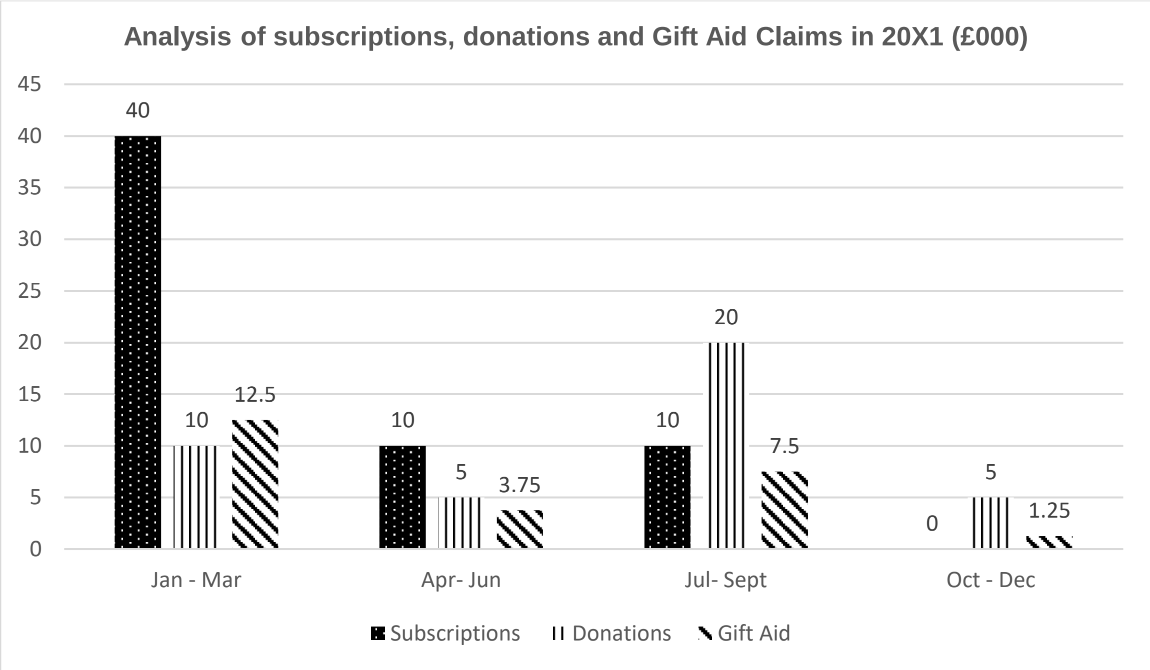




Analysis of Cost of Sales (by quarter) – Shop / Café

	Jan – Mar £000	Apr – Jun £000	Jul – Sept £000	Oct – Dec £000
Opening inventory	5	30	30	10
Purchases	25	40	30	15
Closing Inventory	(30)	(30)	(10)	(15)
Cost of Sales	0	40	50	10

APPENDIX 1 (QUESTION 9) (continued)



APPENDIX 2 (QUESTION 9) – Meeting notes - Meeting with director of finance and IT – 15 September 20X1

Passenger traffic

The railway continues to carry passengers on the stretch of line that is open. Passengers pass through a turnstile when their ticket is inspected prior to joining the train, and turnstile records show that 25,000 passengers were carried in the year at a flat fare of £10.

Shop and cafe

It is estimated that each passenger spends £8 in the shop / cafe. The shop / cafe marks up the cost of goods sold by 100%.

Membership subscriptions

Membership of CC is encouraged. Each member pays £20 year, due on 1 January. Although no discounts are offered on fares or retail facilities, members receive a quarterly newsletter and a souvenir such as an engine driver's hat or a whistle. In the previous year there were 2,000 members, and in the current year a further 1,000 members joined. A full year's membership fee is payable irrespective of the month in which new members join. No membership subscriptions are sold in the last calendar quarter of the year.

Donations

The trustees were delighted to receive a £3,000 donation from an Italian entrepreneur B Ertie who had been visiting the local area and had been impressed with CC's activities.

Gift aid

Approximately 80% of donations and membership subscriptions attract Gift Aid. Gift Aid is reclaimed at 25% of donations at the end of each calendar quarter.

Legacies

The staff and trustees were delighted to hear that, in July 20X1, following the sad death of a long-time philanthropist and railway enthusiast, Mr B Eeching, CC received a legacy of £150,000. The terms of the legacy are that the railway will receive an annual payment of £10,000 for 15 years. The first payment was received in August 20X1. This is the first legacy payment that has ever been received by CC.

Lottery

In August CC ran a lottery to raise funds with the first prize being an opportunity to ride in the driver's cab of an old fashioned steam train. 2,000 tickets were sold at a face value of £10 per ticket.

Support from the Scottish Government

During the year CC received an unconditional grant of £100,000 from the Scottish government. In addition, a loan of £50,000 was received to assist with track restoration. The loan is repayable in 20X5.

APPENDIX 3 (QUESTION 9) – Gift Aid claim submitted for October to December 20X1

Title	**Name**	**Postcode**	**House number**	**Date of donation**	**Donation amount £. p**	**Gift Aid Claimed £. p**
Mr	T Homas	IN2 6ER	77	1/10/X1	750.00	300.00
Ms	G Ordon	ED1 1AA	1	7/10/X1	1,000.00	250.00
Major	C Ontroller	G34 3DD	5	14/11/X1	250.00	62.50
Mr	B Ertie	00119 (Rome, Italy)	4A	22/12/X1	3,000.00	637.50
	TOTALS				**5,000.00**	1,250.00

Question 10 (18 marks)

Rainbow Sausages Ltd

You are the audit senior on the audit of Rainbow Sausages Ltd (‘Rainbow’), a manufacturer of premium frozen vegan sausages. This is the second year of trading.

The company has a year end of 31 March and it is now 24 January 20X1. You are considering the range of procedures required in order to audit inventory, which comprises raw materials and finished products. Work-in-progress is immaterial.

Rainbow manufactures four ranges of sausage, named after colours of the rainbow (‘Red’,’ Orange’ ‘Yellow’ and’ Green’) and has a factory just outside of Perth, Scotland. Additional natural colourings are added to the sausages in order to make them attractive to children.

Raw materials and finished products are stored in separate warehouses. The company maintains a perpetual inventory counting system with all product lines counted at least once a year and there are no plans to conduct a full count at the year end. Your firm sent an audit assistant to attend one of the counts on 31 July 20X0.

Your audit firm plans to utilise Audit Data Analytics (‘ADA’) as part of its audit approach for inventory. This will include routines over audit risk analysis as well as substantive testing. Your firm’s internal Analytics Team, who are not otherwise involved in the audit process, have extracted inventory data from the client’s records. The extracted data has been cleansed and uploaded to your audit firm’s ADA software with no issues noted. A number of outputs have been produced (Appendix) and your audit manager has also annotated some relevant notes following the planning meeting with Rainbow’s financial controller.

In order to place reliance on the inventory data for the purposes of the audit, your manager has asked you to analyse the outputs to confirm if there are any concerns over the completeness, accuracy and validity of the data gathered relating to inventory. She would also like you to describe, if applicable, any further audit evidence that may be required in order to conclude on whether reliance can be placed on the underlying data by the audit team.

Required:

(a) Analyse the results of the outputs of the audit data analytic exercise over inventory to highlight any concerns over the accuracy, validity and completeness of the underlying data related to inventory; and

(b) Describe, where applicable, any further audit evidence that is required in order to conclude on whether reliance can be placed on the underlying data by the audit team.

(18 marks)

APPENDIX (QUESTION 10) – Outputs from audit data analytics team

Inventory valuation at 31 December 20X0 (with comparatives)

	31 December 20X0	31 March 20X0
	£	£
Raw materials	8,100	8,400
Finished products	47,060	54,870
Total	55,160	63,270

Inventory days of finished products

	Apr X0	May X0	Jun X0	Jul X0	Aug X0	Sep X0	Oct X0	Nov X0	Dec X0
Red	28	29	30	29	28	27	28	29	26
Orange	35	36	37	38	389	39	44	46	55
Yellow	27	25	23	22	27	26	29	26	25
Green	25	26	23	27	27	22	11	6	(7)

Results of inventory counts during the year (finished products)

	Last count date	Quantity per perpetual inventory records	Quantity per physical count	Difference
Red	31 May 20X0	8,602	8,500	(102)
Orange	31 July 20X0	11,465	10,100	(1,365)
Yellow	30 November 20X0	4,622	4,600	(22)
Green	To be counted on 31 January 20X1			

Gross margin achieved by product (9 months to 31 December 20X0)

	Actual	Budget	Prior year
Red	80%	57%	57%
Orange	58%	60%	59%
Yellow	(18%)	4%	2%
Green	55%	52%	54%

Calculation of average manufactured cost and selling price per product

	Cost	Selling price (approximates to net realisable value)
	£	£
Red	2.00	4.70
Orange	1.80	4.50
Yellow	2.50	2.70
Green	2.30	4.80

APPENDIX (QUESTION 10) (continued)

Extract of adjusting journal entries posted to inventory account in nominal ledger

Date		**Dr** **£**	**Cr** **£**
15 June 20X0	Dr Inventory	306	
	Cr Cost of sales		306
	Being adjustment to inventory following count (Red)		
31 August 20X0	Dr Cost of sales	2,457	
	Cr Inventory		2,457
	Being adjustment to inventory following count (Orange)		
2 September 20X0	Dr Cost of sales	2,457	
	Cr Inventory		2,457
	Being adjustment to inventory following count (Orange)		
12 December 20X0	Dr Cost of sales	55	
	Cr Inventory		55
	Being adjustment to inventory following count (Yellow)		
2 January 20X1	Dr Inventory	8,000	
	Cr Cost of sales		8,000
	Being equalisation adjustment		

Notes from management

Storage

A flood in May 20X0 resulted in some damage to the freezers used to store the finished products. As a result, some products were temporarily stored offsite in rented premises in Blairgowrie.

Product recall

In December 20X0 the company had to recall 2,000 units of Red following suspected contamination of a batch of beetroot powder. The Board are confident that there was no cross-contamination of other products.

Question 11 (13 marks)

Long-Haul Haulage Ltd

You are the audit manager on the audit of the financial statements of Long-Haul Haulage Ltd ('Haulage') for the year ended 31 October 20X5. You are reviewing the results of the trade receivables circularisation so that you can design the further substantive tests your audit team will carry out at the final audit to complete the trade receivables circularisation testing.

Your audit senior has provided you with a summary of the results of the circularisation performed at 30 September 20X5, including notes of discussions with Haulage's financial controller:

Customer	Balance per trade receivables ledger	Balance per trade receivables circularisation response	Difference	Comments
A to Z Supermarkets	£55,763	£55,763	Agreed	
East Proctor District Council	£34,050	£41,233	£7,183	Balance confirmed as at 9 October 20X5
Lowland Whisky Ltd	£74,321	£43,974	£30,347	Invoice No. H23402 for £30,347 dated 28 September.
Second-hand Motors Ltd	£17,859			Reply from liquidator confirming that the company has entered liquidation.
Lowcost Shops Ltd	£49,364	No reply		
Cereal Makers Ltd	£64,791	£64,791		Agreed balance but customer refusing to pay one invoice for £20,765 as some goods damaged in transit and awaiting credit note from Haulage.
Pied Piper Ltd	£26,596	USD$35,904		The customer is invoiced in US dollars and confirmed in this currency.

Required:

Design further substantive tests to complete the trade receivables circularisation testing.

(13 marks)

Question 12 (15 marks)

Frazier Fund

It is 2 March 20X2. You work as a management consultant specialising in FCA CASS compliance, specifically client money and custody assets. You previously worked for a firm of auditors based in Edinburgh. You have recently been appointed to conduct a review of CASS management and reporting processes for the Frazier Fund ('Frazier') which is an investment fund operated by an investment company called Norton Lister plc ('NL').

Frazier is managed by staff who work in the NL head office, which is also based in Edinburgh. NL has recently been acquired by a private equity firm called Foreman Berbick LLP ('FB') which is known for its efficient management of funds via the adoption of robust internal controls and policies designed to ensure FCA CASS compliance.

You have been provided with the Key Investor Information Document ('KIID') for Frazier as well as some basic information about how the fund is administered. Extracts of the KIID are shown in the appendix. Frazier has only recently been created and is made up of three sub funds (SR64, BB67 and VP77) which are manually aggregated in order to consolidate their results for NL.

Frazier employs client account managers to manage funds on behalf of its investors. The 20X2 budget for Frazier includes funding for ten client account managers, but currently there are four positions that are vacant, although the workload for these vacant posts is being covered by staff who work in the finance team responsible for maintaining the nominal ledger.

You understand that there is currently a three-month backlog in performing internal reconciliations on some of Frazier's clients' accounts. Focus has been placed on ensuring daily external reconciliations are completed.

You have requested to see NL's policy on verifying the identities and sources of funding for new clients, but this has not been provided by management. However, you are aware of allegations of general mismanagement at NL that have appeared on social media which you have not yet been able to investigate.

Required:

Prepare information in a suitable format for inclusion in a letter to management in which you identify the weaknesses, explain the implications and recommend improvements in the CASS management and reporting processes for Frazier.

(15 marks)

APPENDIX (QUESTION 12) - Key Investor Information Document extracts for the Frazier Fund

Investment policy

We hold the CASS classification of a small firm and as such, our aim is to provide a tailored approach that recognises the individual needs of our investors. We aim to focus on income and capital growth.

Risk profile

The fund is expected to favour bonds and equities, tailored to anticipate global events and trends.

Charges

Investment management fees are charged at 1.467% of the fund's average net asset value (NAV).

Performance

The Frazier Fund comprises three sub funds: SR64, BB67 and VP77. The following table contains examples of how each of them is funded and how investors have performed over the last year:

SR64		**Average growth: 6.7%**
Client name	**Client account**	**Average NAV of holding**
Hunsaker Ltd	19602910	£61,830
Siler Ltd	19602712	£412,770
Robinson Ltd	19610702	£94,101
BB67		**Average growth: 6.4%**
Client name	**Client account**	**Average NAV of holding**
Clark Ltd	19611904	£240,907
Hunsaker Ltd	19602910	£61,830
Banks Ltd	19621002	£1,405,444
VP77		**Average growth: 6.8%**
Client name	**Client account**	**Average NAV of holding**
Cooper Ltd	19631806	£501,328
Warner Ltd	19622803	£405,125
Hunsaker Ltd	19602910	£61,830

Each sub fund is maintained on an excel spreadsheet which is manually consolidated in order to produce the overall results for fund reporting.

Key contact

Our fund manager is George Clay who joined Frazier as a creditors ledger clerk in 20X0. Before embarking on a career in financial services, George worked in retail for a famous fashion brand.

You can contact Georgia on 0131-555-3756 or email georgiaclay@frazierfund.co.uk.

Question 13 (18 marks)

Gairlochy Laggan Oich Wealth Services and Caledonian Green Investments Ltd

You work as an audit manager for Augustus LLP ('Augustus'), a firm based in the Highlands of Scotland. You are currently undertaking audit procedures for two clients, Gairlochy Laggan Oich Wealth Services ('GLOWS') which operates a number of funds and Caledonian Green Investments Ltd ('Caledonian') an investment management company based in Inverness.

GLOWS

Augustus has accepted the engagement to perform external audit services for the year ended 30 June 20X1 for a local client, Gairlochy Laggan Oich Wealth Services ('GLOWS') which operates a number of funds. This year will be the first year that Augustus has audited GLOWS.

You are planning the audit of revenue for GLOWS and have decided to perform substantive analytical procedures as part of your audit work. You are also liaising with a colleague in your firm who specialises in compliance with the requirements of the FCA CASS handbook. The draft revenue figure for the year ended 30 June 20X1 is £382,664. Tolerable error has been set at £3,500 for the purpose of the substantive analytical review.

GLOWS generates revenue as follows:

- Dividend income from its equity investments
- Interest earned on deposit accounts
- Gains from any derivatives held
- Increases in value from other funds
- Performance fees from equity investments calculated as 2% of the net asset value at year end.

Details of the assets held by GLOWS and associated market data have been supplied by the fund manager (Appendix 1).

Caledonian

Caledonian specialises in offering wealth solutions for those living in the Highlands of Scotland who wish to invest in renewable energy sources such as wind, wave and solar power.

You are starting to plan the Caledonian audit for the year ending 31 October 20X1 and are calculating overall materiality. In order to complete this work, you have been provided with relevant financial information on Caledonian (Appendix 2).

You have read an article by a famous investment analyst that suggests eco-friendly investments grew during 20X1 at an abnormal rate due to uncertainty in other parts of the economy and that the eco-friendly investment market may be artificially inflated by as much as 10%.

AS part of the planning process, a number of significant risks have been recognised in relation to accounting for derivatives, fraud risk due to management override and revenue recognition.

Required

1. Using substantive analytical procedures, analyse revenue for the year ended 30 June 20X1, analysing if it is reasonable or if any further audit work is required.

(13 marks)

2. Recommend a level for overall materiality for the audit of Caledonian.

(5 marks)

(18 marks)

APPENDIX 1 (QUESTION 13) - Information on GLOWS investments supplied by fund manager

Investment type	Details of investment
Equity investments	
EC Holdings plc	279,980 ordinary shares on average
Spean Bridge plc	400,000 ordinary shares on average
CCHR Ltd	186,430 ordinary shares on average
Canal plc	200,000 ordinary shares on average
LNM Ltd	150,500 ordinary shares on average
Kytra plc	160,000 ordinary shares on average
Invergarry plc	12,890 ordinary shares on average
Torlundy Ltd	120,000 ordinary shares on average
Nevis plc	185,000 ordinary shares on average
Other investments	
Deposit accounts	£120,000 in a deposit account with the AS Bank in Edinburgh
Derivatives	Forward contract to sell $200,000 to an investor for £1:$1.35 on 30 September 20X1
Index tracking funds	25,000 units with Heaton Global

Market data
The closing spot rate of exchange at 30 June 20X1 = £1:$1.45.

Interest rates on deposit accounts are currently fixed at 0.97% per annum.

The market price of Heaton Global's index tracking fund as at 30 June 20X1 is £7.76 per unit. No information on fees and dividend income is yet available for this fund.

Stock market data on equity investments is also available as follows:

Investment name	Market price per share at 30 June 20X1	Dividends per share issued in year
EC Holdings plc	£1.20	£0.15
Spean Bridge plc	£3.99	£0.15
CCHR Ltd	£2.11	£0.03
Canal plc	£9.09	£0.08
LNM Ltd	£5.77	£0.03
Kytra plc	£3.55	£0.03
Invergarry plc	£2.66	£0.11
Torlundy Ltd	£8.56	£0.20
Nevis plc	£6.39	£0.15

APPENDIX 2 (QUESTION 13) – Financial information for Caledonian

£'000	Year ended 31/10/20X1 (forecast)	Year ended 31/10/20X0 (actual)	Year ended 31/10/20W9 (actual)	Year ended 31/10/20W8 (actual)
Profit before tax	82	65	33	52
Operating expenses	374	348	337	321
Revenue	1,290	1,088	687	890
Total assets	14,658	11,826	12,334	13,097

Question 14 (25 marks)

Rest and Be Thankful Ltd

You are a consultant engaged by the board of directors ('the board') of Rest and Be Thankful Ltd ('Thankful') to review the design of the controls in the company's payroll system.

Thankful operates an increasingly popular and burgeoning hotel in the Lake District region of England. The hotel has expanded over the last five years from a small boutique hotel, with additional rooms and facilities added, resulting in the hotel being the 'go to' venue for weddings, dinners and conferences in the area. Consequently, the number of full and part time staff has increased. Thankful's board is conscious that the increase in employees may be putting a strain on the company's payroll processes. Therefore, they have engaged you to review the payroll system and to draft a letter identifying the weaknesses, analysing the implications and recommending improvements to the payroll system.

You visited the hotel and held a meeting with Jennifer Weeks, the company's payroll clerk, to obtain an understanding of the payroll system. Jennifer has been with Thankful for many years and is due to retire in two years' time. You also held discussions with various other employees from different departments and observed the processes in action. Following this, you have documented your observations and other relevant information concerning the company's payroll system. (Appendix)

From your discussions with management, you understand that the board is debating whether to replace Jennifer on her retirement with another payroll clerk or to outsource the calculation and administration of payroll to a specialist payroll provider. The board has identified a potential payroll service provider and is happy that they have the relevant competence and resources to undertake the work. However, in order to make a final decision they have asked that, in your letter, you recommend any specific controls that the company should put in place to ensure that the outsourced service is undertaken appropriately and in line with management's expectations.

Required:

Prepare information suitable for inclusion in a letter to the board:

1. identifying the weaknesses, analysing the implications and recommending improvements in the payroll system; and

(20 marks)

2. recommending controls the company should have in place should the payroll process be outsourced.

(5 marks)

(25 marks)

APPENDIX (QUESTION 14) - PAYROLL SYSTEM NOTES – FROM MEETING WITH JENNIFER WEEKS AND FROM OBSERVATION OF WORKING PRACTICES

General

Jennifer has been with the company for a number of years, joining the hotel from a professional payroll service organisation. Since joining Thankful, Jennifer has not completed any additional training or professional development courses and tries to keep up to date with payroll, tax and pension legislation herself through review of professional finance magazines and newspapers.

Thankful employs 20 permanent core team staff and up to 80 short-term and casual staff at any time. A large number of these short-term and casual staff work in areas such as the kitchen, housekeeping and dining room. Often the casual staff are school or college students from the local area. They are hired to cover large functions that are held on a weekly basis as the hotel has grown in popularity.

Human Resources ('HR')

All employee related matters are dealt with by Emma Daily who is Thankful's HR manager and manages the HR records for all staff. Emma is a part-time member of staff and Jennifer often acts as cover for her duties in her absence.

Starters and leavers

If new staff members are required, department heads submit a business case to Emma and recruitment is then authorised or declined by Davina Miller, Thankful's managing director. When new starters join the company, they must provide proof of identification and right to work documentation. New starters must also complete a 'new starters' form which acts as their employee record which includes key details including date of birth, National Insurance number, bank account information and emergency contacts. Formal employment contracts are then prepared and must be signed by the employee before their employment begins.

When an employee leaves, the department manager completes a termination form and sends it to Emma for review. This is checked against the employee's letter of resignation. Emma informs Jennifer of the final payment date for the employee and Jennifer records the final salary payment date.

If an employee wants to change any personal information such as bank account details, address or other relevant standing data, they will inform Emma who, in turn, advises Jennifer, usually via email or through a note left on her desk. In Emma's absence, some employees will contact Jennifer directly.

APPENDIX (QUESTION 14) (continued)

Payroll

Staff are either salaried or hourly paid and all are paid monthly. Core team members are paid a monthly salary and some are entitled to overtime at a rate of 1.5 times their regular hourly rate for additional hours they work above their contracted hours of 40 hours per week.

Short-term and casual staff are paid on an hourly basis with no set minimum number of hours of work. They receive pay at a rate of 1.5 times their regular hourly rate for any hours worked before 7am or after 9pm which are classed by the company as unsociable hours.

All short-term and casual staff are paid the relevant National Minimum Wage or National Living Wage based on their age when they initially join Thankful. If they remain employed after six months the hourly rate is re-assessed and increased.

Payroll is administered using a workings spreadsheet and an off-the-shelf payroll package, both require access through unique usernames and passwords. The spreadsheet is used to calculate the gross salary due to each employee. The payroll package is then used to calculate the relevant tax liabilities and other deductions, such as pension, for each employee and to make statutory monthly data submissions to HMRC. Both the spreadsheet and payroll package are maintained by Jennifer. The spreadsheet details the names of all employees and their agreed rate of pay together with each employee's bank details. The payroll package includes key data such as each employee's tax code in order to make sure that relevant liabilities are calculated correctly.

There is no formal procedure for staff clocking in or out and every employee enters the hours they have worked on a 'payroll sheet'. This is a pre-printed document, listing all employees by department, produced by Jennifer at the start of each month. At the start of each day, the department managers will hold a team briefing meeting with staff and use this to verify that staff are present for their shifts. There are some employees who work early mornings or through the night when there are no managers in the hotel. These employees operate on a trust basis that they have arrived for work when required.

On a weekly basis, department managers confirm that each employee within their department has completed an entry for each day they were present at work and signs the payroll sheet as evidence of hours worked. When a salaried staff member is off sick, they should notify their department manager and they should complete the payroll sheet for each sick day and sign to confirm that the employee was ill. In the event of the department manager being ill, another department manager must sign the form to confirm that they have been absent. The payroll sheets are collected from each department by Jennifer at the end of the last Monday of each month. It was noted that this includes Jennifer's own payroll sheet and, as a salaried employee, she does not receive overtime.

The payroll cut-off date is the last Monday of the month and any hours worked until this point are paid on the scheduled payment date, which is always the last Thursday of the month. This allows Jennifer three days to calculate and process payments. There is no requirement for employee wages and salaries to be paid directly into a bank account, and it was observed from a review of the process that casual staff working on functions are often paid in cash at the end of the night by the bar or restaurant manager.

APPENDIX (QUESTION 14) (continued)

Jennifer enters the hours worked by each employee from the payroll sheets into her payroll spreadsheet (regular and overtime hours for short-term/casual employees and overtime hours only for longer term employees as the remainder of their pay is salary). The spreadsheet then uses embedded formulae to calculate the amount due to the employee based on the hours and rates of pay. The total gross salary for each employee is then entered manually into the company's payroll package which calculates relevant tax, pension and other deductions. The payroll package was bought a number of years ago following changes in legislation and is capable of calculating the gross salary as well as other features like BACs run generation. However, Jennifer has never received training on this part of the system and, as a result, has continued using the spreadsheet to do her monthly gross salary calculations.

Once the net payments due to employees have been calculated by the payroll package, Jennifer submits the statutory 'Full Payment Submission' to HMRC. This is generated automatically from the payroll package. Once this has been submitted, Jennifer then runs a summary report showing the net pay for each employee and uses this to make individual transfers to each employee through online banking on the last Thursday of the month. Jennifer also processes payments due to external parties such as the company's pension provider. The exception to this is payments relating to PAYE and National Insurance ('NI') due to HMRC.

Jennifer drafts the monthly payroll journal and passes this to the accounts department for processing. The accounts department use the information from this journal to raise a payment order for PAYE and NI due to HMRC and process this payment as part of their fortnightly creditor payment run. Jennifer does not receive any notification from the accounts department to confirm that this has been paid.

Question 15 (6 marks)

Jolly Builders Limited

You are the audit manager working in a medium sized accounting firm. Your firm has been approached by Jolly Builders Limited (‘Jolly’) to see if it would be interested in undertaking a new engagement.

Jolly undertakes building work for a variety of private and public sector organisations. This includes a mixture of new developments as well as extensions and conversions of existing buildings. In 20X7 the company began construction on a new affordable housing development for a local council. As part of the development agreement Jolly was informed that it would be eligible to apply for a local government grant.

The grant terms and conditions only allow the grant funds to be applied against certain types of expenditure, which can then be reclaimed under the terms of the grant. The grant covers expenditure incurred in the 12 months ended 31 December 20X7.

Your firm has been asked if it would be willing to sign off on a regulatory return (‘return’) relating to the government grant. The return requires Jolly to disclose the total cost of the work completed together with the total cost of ‘allowed’ expenditure it wishes to claim back under the terms of the grant. The terms of the grant require a registered auditor to provide assurance that the figure related to ‘allowed ‘expenditure is correct. The different categories of expenditure per the grant terms are as follows:

Allowed categories of expenditure:

- Building supplies required for housing primary structure and roofing
- Landscaping costs for communal areas within development
- Heating and smart meter installation

Disallowed categories of expenditure

- Payroll costs
- Architects’ fees
- Electrical items (‘white goods’) provided with property, excluding electrical wiring

The financial director of Jolly met recently with your engagement partner and highlighted that there are a significant number of transactions that Jolly will be claiming under the grant. They are also keen to keep the engagement fee as low as possible. Your engagement partner has explained to the financial director that the firm needs to firstly consider whether this could be classified as an assurance engagement and can then recommend what type of engagement would be most suitable. They have therefore asked you to draft a memo explaining the key elements that would need to be considered when concluding whether this would be classified as an assurance engagement and to make a recommendation over which type of engagement would be most suitable.

Required:

Draft information suitable for inclusion in a memo to the engagement partner in which you:

(i) Explain the key elements that would have to be considered when concluding whether this could be classified as an assurance engagement; and

(ii) Recommend, with explanation, the most suitable type of engagement that the auditor could carry out for the proposed work

(6 marks)

Question 16 (40 marks)

Brandalytics Ltd

It is April 2X20 and you are the audit manager responsible for the external audit of the financial statements of Brandalytics Limited (‘Brandalytics’) for the year ending 30 June 2X20. Brandalytics has been an audit client of your firm, MoreTrust Accountants LLP (‘MoreTrust’), a large firm of chartered accountants, for several years. You are preparing information for the audit strategy memorandum, including the planning analytical review and evaluation of audit risks.

Brandalytics is a European business analytics company that provides services to a range of well-known and established retail brands and consumer goods manufacturers. Brandalytics head office is based in Surrey, England, however, there are also 10 offices throughout the UK and major European cities which allow Brandalytics to provide local services by local staff to their range of clients.

Brandalytics was founded by Michael and Janice Ackerman, who have since retired from the business, but remain the majority shareholders. Brandalytics focuses on collecting data from its retail clients about their customers, normally through loyalty card schemes, and analysing this data utilising its internally developed, proprietary technology. Brandalytics aims to assist its retail clients to build loyalty with their customers, with the aim of increasing sales and profitability and to also provide useful data for product manufacturers to assist in the development of new consumer goods. During the year, a new service line was developed which aims to provide bespoke data consultancy services to clients to help with the development and implementation of data-driven strategies and solutions.

The continuance procedures for the year ended 30 June 2X20 have been completed. Nick Purcell, Brandalytics chief financial officer (‘CFO’), has emailed your audit team management accounts for the 9 months to 31 March 2X20 which have been analysed by your firm’s audit data analytics department. The results of this analysis are at Appendix 1. Your audit partner, Shona Woods has also provided you with notes from a recent meeting she held with Nick (Appendix 2).

Shona would like you evaluate the results of the audit data analytics exercise for the purpose of the analytical review and design, where applicable, the audit approach to any audit risks arising from your analysis. She would also like you to evaluate any additional audit risks identified from the information gatherer and also design the audit approach to these additional risks.

Required:

Prepare information suitable for inclusion in the audit strategy memorandum in which you:

1. (a) Evaluate the results of the audit data analytic exercise for the purpose of the planning analytical review;

(19 marks)

   (b) Design the audit approach to any audit risks arising from your work at requirement

(6 marks)

2. (a) Evaluate any additional audit risks identified from review of the information gathered

(8 marks)

   (b) Design the audit approach to any additional audit risks identified

(7 marks)

(40 marks)

APPENDIX 1 (QUESTION 16) – Results of audit data analytics routine: planning analytics, prepared by Tessa Thompson, audit data analytics manager

A Objectives of audit data analytics routine – planning analytics

(i) Revenue stream analysis for 12 month period to 30 June 2X20 (extrapolated and budget) and 12 months ended 30 June 2X19

(ii) Cost analysis for 12 month period to 30 June 2X20 (extrapolated and budget), and 12 months ended 30 June 2X19 (Marketing and business development, depreciation and amortisation, finance costs)

(iii) Plant, property and equipment balances movement from 30 June 2X19 to 31 March 2X20

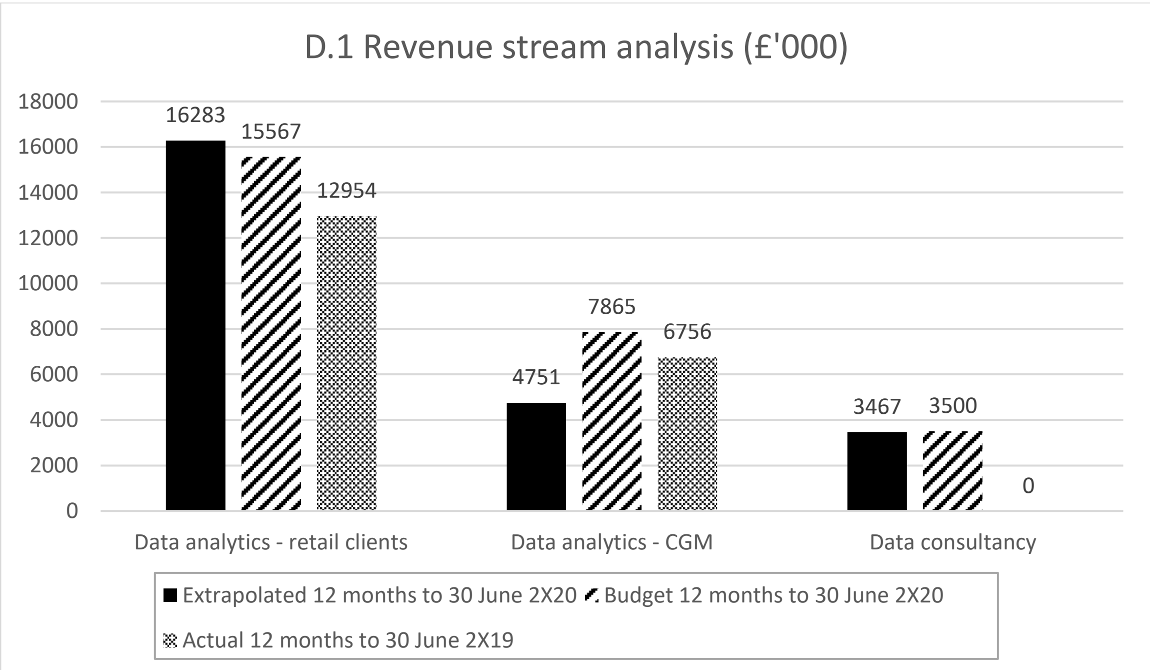
(iv) Calculate requested performance ratios for extrapolated 12 month period to 30 June 2X20, budgeted 12 months to 30 June 2X20 and 12 months ended 30 June 2X19 (gross profit margin %, trade receivables days)

B Cleansing of input data – Tessa Thompson, 15 April 2X20. No issues to report.

C Completeness and integrity check of input data - completed Tessa Thompson 15 April 2X20. No issues to report.

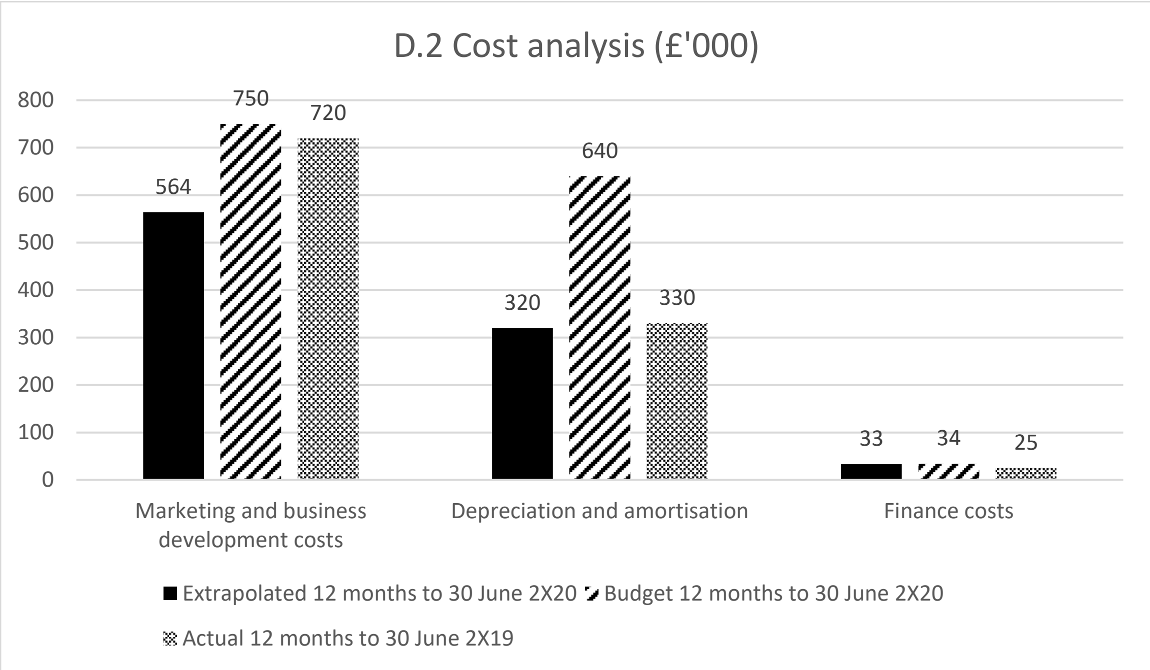
D/E Results and analysis

Output Brandalytics D.1 – Revenue stream analysis for extrapolated 12 month period to 30 June 2X20, budgeted 12 months to 30 June 2X20 and 12 months ended 30 June 2X19

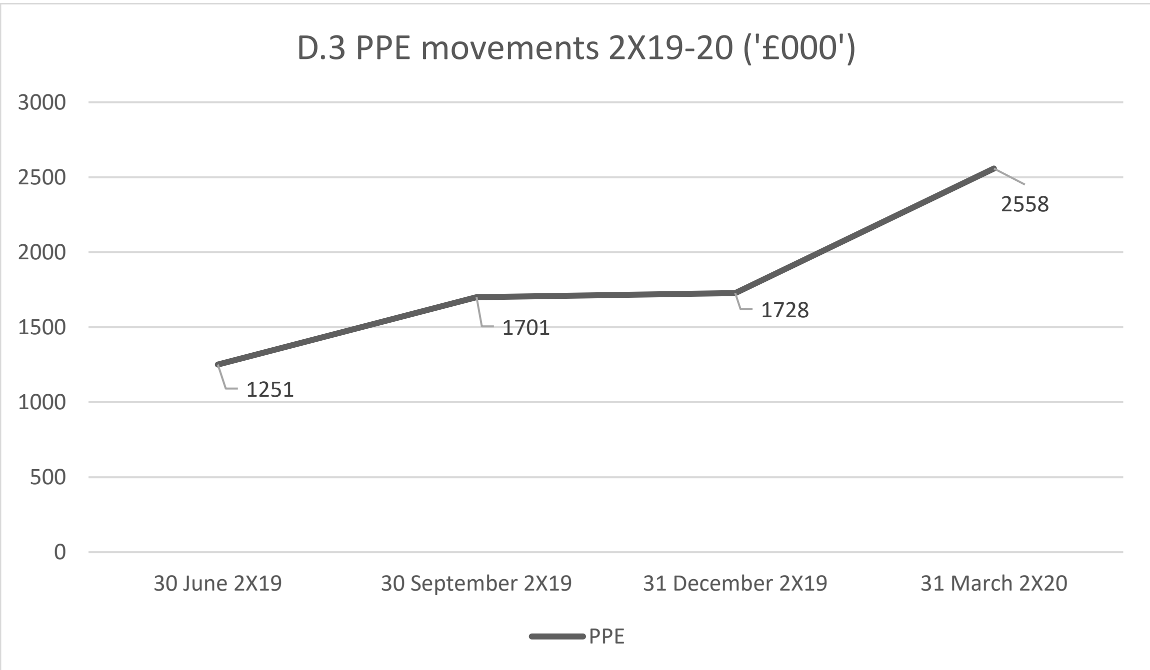


APPENDIX 1 (QUESTION 16) (continued)

Output Brandalytics D.2 Cost analysis for extrapolated 12 month period to 30 June 2X20, budgeted 12 months to 30 June 2X20 and 12 months ended 30 June 2X19

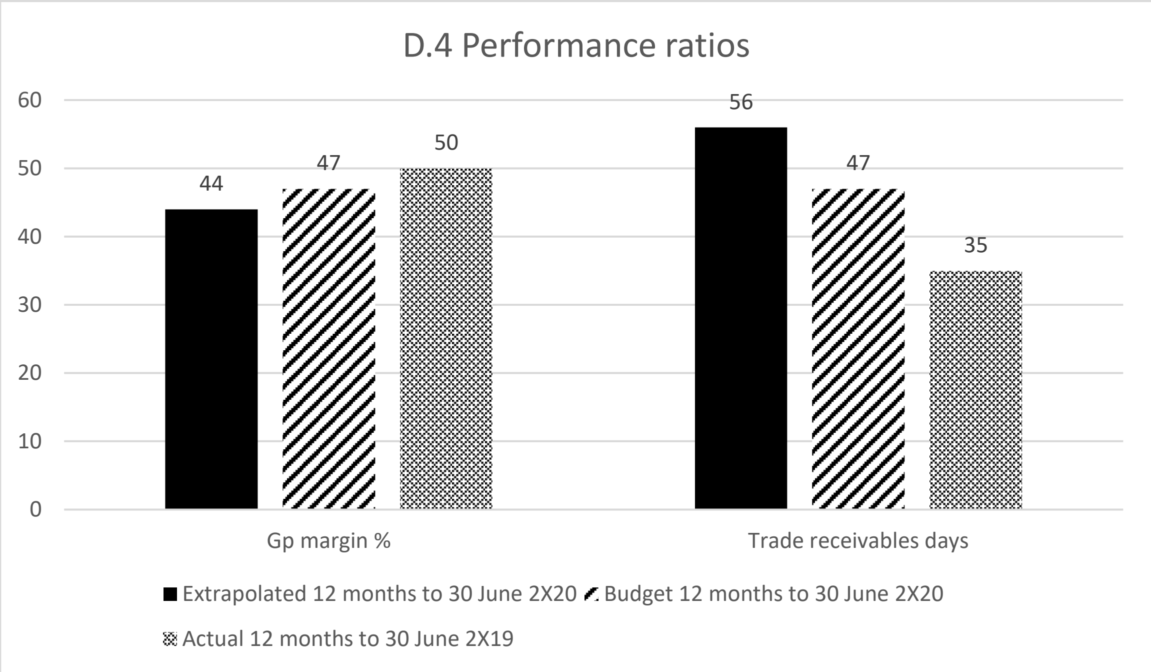


Output Brandalytics D.3 – Plant, property and equipment balances movement from 30 June 2X19 to 31 March 2X20



APPENDIX 1 (QUESTION 16) (continued)

Output Brandalytics D.4 – Performance ratios for extrapolated 12 month period to 30 June 2X20, budgeted 12 months to 30 June 2X20 and 12 months ended 30 June 2X19



APPENDIX 2 (QUESTION 16) - Notes of the meeting between Shona Woods and Nick Purcell (Brandalytics CFO)

Data analytics – retail clients

Retail client data analytics is the key source of revenue for Brandalytics. Throughout the prior and current year, the company ran a successful campaign of targeted marketing and business development relating specifically to the retail client data analytics service line. The targeted growth for this campaign was around a quarter of prior year sales and has led to several additional contracts being won during the year including a significant contract with a large UK wide supermarket. However, the gross margin has reduced by approximately 3% due to downward price pressure from new clients and annual contract renegotiations with existing clients.

Data analytics – consumer goods manufacturers (cgm)

A competitor has entered the consumer goods manufacturer (cgm) market in Scotland and they are aggressively pursuing a number of Brandalytics clients by providing similar services at significantly discounted prices.

This has led to a loss of market share and, for the first time, in February 2X20, Brandalytics undertook a redundancy consultation process in the Edinburgh and Birmingham offices. It is anticipated that, before the year end, a similar process will commence at the Exeter office. Brandalytics offers any employees affected by the redundancy process the opportunity to move to a different European office if a suitable vacancy exists, however, this offer is usually declined and, as a result, the majority of the staff concerned will receive a redundancy package in line with statutory requirements. An estimate for redundancy costs will be included in the year end accounts.

Data consultancy

The new data consultancy service line is expected to grow significantly in future years and offers the highest margin of all three service lines due to the higher billing rates achievable by consultants. Revenue from this service line is in line with expectations during 2X19-20. To expand this service line, extended credit terms have been offered to all new customers.

Cost of sales

The company records other operating costs which includes travel costs to attend client meetings. A journal error resulted in £237,000 relating to travel costs incurred to 31 March 2X20 being included within cost of sales.

Property, plant and equipment

On 1 July 2X19, further leasehold improvements of £450,000 were capitalised relating to five different office locations. Leasehold improvements have a useful life of 10 years.

On 31 March 2X20, Brandalytics engaged Valuations4U Limited, a firm of property surveyors, to undertake a revaluation of the Head Office building in line with its three-year revaluation policy of owned buildings. This resulted in an upward revaluation of £830,000.

Other additions during the year include new computer equipment and upgrades to office fixtures and fittings.

APPENDIX 2 (QUESTION 16) (continued)

An upward movement of £830,000 was recorded in plant, property and equipment at 31 March 2X20 following the revaluation of the company's head office. Nick noted that the company Valuations4U Limited was a recently formed company and had approached Brandalytics offering a discount as a new customer. They had been very happy to see such a significant increase in value at a time when property prices in the local area had been falling.

Trade receivables
For a number of years, Brandalytics provided services to a soft drink manufacturer. However, on 4 July 2X19 the board received notification that the company had gone into administration owing £270,000. Brandalytics has since received correspondence from the administrator that it should expect to receive 60% of the outstanding amount. However, no provision has yet been recognised in the management accounts.

Funding
In September 2X19, Brandalytics increased its borrowings from the Bank of Edinburgh PLC by £2,500,000 to £3,000,000. The loan is secured over the assets of Brandalytics and has a 48-month repayment term with no capital repayments being made until the end of the term.

Nick stated that the purpose of the loan was to further develop the proprietary internally developed analytics software, which is a unique differentiator of Brandalytics in the market. This was forecast to cost £2,500,000 and costs were included within 'development costs – assets under construction' until it was completed on 31 March 2X20 when the costs were moved to intangible assets and amortisation commenced. The actual cost of development was £3,500,000 with the additional £1,000,000 being funded through a shareholder loan. Nick highlighted that they had revised budgeted finance costs for the year to include interest payable on the bank loan. However, they had recently realised that this should actually have been included within the expected capital costs for the internally developed analytics software as the loan was obtained solely for this purpose.

The bank borrowings are subject to a covenant agreement, which requires that a net debt ratio of less than 0.80 is maintained. The net debt ratio is calculated as total borrowings less cash divided by the annualised operating profit. The net debt ratio at 31 March 2X20 was 0.92.

The shareholder loan was received from Michael Ackerman and is non-interest bearing. Michael has confirmed verbally that the amount will remain available for the next two years, but has not yet provided any formal guarantee.

Outsourcing of payroll

Nick also noted that, during the year, Brandalytics had performed a review of the efficiency and effectiveness of the finance department. This has led to the outsourcing of the monthly payroll processing, for all offices, in January to Prosperity Payroll, a specialist payroll bureau.

Question 17 (25 marks)

You R Fashion Ltd

You are a manager at Stevens & Hartson LLP ('S&H'), a medium-sized firm of accountants. S&H is the newly appointed advisor of You R Fashion Ltd ('YF'). Your firm has been asked to provide some advice to YF on its current sales system.

YF trades in the UK. The company imports basic garments from China to its factory in Milan, Italy, and customises these for the British market. These garments are then transported to its warehouse in Birmingham, England and sold to large department stores and smaller independent boutiques throughout the UK. YF has three sales divisions: womenswear, menswear, and childrenswear. These divisions operate autonomously and have responsibility for the entire order fulfilment process from purchasing the raw garments, to customisation, through to sales of the finished products.

The head office and other support functions of YF, including the accounts department, are based in Birmingham, England.

YF was founded in 19X0 by brothers John and Jim Watson. The company started with one store in Dundee which sold womenswear manufactured in Italy. As the company grew it was decided that the main head office functions and also the distribution warehouse would be situated in Birmingham. However, YF still has a small office in Dundee.

At a recent meeting with the client, system notes were provided (Appendix) for the company's sales system. It was highlighted that the board of directors ('the board') is concerned that with the company being dependent on production of goods in Milan and the multiple divisions coordinating their own activities, any weaknesses in current sales processes could have a severe impact on the company's operations. The board has requested that S&H undertakes a review of the sales system and drafts a letter identifying any weaknesses, explaining the implications and recommending improvements in the sales system.

Required:

Draft paragraphs suitable for inclusion in a letter to the board identifying the weaknesses in the sales system, evaluating the implications and recommending improvements.

(25 marks)

APPENDIX (QUESTION 17) - YF Sales System Process Notes

1. Sales Order

General

Each division has a sales department which is responsible for its own sales and for managing its customer relationships. Consequently, each department store has to place three orders – one each for womenswear, menswear and childrenswear each time it places an order with YF. YF does not perform formal credit checks on any new customers.

At the start of each month the head of each division sets the selling price of each item, recording it on a spreadsheet. This spreadsheet file is sent to the finance director for subsequent board approval. This file is then used to update YF's electronic trade catalogue which is used by customers. The update is performed by a member of the IT department. No review is carried out following the update. During the year there have been instances where the incorrect price has been recorded in the catalogue.

Customer orders

When a new order is received from a customer, each divisional sales team completes a sequentially numbered pro-forma sales order form on YF's Enterprise Resource Planning ('ERP') system. There are four copies of the order:

- a paper copy printed for that division's sales order pending file;
- an electronic copy sent to the customer;
- an electronic copy sent to the accounts receivable team in the accounts department; and
- an electronic copy for submission to the factory in Milan.

The system automatically flags customers who are breaching their credit limits. However, to avoid delays and maximise sales, these are habitually overridden by a sales team member and the sales order is released into the ERP system.

Submission of sales orders to factory

The system automatically collates sales orders on a weekly basis for each inventory item and, at 5:30pm on a Friday, the system automatically generates a combined total order which is emailed to the factory in Milan. The orders are picked through the night on Friday night/Saturday morning ready for shipment to the UK on Saturday around 6pm. There are four electronic copies of the internal despatch note ('IDN'):

- IDN 1 is included in the completed order file for Milan;
- IDN 2 is sent with the goods to the warehouse in Birmingham;
- IDN 3 is sent to the accounts receivable team in the accounts department in Birmingham; and
- IDN 4 is sent to the sales team for each division.

Once the garments leave Milan they typically take 60 hours to be transported to Birmingham by road via the channel ferry.

APPENDIX (QUESTION 17) (continued)

2. Order Fulfilment/ despatch

Receipts from Milan

The garments normally arrive on a container lorry in Birmingham at 6am on a Tuesday morning. These goods are checked by the warehouse staff against the IDN and receipted onto the system. Only receipts matching orders result in the sales order being fulfilled. Where excess quantities are received the garments remain in the UK and the head of the relevant division is emailed notifying them of the 'surplus inventory'. As storage space in the warehouse is minimal, the division head instructs their sales team that the garments must be sold, even at a reduced price, as soon as possible. Any garments that have not been delivered from Milan are added to the next week's order by the warehouse staff.

Despatches to customers

The warehouse staff print out the individual external picking lists that the system generates from the individual customer sales orders. All garments on a picking list are selected by one individual and stacked for dispatch. Once the garments have been picked, warehouse staff generate the pre-numbered goods despatch notes ('GDN'). There are four copies of the GDN:

- GDN1 is included in the closed/ uninvoiced order file for each division in Birmingham;
- GDN2 is printed and sent with the garments to the customer;
- GDN3 is emailed to the accounts receivable team in the accounts department; and
- GDN4 is emailed to the relevant sales team to confirm the order is fulfilled.

Once the GDN is printed, the garments are loaded onto the delivery vehicles. Customer orders are often sent out incomplete due to incorrect items being sent from Milan. YF management feels it is better to have the sales orders delivered 'on-time' rather than 'in-full'. Once the missing items are received, they are sent out to the customer in the next delivery run.

All orders must be signed for by the customer on a hand-held computer device.

The warehouse manager marks the GDNs which have only been partially filled as 'awaiting item' on the system. A weekly exception report detailing GDNs that are 'awaiting item' is automatically emailed to the accounts receivable team within the accounts department. There is no review of this report by the warehouse manager.

3. Invoicing

Once the orders have been despatched, the warehouse manager marks on the system the orders that have been 100% fulfilled. This allows the system to automatically generate an invoice. The accounts receivable team matches electronic invoices with sales orders, IDN3 and GDN3, and investigates any variances. The electronic invoice must then be reviewed by the accounts receivable manager before it is released and sent electronically to the customer.

APPENDIX (QUESTION 17) (continued)

The sales orders which have not been 100% fulfilled are included in a system-generated exception report which is automatically run on a weekly basis. The accounts receivable team matches this report against the exception report detailing GDNs that are ‘awaiting item’. If a sales order does not have all line items matched against a corresponding GDN within four weeks, a member of the accounts receivable team will manually close off the sales order and raise an invoice for the goods that have been despatched and matched with a GDN. This is then sent electronically to the customer. Any part of the order outstanding is then marked as cancelled within the ERP system.

YF’s ERP system automatically posts general ledger transactions to match the sub-ledger transactions that are posted by the accounts receivable team.

4. Payment Processing

Each customer has different payment terms, with the larger department stores having up to 120 days’ credit and smaller independent boutiques having 30 days’ credit, from the date on the invoice. Each Thursday afternoon, a member of the accounts receivable team runs a ‘Statement of Account’ for each customer listing all outstanding balances and emails it to them.

All payments are received via bank transfers, using the customer account number as the reference. YF does not have a standardised remittance form that customers must email when making their payment. As many customers do not email any details of their remittances, the accounts receivable team allocates the payments received to the oldest invoices first.

Aged trade receivable reports are sent to each division head on a monthly basis. They are responsible for chasing up old outstanding invoices and deciding whether or not to put a stop on customers accounts. Over the past 12 months, only one stop has been applied to a customer account.

Question 18 (25 marks)

Hobert Dairies Limited

You are an audit senior at Griffin & Smith, a medium sized firm of accountants based in Cardiff. Your firm recently won the audit of Hobert Dairies Ltd ('Hobert'). The audit acceptance procedures have been completed and you are planning the audit. At present you are reviewing the purchases system and considering the audit approach to trade payables for the year ending 30 September 20X6.

Hobert is a family-run dairy company based in Wales. It has supply agreements with supermarket chains in Wales, as well as local schools, hospitals and prisons. The company has two dairies of similar sizes, one in Abergavenny in the south and the other in Welshpool, in the north. The dairies take liquid milk, supplied by local farmers, pasteurise and bottle it. Hobert has agreements with farmers to take all the milk they produce. Hobert is responsible for collecting the milk from the farms, delivering the milk to the dairies, and delivering the bottled milk to its customers. Hobert's main suppliers for the milk production process are the farmers and the plastic bottle manufacturer, Polybottle UK Ltd, ('Polybottle') which provides the bottles that the milk is packaged in.

Hobert's head office ('HO') function is based in Newton, situated mid-way between the dairies, and houses the accounting, HR, IT and marketing departments.

As this is the firm's first year as Hobert's auditors, your audit team are looking at major business processes in the company. Your audit manager, Mark Maddox, believes that the company's controls over purchasing are well designed and has reviewed the notes of the purchases system you prepared (Appendix 1). Therefore, your firm plans to obtain assurance over the controls as part of the audit approach. As a result, he has asked you to design tests of controls to confirm the operating effectiveness of Hobert's purchasing system.

At her last meeting with Mark, Shona Scott, Hobert's finance director, discussed some matters with which she would like the firm's assistance (Appendix 2).

Shona highlighted that the company is reaching the implementation stage of its latest IT project which will allow self-billing by farmers. Hobert is still to determine which method to use to implement the new system and she would like a brief analysis of the different methods of systems implementation available to Hobert and a consideration of the suitability of each.

Finally, Shona explained that from November 20X6 the company is switching to a new environmentally friendly bottle supplied by Polybottle. In May, the company received a small batch of the new bottles to trial within its milk production system. However, Shona has some concerns that the system used to record the bottles received did not function correctly, failing to record the quantities delivered by Polybottle. Actions are in place to rectify this issue, but Shona is concerned that if the system fails to function correctly, then this could have a significant impact on the entire milk procurement system process next year.

A second trial batch of bottles is due to be delivered in October and Shona wishes to confirm that the total number of bottles received is being recorded correctly by Hobert's systems before the planned permanent switch of bottle types.

She recognises that this type of engagement is outwith the scope of our statutory audit so Mark agreed to provide her with an outline of the different forms of engagement that the firm could undertake together with a recommendation on the most suitable.

Required:

1. Design tests of controls that your audit team could carry out to test the operating effectiveness of Hobert's purchases system.

(14 marks)

2. Prepare information in a suitable format for inclusion in a briefing note in which you analyse the methods of system implementation available to Hobert for the new IT system commenting on the suitability of each method and present a recommendation.

(7 marks)

3. Prepare information in a suitable format for inclusion in a letter to Shona explaining the types of engagement that your firm could undertake in relation to the recording of the new bottle type by Hobert's systems, recommending the most suitable.

(4 marks)

(25 marks)

APPENDIX 1 (QUESTION 18) - System notes for purchasing

There are three areas of purchasing; milk, polybottles and other supplies.

Milk purchases

The milk procurement team is responsible for agreeing contracts with new farmers and managing contracts with existing farmers. This includes signing supply contracts, raising purchase orders and monitoring test results relating to the quality of the milk supplied by the farmer.

New or renewed contracts

When a new contract has been signed, the milk procurement team is responsible for ensuring the farmer's details are set up on the purchases system ('the system').

A paper contract is completed with the farmer's details including address, length of contract, expected quantities, the agreed purchase price per litre of milk (in pence) and the farmer's bank details. The price the farmer will receive for their milk is set for a specific period normally between 12 and 24 months. This contract is signed by the head of milk procurement and the farmer as evidence of the agreement and the original contract filed.

A copy of the contract is sent to the creditors ledger staff for creation of an account on the system. A new supplier number is created on the system and this number is only valid for the duration of the contract.

An exception report detailing any account numbers which have undefined contract durations is sent to the head of milk procurement on a monthly basis. The head of milk procurement is responsible for ensuring that such instances are resolved and the contract duration is reflected accurately in the system.

Changes to the price paid per litre of milk to the farmers are reflected in a revised contract. Renewed contracts must have their supplier number reactivated on the system for the duration of the new contract. The creditors ledger department is notified of these changes by a separate 'changes to farmers standing data' form with a copy of the revised contract attached. The system is then updated with the revised price and the new contract duration. The creditors ledger department staff sign the changes to farmers standing data form as evidence of amendment.

Collection of milk and creation of purchase order ('PO')

The logistics department is responsible for planning the milk collection runs and delivery to the dairies.

Hobert's tanker drivers collect the milk from the farms twice a day. The tanker drivers leave with the farmer a copy of the printout from their onboard collection meter detailing the date and time of the collection, the tanker registration and the quantity of milk collected. A copy of the meter reading is passed to the milk procurement team following delivery to the dairy. Depending on the size of the tanker and the size of the dairy herd at each farm, the driver may visit up to five farms before making their way back to the dairy.

On return to the dairy, the milk is pumped into the silos prior to pasteurisation and bottling. The total volume pumped into the silo is manually recorded by the dairy supervisor in the 'milk receipt log' and is agreed to the total collected from farms per the onboard collection device printout. If this does not agree, the milk procurement team is responsible for resolving any differences found.

APPENDIX 1 (QUESTION 18) (continued)

Farmers send an invoice to the milk procurement team at each dairy on a weekly basis. The procurement team reconciles the pro-forma invoices to the tanker meter totals and silo totals. Once the pro-forma invoices have been reconciled, the milk procurement team raises a sequentially numbered milk PO and emails a copy of the PO to the farmer allowing them to raise their final farmer supplier invoice. The reconciliations are reviewed and approved by the milk procurement manager for that geographical area which serves as the authorisation for the PO.

Receipt of purchase invoice

The farmer supplier invoices are received by the accounts payable department who match these to the PO prior to posting to the creditors ledger. Any invoices that do not match the PO are still entered, but flagged as unmatched on the system.

On a monthly basis, the system generates an exception report highlighting invoices that are unmatched against a PO (i.e., quantities and/or prices do not match). This is discussed and minuted at the monthly interdepartmental meeting between milk procurement and creditors ledger teams with actions noted to allow the discrepancies to be resolved and the invoice to progress through to payment.

Purchases from Polybottle

Polybottle has production units situated next door to each of Hobert’s dairies in adjoining buildings. The bottles are made in these production units and are fed into Hobert’s dairies through a ‘hole in the wall’ by means of a conveyor system.

The Hobert dairy managers and the Polybottle site managers, at each dairy, meet on a daily basis to discuss production requirements for the following day. This involves the required volumes for varying sizes of bottle, ranging from 1 to 6 litres.

The sensors on Polybottle’s side of the ‘hole’ count the bottles leaving its factory and the sensors on Hobert’s side of the ‘hole’ count the bottles it receives.

On a weekly basis the Hobert dairy managers and the Polybottle site managers, at each dairy, review the count totals and agree the bottle quantities. There are regular minor discrepancies due to bottles falling off the line between the sensors. The agreed totals are documented in the weekly bottle count total form and signed by each manager as evidence of agreement. This is used by Hobert's creditors ledger clerk to create a PO and by Polybottle to create their supplier invoice.

APPENDIX 1 (QUESTION 18) (continued)

All Other Supplies

Purchase requisition and PO

For other purchases such as bottle labels, plant and equipment, office suppliers etc, a purchase requisition can be created in the purchasing system by approved individuals in each department. A unique sequential number is created by the system and a notification is automatically sent to the relevant department head to notify them that a requisition requires approval. The department head electronically 'ticks' to approve the requisition.

Once the requisition is approved, the system creates a sequentially numbered PO. A copy of this is sent electronically to the supplier.

Receipt of goods

When the goods are received at the dairy or head office they are signed for by site personnel and recorded on the purchases system as follows:

Dr Inventory (Statement of Financial Position) or Expenses (Statement of Profit or Loss)

Cr GRNI (Statement of Financial Position)

The delivery note that accompanied the goods is sent to HO for matching with the purchase invoice.

Receipt of invoice

All non-milk and Polybottle purchase invoices are sent to HO. The creditors ledger department matches the purchase invoice to the delivery note and posts the invoices on the system. Invoices with valid POs will be entered into the system, as follows, where they are automatically matched:

Dr GRNI

Cr Trade Payables

Invoices that are received with no PO number are also logged on the system. On a weekly basis, an 'unmatched invoice' report listing all logged invoices without POs is generated and sent to every department head to discuss at their weekly interdepartmental meetings. These are then approved for the creditors ledger department to use for matching or for any further investigation to be undertaken.

Payment of all suppliers

The creditors ledger department creates a BACS payment run on a weekly basis. The BACS run listing is authorised by the finance director, Shona Scott.

All suppliers send in supplier statements, except Polybottle and the farmers. The supplier statement reconciliations are performed by the accounts payable clerks on a monthly basis and are reviewed by the accounts payable manager, Louis McGuire. The signed reconciliations are filed and held for a period of 12 months prior to being archived.

APPENDIX 2 (QUESTION 18) - Extracts of notes from meeting with Shona Scott, Finance Director, Hobert, regarding business developments

New milk procurement system to allow self-billing of milk

Hobert is consolidating its milk procurement teams from each dairy into its HO function in Newton. In order to do this, the company is automating administrative work including the reconciliation of the farmer invoices to its own information. The company has developed a new computerised milk procurement system. This is the first time that the company has undertaken such a significant system development.

The company plans to install new systems at each site which will automatically record the volume of milk received at each site and generate reports which compare the tanker volumes with the final volumes emptied into each silo, per delivery. There is a tolerable percentage variance of 1%. Variances over and above this will be investigated by the milk procurement team.

The new milk procurement system will post the following entries in the accounting system:

Dr Inventory

Cr GRNI by farmer

On a weekly basis the new milk procurement system will generate a self-billing invoice by the farmer and the following entry will be automatically posted:

Dr GRNI by farmer

Cr Accounts Payable by farmer

The farmers will no longer generate their supplier invoices as Hobert will now do this on their behalf.

The systems development life cycle model has been followed. The business analysis and feasibility study have been carried out in-house. The system analysis, design, development and testing have been carried out with the help of an external IT provider with experience in food manufacturing. Hobert's key users have now accepted the new system and the board must now decide on the most appropriate method of implementation.

Switch to new environmentally friendly Polybottles

In May 20X6 the company received a batch of new environmentally friendly bottles from Polybottle for trial. These were delivered using the existing 'hole in the wall' process. Following the daily meeting of Hobert's dairy managers and the Polybottle site managers, it was identified that Hobert's collection system had failed to record any of the new bottle types as being delivered. On investigation, it was found that there had been a malfunction with the sensors and they had not recognised the new bottle style and had not recorded these bottles in the overall count of bottles received. As a result, the dairy manager used the count figures from Polybottle to generate the quantities in the PO for these deliveries.

The sensors are due to be upgraded at the start of October 20X6. Once this is completed three separate batches of the new bottle type will be delivered over a seven-day period to allow for testing of the upgraded 'hole in the wall' collection system. If this is found to be functioning correctly, only then will Hobert receive the new bottle type from November 20X6 onwards.

Question 19 (16 marks)

Remote Vision Ltd

It is December 20X7. You are the newly appointed internal audit manager of Remote Vision Ltd. ('Remote').

Remote is a successful company which manufactures and sells security video recording and transmission systems for the transportation sector. Its portfolio includes a range of products with live video streaming capabilities over wireless and cellular networks. These solutions enable remote centralised monitoring of any site, from any location, at any time.

As part of the annual internal audit plan you are carrying out a review of the operating effectiveness of the controls within the company's sales system.

You have obtained the sales system process notes prepared by your internal audit assistant (Appendix 1) and have concluded that the controls are designed appropriately. You are now designing the tests of controls that IA will carry out to test the operating effectiveness of the sales system.

Required:

Design tests of controls that your internal audit team could carry out to test the operating effectiveness of the controls within the sales system.

(16 marks)

APPENDIX 1 (QUESTION 19) – Sales system process notes prepared by internal audit assistant

Sales orders

Sales are generated from regional sales representatives who contact potential customers in their nominated region.

All orders are on credit with standard credit terms of 60 days. The credit controller approves the opening of all credit accounts after performing a credit investigation and obtaining trade references on the potential customer. Details of the customer and credit limits are reflected in an approved customer listing within the order management system.

The sales representatives enter orders on the order management system. The sales representatives are permitted to offer discounts within approved limits, generally up to 12%, to selected customers. The system will only allow regular orders to be raised up to the customer's approved credit limit and for discounts up to 12%. If a proposed order will take a customer over their credit limit or requires a discount greater than 12% this is entered as a 'special order' in the system which is then submitted to the sales director for review who will tick an onscreen confirmation box to confirm approval.

Copies of the approved orders are then emailed to the warehouse manager, the finance team and the customer.

Delivery

Each day the warehouse manager generates pre-numbered despatch notes from the orders. The despatch notes are then passed on to warehouse staff who pick the relevant items and box them. Before the boxes are sealed the warehouse manager checks that the quantity and description of the goods boxed match the details of the despatch note. They initial each despatch note as evidence that the check has been completed.

Goods are then despatched to customers using a courier delivery service. Once delivery is completed, the courier sends electronic confirmation of the delivery to Remote.

On a weekly basis, an exception report is automatically produced which details all unfulfilled orders for deliveries that were scheduled that week. This is reviewed by the warehouse manager who notes reasons why orders are unfulfilled and undertakes any follow up actions.

Invoicing

Once delivery has been confirmed by the courier, the delivery is automatically matched to an approved order and despatch note and invoices are automatically generated. The invoice includes detail of the despatch note reference.

Invoices are generated using prices from the masterfile and approved order information in respect of discounts. Despatch notes are filed electronically with a copy of the invoice. These are filed in invoice number order, with a weekly sequence review within the accounting system performed to confirm no missing invoices. Each week an exception report is automatically generated which identifies any despatch notes which have not been invoiced. This is checked by the invoicing supervisor and initialled to evidence their review.

APPENDIX 1 (QUESTION 19) (continued)

Accounting

The sales invoices are automatically posted to the debtors ledger when raised and the daily total of sales per the debtors ledger is posted automatically to the accounts receivable account in the general ledger. This is reviewed by a supervisor daily.

Each month a debtors ledger control account reconciliation is prepared by the credit controller. This is reviewed by the finance manager who investigates any differences and signs as evidence of review.

On a monthly basis the credit controller also reviews the age-profile of all outstanding customer balances for evidence of any balances where credit terms have not been met. The credit controller then contacts customers for collection of the overdue amounts. The credit controller does not follow up any invoices until they are outstanding for 90 days.

A monthly report detailing invoices outstanding for more than 120 days is automatically generated and reviewed by the finance manager. They evidence their review and discussion with the credit controller before passing invoices to a debt collection agency for collection. Invoices outstanding for more than 120 days are provided for at 50% in the monthly management accounts.

Banking

Receipts are made by electronic banking and are recorded in the accounts and updated in the debtors ledger daily by clerks in the accounts department. Bank reconciliations are prepared monthly by the cashier and reviewed by the finance manager who evidences their review and investigates a sample of unreconciled items.

QUESTION 20 (15 marks)

Go-Go Buses Ltd

You are the audit senior of an established audit client, Go-Go Buses Ltd (‘Go-Go’), a company offering bus tours across the UK and Europe, for the year ended 31 January 2X21. You have been asked by your audit manager, Cynthia Abraham, to undertake two tasks as part of substantive testing phase of the audit. These relate to the substantive testing of property, plant and equipment (‘PPE’) and share capital and reserves.

Firstly, the audit team are planning to undertake a substantive analytical review (‘SAR’) of PPE using audit data analytic procedures. The basis for the SAR will be summary information provided by the finance manager of Go-Go (Appendix 1).

As this is the first year the firm has planned to audit PPE using SAR, Cynthia has specifically asked that you explain the matters that will have to be considered regarding the reliability of the underlying data and to design specific procedures to confirm the integrity of the data. The procedures are to cover the summary information only and not the SAR procedure itself. Equally, Cynthia does not require you to consider procedures relating to the design and operating effectiveness of any controls over recording of PPE information in the general ledger. Summary information obtained from Go-Go finance manager has been provided to you to help with this task (Appendix 1).

Secondly, Cynthia has asked you to design substantive audit procedures to audit the movements in share capital and reserve balances as at 31 January 2X21. Please note that your firm’s audit software generates standard tests and substantive analytical procedures so these are not required. She has provided you with an extract from Go-Go’s draft financial statements as at 31 January 2X21 in relation to share capital and reserves (Appendix 2).

Required:

1. Prepare information suitable for inclusion in an audit workpaper in which you:

   (a) Explain the matters that the firm will have to consider regarding the reliability of the underlying data to be used in the SAR; and

   (3 marks)

   (b) Design specific procedures to confirm the integrity of the data that the SAR will be based on.

   (6 marks)

2. Design a list of substantive audit procedures to audit the movements in share capital and reserves.

   (6 marks)

(15 marks)

APPENDIX 1 (QUESTION 20) - Summary information from the finance manager at Go-Go in relation to PPE:

	Note	**Land and buildings** *£000's*	**Buses** *£000's*
Cost as at 1 February 2X20		5,500	2,870
Additions during the period		-	578
Disposals during the period	1	(500)	(435)
Accumulated depreciation as at 1 February 2X20		(2,865)	(546)
Depreciation charge for the period		110	50
Depreciation rate		4% straight line	20% straight line
Cost of fully depreciated assets		150	730

Note:

1. Depreciation on disposed assets and any relevant gain or loss on sale is being considered separately by the audit team and does not need to be considered as part of your procedures.

   Notes from prior year audit file

   1. Depreciation is automatically calculated by Go-Go's Enterprise Resource Planning system on a monthly basis.
   2. No depreciation is charged in the month of acquisition or the month of disposal.

APPENDIX 2 (QUESTION 20) – Extract from draft financial statements

Share capital and reserves

	Ordinary share capital (£'000)	Share premium (£'000)	Revaluation surplus (£'000)	Retained earnings (£'000)
At 1 February 2X19	265	-	45	1,543
New shares issued	45	10	-	-
Dividends	-	-	-	(250)
Net profit for the period	-	-	-	313
At 31 January 2X21	**310**	**10**	**45**	**1,606**

Note:

At 31 January 2X21, ordinary share capital consisted of 310,000 ordinary shares of £1 each (at 1 February 2X20: 265,000).

ASSURANCE & DATA RETAKE MATERIAL

SOLUTIONS TO QUESTIONS 1 – 20

Question 1 – Lemon Home Appliances Limited

Requirement 1 – Evaluate impact on audit report and audit opinion

New product – stock valuation
At the year-end the company has is holding £120,000 of a new product, but no formal supply contracts have been agreed. **(½ mark)** This raises an uncertainty over the value of inventory recognised in the financial statements at 31 December as if the stock is not able to be sold, or is sold at a price below cost, the value of stock may be overstated. **(1 mark)**

It would be necessary for us to consider how this is being accounted for and disclosed in the financial statements, and whether a provision or write off is required, in order to determine our audit opinion on the financial statements. **(1 mark)**

As the value of the stock is above the level of materiality the matter is considered material. However, given its size (12% of PBT) and that the misstatement only impacts the specific balances for stock, it is unlikely to be pervasive to the financial statements as whole. **(1 mark)**

If we assess that the stock is unable to be sold, and no adjustment is made to the financial statements this is a material misstatement **(½ mark)** in the financial statements that would result in a qualified opinion. **(½ mark)**

Should the company appropriately include a provision or write off against the value of stock, or we assess that no provision or write off is required **(½ mark)**, then we would issue an unmodified audit opinion **(½ mark)**

Inventory Count – inability to obtain audit evidence
Due to circumstances relating to the timing of our appointment as auditors, our firm was unable to attend the inventory count**. (½ mark).** If we are unable to obtain the requested information to confirm rollback of the company's inventory records to 31 December 2X20 then this would constitute a limitation of scope as we would be unable to obtain sufficient appropriate audit evidence with reference to existence and completeness of inventory at the year end. **(1 mark)**

The nature of the matter is material, but also likely to be pervasive as the total inventory value of £800,000 accounts for 88% of the company's net assets of £900,000 at 31 December 2X20. **(1 mark)**

In these circumstances we would issue a modified audit report with a disclaimer of opinion. **(½ mark)**

Cash and Bank - immaterial
Due to the delayed recording of a supplier payment, cash and payables in the accounts are overstated by £4,000. **(½ mark)** The amount concerned is immaterial and therefore does not have any impact on our audit report or audit opinion. **(½ mark)**

Holiday pay – material misstatement

Holiday pay has been understated by around £102,000 and management's consultant has indicated that this liability appears accurate. **(½ mark)** If this is not provided for in the financial statements it would constitute a material misstatement. **(1 mark)** However, given its size (10% of PBT) and that the misstatement only impacts the specific balances for payroll expenses and provisions and the related tax impact, it is unlikely to be pervasive to the financial statements as whole. **(1 mark)**

In these circumstances, a modified audit report with a qualified 'except for' opinion would be issued. **(½ mark)**

Relocation loan – related party transaction

Although the amount of the loan is below materiality it would constitute a related party transaction and is likely material by nature and therefore requires disclosure in the financial statements. **(1 mark)** If this is not disclosed in the financial statements then there is a material misstatement with regard to disclosures. **(1 mark)** However this is unlikely to be pervasive to the financial statements as whole due to the value of the transaction. **(1 mark)**

In these circumstances a modified audit report with a qualified 'except for' opinion would be issued. **(½ mark)**

Total marks available (16 marks)

Restricted to (15 marks)

Question 2 – Bespoke Bolts Ltd

Requirement – analysis of assumptions for cash flow forecast and further audit evidence required.

On the cashflow projection assumptions

- Overall revenue receipts are expected to increase by 4%. **(½ mark)** This is expected to be a result of the new contract with car manufacturers which will impact revenue from March 20X5. (**½ mark)**

  Discuss business developments with management to understand the status of planned developments and obtain written evidence to support the status of each. **(½ mark)** Specifically:

  - obtain a copy of the new contract with the car manufacturers; and **(½ mark)**
  - obtain evidence to support the extension of the contract with the oil company**. (½ mark)**

- Other operating costs have increased by 4% against the prior year with no supporting explanation. **(½ mark)**

  Request that management prepare a more detailed cash flows showing a breakdown of costs included within other operating costs and enquire as to the drivers behind the increased costs. **(1 mark)**

- Payments to suppliers are 57% of forecast revenue whilst they were 60% in the year ended 31 August 20X4**. (½ mark**) There is also a decrease in payments to suppliers of 7% in Q1. **(½ mark)** This may be due to the change in supplier payment terms delaying payments into next year and having a positive impact on cashflow. **(½ mark)** However it may also indicate an understatement of costs. **(1 mark)**

  Inspect correspondence with suppliers to confirm revision of payment terms to 45 days. **(1 mark)**

- The increase in Q4 revenue of 11% (compared to Q3) appears to be high. **(½ mark)** It is expected that the new contract would result in a long-term increase in revenue of 10% so we would not expect such a steep increase in the first quarter that the contract is active. **(1 mark)**

  We should enquire of management as to the reason for the reduction and corroborate explanations provided **(½ mark)**

- There is a forecast breach of overdraft limit at 31 May 20X5 **(½ mark)**. There is a risk that the bank may withdraw the overdraft facility as a result of this breach which would raise concerns over the going concern status of the company. **(1 mark)**

  Inspect correspondence with the bank for evidence of penalties or actions applied if the overdraft limit is breached or for anything to indicate Bolts would not be granted renewal of its overdraft. **(1 mark)**

- Obtain a copy of the loan agreement to confirm loan instalment dates and that on payment in March 20X5 the loan will be settled**. (1 mark)**

- The cashflow forecasts do not currently include tax and interest. **(½ mark)** As the company is profit making there is likely to be tax payable. Furthermore, as the company is still making payments on the loan there will be interest payable. This results in cash outflows being understated. **(1 mark)**

  Request that management re-prepare cashflow forecasts including the impact of tax and interest. **(½ mark)**

- To comply with ISA 570, auditors are required to gain assurance that management's assessment of going concern has covered a period of least 12 months from the financial statements signing date. **(½ mark)** The cashflow forecasts only cover the period to 31 August 20X5 which will be less than 12 months from the date the financial statements are approved. **(½ mark)**

  Request that management extend the cash flow forecasts to 12 months from the date of signing the financial statements, not just 12 months from the statement of financial position date. **(1 mark)**

- The cash flow projections are quarterly which are not sufficient to effectively assess cashflows and overdraft breaches. **(½ mark)**

  Inspect monthly/weekly cashflows (if available) given the forecast breach in the overdraft in December. **(½ mark)**

Other procedures

- Enquire of Bolts' lawyer of any ongoing legal matters that will have a material effect on the company. **(½ mark)**
- Evaluate management's plans for future actions relating to the going concern assessment **(½ mark)** and any other additional facts of information that have become known since the initial going concern assessment **(½ mark)**
- Enquire of Robert regarding any contingency plans (i.e., alternative sources of funds) should the bank overdraft not be renewed. **(½ mark)**
- Obtain written representations from Bolt's management confirming their plans for future actions and the feasibility of these plans. **(½ mark)**
- Perform sensitivity analysis to test the effect of varying dates of revenue receipts and varying dates of payments to suppliers**. (½ mark)**
- Review quarter one actual cash flows against projected results to determine reliability of the projections. **(½ mark)**

Total marks available (21½ marks)

Restricted to (20 marks)

Question 3 - Masters Sports Shops Ltd

Requirement - Information in a suitable format for inclusion in a report identifying the weaknesses in the HR department's current processes, explaining the implications and recommending improvements

	Weakness	Implications	Recommended improvements
1	There is a lack of segregation of duties within the HR and payroll function as the HR clerks spend 50% of their time on HR tasks and 50% of their time on processing payroll. **(½ mark)**	Clerks have the ability to create fictitious employees in the HR system and in the payroll system. Any errors made are less likely to be detected, which could mean payroll fraud remains undetected. **(1 mark)**	The clerks should not split their time between payroll and HR duties. Instead one clerk should perform HR tasks and the other process payroll. **(1 mark)**
2	The three members of HR all use the same password to access the master file. **(½ mark)**	There is no audit trail indicating who makes amendments to the master file, so in the instance of any accidental or deliberate errors the source will not be able to be established. **(1 mark)**	Each employee within HR should have their own user name and password to access the master file. **(1 mark)**
3	The weekly report of new starts is not checked for accuracy by Frank or the clerks. **(½ mark)**	There may be errors in new employee data that are undetected resulting in new employees receiving incorrect pay. **(1 mark)** OR Fictitious employees may be created on the system and this goes undetected resulting in fraudulent costs to Masters. **(1 mark)**	Frank should select a sample of new starts from the report and inspect the hard copy of the employee contract to confirm that the details in the master file are correct and that the employee is genuine. **(1 mark)**
4	Frank processes the leavers forms through the master file and is automatically sent the weekly report detailing leavers. No independent check is carried out over the accuracy of the information processed. **(½ mark)**	Frank may process a leaver's form incorrectly and any errors, such as incorrect leaving date could go undetected. This could result in an incorrect final salary payment being calculated for the employee. **(1 mark)**	Leavers forms should be processed by one of clerks and Frank should review together with the final salary calculation to confirm that they have been processed correctly. **(1 mark)**

5	No evidence of amendments to employee driven changes is kept by the HR department and changes are not identified in the weekly report. **(½ mark)**	There is a risk that unauthorised amendments are made to employee data with no audit trail available to identify such amendments, such as changes to bank payment details, which could result in misappropriation of funds. **(1 mark)**	All forms relating to employee amendments should be kept and filed with the employee's contract. The 'changes to employee data report' should also include any employee driven changes and be considered by Frank as part of his review. **(1 mark)**
6	There has been a successful hacking of the HR master file data. **(½ mark)**	Masters may experience data loss, further overpayments and likely misstatements in management and statutory accounts. **(1 mark)**	Implement improved general controls over data security, such as firewalls and encryption of data. **(1 mark)**
7	There are no means by which store managers can detect when their store has been charged incorrectly for staff costs. **(½ mark)**	Significant frauds and errors may be undetected and store managers' ability to control staff costs effectively will be weakened, incurring unnecessary costs for Masters. **(1 mark)**	Staff costs should be analysed in more detail in monthly budget reports and, on a monthly basis, store managers should receive a report listing all recorded employees at that site, for them to review and highlight any differences from their knowledge of the store's staff. **(1 mark)**
8	Some overtime payments have been paid to the wrong employee. **(½ mark)**	This will result in staff complaints and demotivation and will incur unnecessary disruption and cost to resolve, particularly when seeking to recover overpayments. **(1 mark)**	The master file should be amended to include a final 'check' digit which is derived by means of an algorithm which is applied to all of the earlier digits in the staff reference number. **(1 mark)**

Total marks available (20 marks)

Restricted to (18 marks)

Question 4 – Animal Park Ltd

Requirement 1: Planning materiality

Revenue should be used as a benchmark for planning materiality as the company is a not-for-profit organisation **(1 mark)**, and an appropriate range would be between 0.5% and 2% **(½ mark)**. As such we will use extrapolated revenue based on the actual six-month results. However, due to the fluctuations in the company's performance in the first six months of the year we will use an average of expected revenue for 20X4 and last year's revenue. **(1 mark)**

	£'000	
Revenue to March 20X4	4,286	
Extrapolated for 12 months	8,572	
20X3 Revenue	9,768	
Average	9,170	**(1 mark)**
At 0.5%	£45,850	
At 2%	£183,400	**(½ mark)**

As there are no significant risks identified at Animal Park, the higher end of the range has been selected. **(1 mark)** Overall planning materiality rounded to £180,000. **(½ mark)**

Total marks available (5 ½ marks)

Restricted to (5 marks)

Requirement 2: Fraud risk factors

RGL

A significant proportion of the RGL's pay is performance-related **(½ mark).** This provides an incentive to fraudulently manipulate reported donation and fund income, which drive reward to the RGL **(1 mark).**

Gift aid

The RGL is incentivised to maximise gift-aid collection **(½ mark)** and is personally responsible for receiving and manually inputting gift aid details from donors **(½ mark)**.

The lack of segregation of duties in the processing of gift aid creates a general risk of fraud. **(½ mark)** More specifically, the RGL would have an incentive and the opportunity to create fake gift aid forms or enter gift aid details that do not match the form to maximise their remuneration. **(1 mark)**

Cash

Significant cash amounts are still dealt with at all shop and café locations. **(½ mark)** Cash banked locally is reported but these reports are monitored with no reconciliation to bank statements **(½ mark**). This presents an opportunity for staff to fail to bank all monies and misappropriate the remainder without being detected **(1 mark).**

Safe code

The safe code has a code which is thought to be short and detectable **(½ mark).** This would allow unauthorised persons to access and misappropriate Park's cash **(½ mark).**

Other cash held in safe

Monies that do not belong to Park are stored in envelopes in the safe, with no accounting records in place **(½ mark)**. There creates an opportunity to perpetrate a theft. **(½ mark)** A staff member with access to the safe could place Park's money in an envelope and, once investigations into the discrepancy had been investigated, remove the money from the envelope at a later date **(1 mark)**.

Bookkeeper

The bookkeeper is resentful that they have taken on extra responsibilities without extra pay**.** This creates a potential rationalisation for misappropriate of assets, which the bookkeeper would be in a position to perpetrate given their role. **(1 mark)**

The bookkeeper has not taken any leave since taking on additional responsibilities **(½ mark).** This is a common indicator of fraud, as it provides an opportunity to cover up fraudulent activity by keeping other staff member away from activities that might result in the detection of a fraud **(1 mark)**

Total marks available (11½ marks)

Restricted to (10 marks)

Question 5 - Top Tubs Ltd

(a) Outstanding point from audit	(b) Additional actions or evidence required
Fifteen hot tubs had been delayed in dispatch, and were sitting in the warehouse packing area, however they were not included on the inventory listing at the year-end **(½ mark)** As the goods have not yet been transferred, the sale should not yet have been recognised and revenue, cost of sales and trade receivables are overstated. (**1 mark)** Inventory is also incomplete. **(½ mark)**	Confirm post year end delivery of goods to goods despatch note and confirm date of ownership transfer by reviewing proof of delivery. **(1 mark)**
The pension payment per the payroll listing differs from the payment made to the pension provider per the bank statements due to a transposition error. **(½ mark)** The journal entry has only adjusted the bank account resulting in the pension liability being understated in the financial statements. **(1 mark)** There is also a suspense account balance that should be removed before finalising the financial statements. **(½ mark)**	Inspect correspondence from pension supplier to confirm that payment lodged is in accordance with payroll listing **(1 mark)**
An aged trade receivables balance of £81,000 has been outstanding for over 180 days and only 50% of the balance has currently been provided for despite the company entering administration. **(½ mark)** As the customer is now in administration this raises concerns over the recoverability of the balance and the remaining balance may require to be provided for in the financial statements. **(1 mark)**	Verify that customer has entered administration by confirming to administrator's correspondence or companies house **(1 mark)** Verify any correspondence from administrators on likelihood of Tubs receiving any of the balance outstanding. **(1 mark**)
One hot tub received on 31 October 20X1 was not included in the inventory listing at year end **(½ mark)** If Tubs took delivery of the items at year end then these should be recognised in the inventory listing. Inventory and the GRNI accrual are currently not complete. **(1 mark)**	Verify receipt of goods to GRN to ensure all hot tubs were received prior to year-end **(1 mark)** For a sample of goods received in early November 20X1 confirm the date of receipt and the inventory is recorded in the correct period. **(1 mark)** Confirm the value of the hot tub to the purchase order/ invoice. **(1 mark)** **(Restricted to 2 marks)**
(a) Total marks available (6 marks) **Restricted to (6 marks)**	**(b) Total marks available (6 marks)** **Restricted to (6 marks)**

Requirement 1(c)Summary of audit misstatements

Note to markers: *1 mark is available for appropriate recording of the adjustment*
½ mark awarded for overall conclusion

Turbolite Ltd **Year end: 30 September 20X2** **Summary of audit misstatements**					
Financial Statement Account		**Dr**	**Cr**	**Material**	**Adjusted**
		£	**£**		
1	SPL - Revenue	150,000		Y	N
	Trade receivables		150,000		*Note 1*
	being reversal of revenue for items not despatched				
2	Inventories	120,000		Y	Y
	SPL - COS		120,000		*Note 1*
	being reversal of COS for items not despatched				
3	Dr Suspense Account	36,000		N	N
	Cr Pension Liability		36,000		*Note 2*
	being the removal of suspense account				
4	Dr SPL – Admin Expenses	40,500		N	N
	Cr Trade Receivables/ Allowance for doutbful debt		40,500		*Note 3*
	being additional bad debt write off				
Summary and Conclusion					
Adjusted differences in SPL			30,000 Dr	Unadjusted differences are judged to be immaterial.	
Unadjusted differences in SPL			40,500 Dr		
Adjusted differences in net assets			30,000 Cr		
Unadjusted differences in net assets			40,500 Cr		

(Note to markers: Students may include different financial statement accounts. Credit should be awarded for any relevant financial statement accounts. No credit should be awarded for adjusting for the hot tub not recorded at year end as this is below the trivial threshold)

Note 1

Both adjustments are above materiality and require adjustment in the financial statements. **(1 mark)**

Note 2

The error is below materiality and does not require adjustment in the financial statements. **(½ mark)**

Note 3

The error is below materiality and does not require adjustment in the financial statements. **(½ mark)**

Total marks available (6½ marks)

Restricted to (6 marks)

Question 6 – Swipenfly Ltd

Business Objective	KPI	Relevance of KPI	Actions
Maximisation of profitability	Seat utilisation	The data for the KPI concerns seats booked in advance only, which in some cases may be over booked. Alternatively, some flights may include standby customers or customers from a previously overbooked flight. **(1 mark)**	In order to improve the relevance of the data gathered the company should use the actual number of passengers who boarded the flight and report a breakdown of those customers who have paid in full, stand by customers, or those transferred from other bookings. **(1 mark)**
Maximisation of profitability	Operating profit margin	The data gathered is relevant as it extracted directly from the accounting system on a monthly basis. **(1 mark)**	Not applicable
Maximisation of customer satisfaction	Number and nature of complaints received	The source of the data is freeform emails which may impact the ability of management to interrogate the information in a timely manner and identify key areas of concern. **(1 mark)** Additionally, the manual nature of the data extraction process leaves it exposed to a high chance of error, undermining the information captured by the KPI. **(1 mark)**	The data collection mechanism for complaints should be updated to an online form that can completed by customers and details downloaded by Swipenfly. **(1 mark)** It should also provide customers with an option for selecting the nature of their complaint before adding detail. **(1 mark)**
Optimisation of safety record	Number of staff and passenger fatalities	The data is not relevant in its current form as management do not have any specific, reliable source for gathering information on this area. **(½ mark)**	In order to improve the relevance of the data gathered the company should identify, or establish, an internal system for capturing and risk-assessing all fatality incidents. **(½ mark)**
Optimisation of safety record	Management attendance at monthly Safety Committee meetings	The data is only extracted annually and therefore, does not provide an up to date reflection of attendance and management's continued awareness of safety concerns. **(1 mark)**	In order to improve the relevance of the data the attendance at monthly safety committee meetings should be reported monthly to the board. **(1 mark)**

Total marks available (10 marks)

Restricted to (10 marks)

Question 7 - Scorpion Exploration Ltd ('Scorpion')

Requirement – Evaluation of acceptance risks

Risk	Evaluation
Experience and expertise: Industry Scorpion operates in a specialist industry, oil and gas, and during the year commenced fracking contracts. **(½ mark)**	Although we have experience of the oil and gas industry there is a risk that the firm does not have an appropriate understanding of the nature of the fracking industry, processes or legal requirements which could impact our ability to undertake the audit. **(1 mark)**
Experience and expertise: Specialist knowledge of staff in accounting matters Scorpion is forecasting continued losses which have been contributed to by the write off of development costs and asset impairments. **(½ mark)**	Due to the nature of the losses the firm may need to utilise staff with specialist knowledge / more experience of assessing going concern and impairment judgements and these staff may not be available during the audit. Additionally the firm may have to engage specialists to aid with this area. **(1 mark)**
Overseas resources The Angolan branch is significant to the results of Scorpion for the first time. **(½ mark)**	There is a risk that we do not have access to the appropriate local knowledge, experience or resources to be able to audit the branch in Angola. **(1 mark)**
Financial risk Scorpion UK has been loss making for two years and expects a write-off of development costs in the year to lead to a further loss. **(½ mark)**	Scorpion may be unable to pay our fees which would result in a financial loss to our firm. **(1 mark)**
Reputational risk – bad press Scorpion has had some bad publicity in Angola regarding small earthquakes from the fracking operations undertaken. **(½ mark)**	The firm may be exposed to reputational damage as a result of its involvement with Scorpion. **(1 mark)**
Client identification One of the directors, rarely visits the UK and is secretive regarding their personal background and other business activities. **(½ mark)**	Under Money Laundering Regulations, we must obtain evidence of the full name and address of directors and shareholders to consider the risk profile of Scorpion. If we are unable to obtain this, the firm would be prevented from fulfilling its statutory responsibilities. **(1 mark)**
Conflict of interest The firm audits one of Scorpion's non-fracking competitors. **(½ mark)**	As the firm audits one of the firm's competitors there may be a conflict of interest impacting the independence of the firm. **(1 mark)**

Firm resources Frank has asked the audit to be completed within one month of year end to allow it to bid for further commercial contracts. **(½ mark)**	This is a very short time frame and we may not have sufficient appropriately qualified staff available to undertake the engagement to the required quality level in the time available. **(1 mark)**
Reputational risk – corporate failure A number of Scorpion's competitors have failed due to difficulties in overcoming technical risks. **(½ mark)**	If Scorpion was to collapse, especially as it is consistently loss making, there may be a reputational impact through being associated with a failed company. **(1 mark)**
Previous auditors The firm is not aware of why the previous auditors will not perform the audit for the year ended 31 March 2X21. **(½ mark)**	The firm must contact the previous auditors to ensure that there are no factors which may impact the decision to accept the engagement. **(1 mark)**

Total marks available (15 marks)

Restricted to (15 marks)

Question 8 – Domtherm Ltd

Requirement - Outstanding audit points and subsequent events

Combi Boiler Problem

Evaluation of outstanding audit point

Based on the information provided by the client, the estimated liability to settle customer claims in relation to the problematic Combi boiler model is 15% of revenue or £45,000 which is material to the financial statements. **(1 mark)** As stated by Sheila, as the liability arose from work done during the year to 30 September 20X3 and is material to the financial statements this liability should be provided for in the current year. **(1 mark)**

Audit Evidence needed

In order to assess the likelihood and level of provision required we will need to evaluate the estimate provided by the directors. **(½ mark**) We should review all customer correspondence that has been received registering complaints with the company to ascertain how many boilers are affected. **(1 mark)** We should also review available records to assess the level of costs that have been incurred after the year end to rectify these faulty boilers. **(1 mark)**

Impact on audit opinion and type of report issued

If we determine that a provision should be included within the accounts, it is likely that this will be material, but it would not seem to be pervasive as its effect is limited and it is not fundamental to the financial statements. **(1 mark)** If the client is not willing to incorporate the provision we would need to issue a qualified 'except for' opinion. **(½ mark)**

Venicones Claim

Evaluation of outstanding audit point

As suggested by Sheila it is likely that a contingent liability exists at the reporting date due to the uncertainty over the outcome of the situation. **(½ mark)** It would be expected that a contingent liability as significant as this should be disclosed within the financial statements for the year ended 30 September 20X3. **(1 mark)**

Audit Evidence needed

In order to determine the details of this disclosure we should conduct further discussions with management regarding the claim, including determining if the company has insurance. **(½ mark)**

We should review recent correspondence with the company's lawyer and update our lawyer's confirmation letter, requesting details on their assessment of the status of the claim. (**1 mark)**

We should also obtain written representations from management supporting their assertion that the outcome of the case is still unknown. **(½ mark)**

Impact on audit opinion and type of report to be issued

This contingent liability represents a matter of fundamental importance as the size of the claim could have a significant impact on the going concern of the company. **(1 mark)**

If the company discloses this contingent liability in a note to the financial statements **(½ mark)** we will issue an unmodified opinion **(½ mark)** but will include detail of this matter in the 'Material Uncertainty relating to Going Concern' section of our audit report. **(½ mark)**

If the matter is not disclosed then this would be considered a pervasive matter due to the serious impact that the outcome of this case could have on going concern and the potential inability of the company to continue trading. **(1 mark)** We would issue an adverse opinion **(½ mark)**

Non repayment of loan

Evaluation of outstanding audit point

The outstanding £3,000 loan is not material to the financial statements and we would not insist on an adjustment, although it would be good practice for the company to write off the loan. **(1 mark)**

Audit Evidence needed

We should obtain evidence to support that the loan is only £3,000 by reviewing any available documentation and the bank statements. **(1 mark)**

Effect on type of audit report issued

We would issue an unmodified opinion **(½ mark)**

Management Commentary Statement

Evaluation of subsequent event

The Management Commentary is currently not consistent with the financial statements and may be regarded as misleading. **(½ mark)**

Audit Evidence needed

Under ISA (UK) 720, *The Auditor's Responsibilities Relating to Other Information*, if we as auditors identify a material inconsistency, we should first confirm that the error is not included within the audited financial statements. **(½ mark)** If we are satisfied as to the accuracy of the Statement of Profit or Loss we would ask the directors to amend the figures as they are presented in the management commentary. **(½ mark)**

Effect on opinion and type of audit report issued

If the company fails to make the amendments requested, we would include reference to this in the 'other information' section of our audit report **(½ mark**) describing the material inconsistency and drawing it to the shareholders' attention. **(½ mark)** If the auditor has no issues with the financial statements themselves, other than the material inconsistency regarding the Management commentary, then this does not give rise to a qualified opinion. **(½ mark)**

If all required adjustments are made to the financial statements, **(½ mark)** we will be able to issue an unmodified audit opinion. (**½ mark)**

Epidii balance

Evaluation of subsequent event

As stated in Sheila's comments this subsequent event is an adjusting event because it was known at the end of the financial year that Epidii was in financial difficulty and its subsequent receivership only provides further evidence of the condition that existed at the year end. **(1 mark)**

Audit Evidence needed

We should review the letter received from the liquidator to confirm the doubt over recoverability and review customer correspondence to confirm that the financial difficulties were obvious at the end of the year. **(1 mark)**

As this amount is material, we would need to ensure that the company has provided for or written off the receivable in full (£52,000) within the accounts to 30 September 20X3 as there is little chance of recovery. **(1 mark)**

Effect on opinion and type of audit report issued

If the company does not make a provision against this receivable then this would be considered a material misstatement. However, it would not be considered pervasive as its effect is limited and not fundamental to the financial statements. **(1 mark)** We would issue a qualified ‘except for’ opinion. **(½ mark)**

Loss of boilers in accident

Evaluation of subsequent event

As per Sheila’s comments as the accident took place after the year end and does not affect conditions at the year-end it constitutes a non-adjusting event. **(1 mark)**

Although the company does not need to make an adjustment to the figures, the material size of the loss may warrant a note to the financial statements explaining the position. **(1 mark)**

Effect on opinion and type of audit report issued

If this subsequent event is not disclosed with the financial statements then the disclosures are materially misstated **(½ mark**) This non-disclosure would be deemed to be material but not pervasive to the financial statements as its effect is limited and it is not fundamental to the financial statements **(1 mark)**

We would issue a qualified ‘except for’ opinion. **(½ mark)**

Requirement (a) Total marks available (16½ marks)

Restricted to (14 marks)

Requirement (b) Total marks available (12 marks)

Restricted to (11 marks)

Question 9 – Chuff Chuff

Lottery income

The meeting notes indicate that lottery income of £20,000 (2,000 x £10) was received. This is not reflected in the bar chart showing the analysis of total income. **(½ mark)** It is possible that this income has been mis-classified or not recorded resulting in income being understated. **(1 mark)**

Inspect correspondence to confirm allocation of lottery tickets to ticket holders and that the lottery draw has been completed with prize issued. **(1 mark)**

Inspect bank statements to confirm receipt of monies for issued lottery tickets. **(½ mark)**

Passenger traffic income

The turnstile records would suggest that passenger income should be £250,000 (25,000 x £10). However only £240,000 is reflected in the bar chart and income analysis. **(½ mark)** There is also no information included within the analysis for quarter 1 of the year (this is also the case for shop/ café revenue). **(½ mark)** This would suggest that passenger income is understated. **(1 mark)**

We should inspect passenger records and activity, including bank statements, for the first quarter of the year to confirm any potential unrecognised income. **(1 mark)**

Shop/ café revenue

Recognised income of £200,000 is consistent with our expectation of 25,000 passengers each spending an average of £8. **(½ mark)** However, the income from passenger traffic indicates that passenger numbers were 10,000 in quarter 2, 11,500 in quarter 3 and 2,500 in quarter 4. **(½ mark)** Based on these passenger numbers and the assumed average spend of £8 per customer, the revenue for quarter 3 would be expected to be only £92,000 which may indicate that the shop/ café revenue is overstated for quarter 3. **(1 mark)**

We should inspect passenger records and review a sample of till rolls throughout Q3 to be satisfied that quarter 3 revenue has been correctly recognised in terms of passenger numbers and customer spending. **(1 mark)**

Membership subscription income

Income recognised of £60,000 is consistent with 3,000 members each paying £20 for membership. **(½ mark)**

The pattern of subscriptions is also consistent with expectations: 2,000 members renewed on 1 January generating income of £40,000 in the first quarter **(½ mark)** and the balance of income (£20,000) in the second and third quarters as a further 1,000 members joined **(½ mark)**

Donations

The total of donations in the Gift Aid analysis (£10,000 + £5,000 + £20,000 + £5,000 = £40,000) does not agree to donations recognised in the overall (bar chart) analysis of income (£50,000). **(½ mark)** Which may indicate that donation income is overstated. **(1 mark)**

We should agree a sample of donations received to correspondence and receipt per bank statements**. (1 mark)**

Legacies

We are aware from the minutes of the meeting that CC received a legacy of £150,000, however the full income appears to have been recognised rather than the £10,000 that may be recognised for the current year. **(½ mark)** This would indicate that legacy income is overstated. **(½ mark)**

We should ensure legal correspondence in connection with Mr B Eeching’s legacy to confirm the terms of the funding made available to the charity. **(1 mark)**

Gift Aid

The totals recorded in the Gift Aid claim for the last quarter of the year agree to the totals in the bar chart showing the analysis of Gift Aid claims. **(½ mark)**

However, the minutes of the meeting suggest that only 80% of donations and membership subscriptions attract Gift Aid. **(½ mark)** If this is correct, then Gift Aid income should be in the region of £20,000 (80% x 25% x (£60k + £40k)) and may be overstated by £5,000. **(1 mark)**

Gift Aid also appears to have been claimed for a non-UK resident (Mr B Ertie of Italy). If claims are falsely made then the related Gift Aid will be repayable and income is overstated. **(1 mark)**

It is also noted that while the total gift aid claim is 25% of donations in line with expectations, the gift aid claimed on donations from T Homas and B Ertie is not in line with this calculation. **(½ mark)** This may indicate that gift aid has been incorrectly processed for these two donations and may be partially repayable. There is a risk that similar errors have been processed for other donations received and this income stream is misstated. **(1 mark)**

We should ensure that management process a journal to remove the gift aid claim for B Ertie and that this is communicated to HMRC. **(½ mark)**

We should inspect the gift aid declaration for a sample of donations in the year, including T Homas to ensure that these have been approved and the gift aid calculated correctly. **(1 mark)**

Grant income

The analysis of income shows grant income of £150,000. However, the meeting minutes state that £50,000 (of the £150,000 received from the Scottish Government) was in the form of a loan. **(½ mark)**. This is a classification error as the loan should have been recognised in non-current liabilities and grant income is overstated. **(1 mark)**

We should review grant and loan documentation to confirm the amounts and request that the loan be reallocated within the nominal ledger. **(1 mark)**

Total marks available (23½ marks)

Restricted to (23 marks)

Question 10 - Rainbow sausages

Inventory days

Inventory days of Orange in August were 389 **(½ mark)**. This is not in line with the usual trend for this product and may indicate that inventory days data is inaccurate for August. **(1 mark)**

Inventory days of Green are negative in December. **(½ mark)** This is indicative of either the stock value or cost of sales figures being negative, which indicates that this data is likely inaccurate. **(1 mark)**

Further evidence required:

- We should obtain the underlying calculations for inventory days and agree these back to the accounting system to confirm that underlying data is accurate and how a negative figure has been produced. **(1 mark)**

Results of inventory counts

It is noted that, for each of the counts conducted since the last year end, there have been shortfalls noted. **(½ mark)** This may suggest that the overall inventory on the ledger is not valid and not reflective of actual inventory held. **(½ mark)** However, all quantities counted are round sum amounts which appears unusual and may indicate that inventory quantities counted are inaccurate. **(1 mark)**

In May 20X0 some products were stored offsite following a flood. It is possible that this may account for the shortfall on Red (if counters did not visit the offsite storage in Blairgowrie). **(½ mark)**

Further evidence required:

- Stock count instructions should be obtained and reviewed, along with stock count sheets to establish whether individual items were accurately counted. **(1 mark)**
- We should compare items to the test count performed by the audit assistant to confirm that all items were round sum amounts. **(1 mark)**
- Enquire with management whether offsite stock was included in the stock count and ask for records of stock count sheets for those items. **(1 mark)**
- Enquire with management the reason for the discrepancies noted **(½ mark)**

(Restricted to 3 marks)

Gross margin data

The gross profit margin achieved on Red is 23% above both the margin in the prior year and in the budget. **(½ mark)** The increase in margin appears unusual given the recall of products in December 20X0 which would require to be written off. Therefore, this may indicate that the gross margin data for Red is inaccurate. (**1 mark)**

Further evidence required:

- We should confirm how the recalled products have been accounted for in financial statements and whether they are included in the calculation. **(1 mark)**
- The data used for the gross margin calculation should be obtained and agreed to the accounting system. **(1 mark)**

The gross profit margin reported on Yellow is 18% negative. **(½ mark)** This is inconsistent with the data on cost (£2.50) and net realisable value ('NRV') (£2.70) which would indicate that sales of Yellow should be profitable. **(½ mark)** This may indicate that gross margin data for yellow is inaccurate. **(½ mark)**

Further evidence required:

- Confirm with management whether there have been any changes in NRV of Yellow and agree these to recent sales invoices. **(1 mark)**

Journals

The journal extracted in respect of the inventory of Red is incorrect as the count at 31 May detected an overstatement of inventory, whereas the journal is increasing inventory. **(½ mark)** Furthermore the adjustment should be £204 not £306, because the shortfall is 102 units and the cost price per unit is £2. **(½ mark)** Therefore this journal entry is invalid and inaccurate. **(1 mark)**

Further evidence required:

- None required – error noted

The journal in respect of the inventory of Orange has been recorded twice. **(½ mark)** The two journals are separately dated and it is likely to be an error of the client, with the second journal being invalid. **(½ mark)**

Further evidence required:

- None required – error noted

The £8,000 'equalisation' adjustment is unexplained and may result in financial ledger data being invalid. **(½ mark)**

Further evidence required:

- Enquire of management as to the nature of the journal and agree to supporting evidence. **(1 mark)**

Total marks available (20 marks)

Restricted to (18 marks)

Question 11 – Long-Haul Haulage Ltd

Requirement – Further substantive tests to complete the trade receivables circularisation testing

Roll forward procedures (as circularisation is dated one month prior to year-end)

- Obtain a listing of sales from the trade receivables ledger and agree to invoices, GDN's and customer orders **(½ mark)**
- Select a sample of GDN's in October and agree these to the related invoice and entry in the debtors ledger **(½ mark)**
- Agree cash receipts in the bank statements to the debtors ledger **(½ mark)**
- Agree cash receipts recorded in the ledger during October and agree to the bank statements **(½ mark)**
- Scan the entries in the debtors ledger for invoices and cash receipts recorded for unusual items (large and unusual item review) and follow up **(½ mark)**
- Compare revenue per month (including post year end revenue) to the same period in prior years **(½ mark)**

Total marks	**(3 marks)**
Restricted to	**(2 marks)**

Invoice in transit (Lowland Whisky Ltd)

- Agree the provision of the service to a completed works programme raised before / on 28 September 20X5 to confirm that this is a timing difference. **(1 mark)**

Balance confirmed at different date (East Proctor District Council)

- Perform a reconciliation of the balance as at 30 September to the balance notified as at 9 October and investigate any differences. **(1 mark)**
- Inspect evidence for any reconciling items, including invoices, completed work programmes and bank receipts to corroborate movements between 30 September and 9 October. **(1 mark)**

Customer in liquidation (Second-hand Motors Ltd)

- Review the liquidator's correspondence to confirm any expected recovery of the balance. **(1 mark)**
- If recovery is unlikely, confirm that the balance has been provided for within the allowance for doubtful debts. **(1 mark)**

Non Reply (Lowcost Shops Ltd)

- Send a second confirmation request to the customer and follow with a phone call if no response then received. (**1 mark)**
- If no reply received perform alternative procedures:
  - agree post-period end receipts to bank statement and remittances**;** and
  - for any amounts outstanding agree to pre-month end invoices, completed works programme and orders. **(1 mark)**

Invoice in dispute (Cereal Makers Ltd)

- Inspect correspondence to confirm the nature of the dispute and whether this has now been resolved. **(1 mark)**
- Inspect the debtors ledger post-period end to determine if a credit note has been issued for the amount in dispute and confirm recovery of the remaining balance per the post year end bank statements. (**1 mark)**
- Confirm the amount is included in a provision for credit notes/ returns in the accounts **(½ mark)**

US dollar balance (Pied Piper Ltd):

- Agree the exchange rate used to a reliable, independent source **(1 mark)**
- Recalculate the translation from $ to Sterling using the independent rate and agree to the value stated in the debtors ledger **(1 mark)**

Total marks available (13½ marks)

Restricted to (13 marks)

Question 12 - Frazier Fund

Requirement - Information in a suitable format for inclusion in a letter to management identifying weaknesses, explaining the implications and recommending improvements in the CASS management and reporting processes

Weakness	Implication	Recommendation
The overall fund manager does not appear to have adequate experience or recent knowledge of the CASS requirements from the FCA handbook. **(½ mark)**	The fund may not comply with the CASS requirements for client money and custody assets - such a breach could lead to fines or the firm losing its Financial Services permissions and not being able to trade. **(1 mark)**	Immediate employment of a suitably qualified member of staff with suitable experience and/or qualifications **(1 mark)** OR Ensure that appropriate training and guidance is given to the fund manager. **(1 mark)**
The KIID shows that on average, fund BB67 held a sum of £1.4 million in client money for Banks Ltd but Frazier describes itself as a CASS classified small firm **(½ mark)**	The fund should have immediately informed FCA of its conversion to medium sized status**. (½ mark)** Failure to disclose this may lead to the firm losing its Financial Services permissions and not being able to trade. **(½ mark**)	The company should immediately Immediate submit a Client Money and Asset Return (CMAR) **(½ mark)** to the FCA and appoint a director/ senior manager (CF10a/SMF18) responsible for CASS. **(½ mark)**
The Frazier fund comprises three sub funds which are manually consolidated from excel spreadsheets. **(½ mark)**	This increases the risk of misstatements due to manual error and information may not be accurate for CASS reporting. **(½ mark)**	Consider combining all data into one automated financial ledger system for the overall investment fund to minimise the risk of human error. **(1 mark)**
Account number 19602910 for Hunsaker Ltd appears in all three funds with the same NAV (£61,830) **(½ mark)**	The duplication of Hunsaker Ltd may be an administrative oversight but could also indicate the risk of misstatement of the overall fund values. **(1 mark)**	A reconciliation should be performed for all three funds to confirm the allocation of Hunsaker Ltd monies and that these are correctly recorded. **(1 mark)**
Currently there are four vacancies for client account managers meaning that accounts staff have been temporarily acting in these positions until the vacancies are filled. **(½ mark)**	This may give rise to a lack of segregation of duties between client account custody and preparation of financial information providing an opportunity for fraud or increased risk of error. **(1 mark)**	Accounts staff should be removed from performing work in relation to client account custody and management. Additional client account staff should be recruited to cover any shortfalls. **(1 mark)**

Weakness	Implication	Recommendation
The shortfall in staffing has led to a three-month backlog in internal reconciliations for some clients' accounts. **(½ mark)**	Both internal and external reconciliations are required to be completed on daily basis. **(½ mark)** The lack of reconciliations. could lead to increased risk of fraud and/or error that may go undetected if not investigated promptly. **(½ mark)**	Frazier should ensure that they are completing both internal and external client account reconciliations on a daily basis. **(1 mark)**
No policy has been provided on how new clients are screened for identification or proof of ownership of funds. **(½ mark)**	Failure to perform appropriate checks could result in a breach of the CAAS rules and could lead to potential risks around money laundering. **(1 mark)**	Appropriate identification checks should be completed on all new clients in line with the CASS rules and Money Laundering regulations. **(½ mark)** Appropriate evidence should also be obtained to confirm ownership and source of funds invested. **(½ mark)**

Total marks available (17 marks)

Restricted to (15 marks)

Question 13 - Gairlochy Laggan Oich Wealth Services and Caledonian Green Investments Ltd

Requirement 1(a): Substantive analytical review

The approach that should be used for our analysis is as follows:

1. Form an expectation
2. Compare expectation to actual
3. Investigation required (yes or no)
4. Conclusion

1. Form an Expectation

	average number of shares held	price per share at 30 June 20X1	dividends per share issued in year	**net asset value**	fees earned (2%)	dividend income	other income	**total income**
EC Holdings plc	279,980	£1.20	£0.15	**£335,976**	£6,720	£41,997		**£48,717**
Spean Bridge plc	400,000	£3.99	£0.15	**£1,596,000**	£31,920	£60,000		**£91,920**
CCHR Ltd	186,430	£2.11	£0.03	**£393,367**	£7,867	£5,593		**£13,460**
Canal plc	200,000	£9.09	£0.08	**£1,818,000**	£36,360	£16,000		**£52,360**
LNM Ltd	150,500	£5.77	£0.03	**£868,385**	£17,368	£4,515		**£21,883**
Kytra plc	160,000	£3.55	£0.03	**£568,000**	£11,360	£4,800		**£16,160**
Invergarry plc	12,890	£2.66	£0.11	**£34,287**	£686	£1,418		**£2,104**
Torlundy Ltd	120,000	£8.56	£0.20	**£1,027,200**	£20,544	£24,000		**£44,544**
Nevis plc	185,000	£6.39	£0.15	**£1,182,150**	£23,643	£27,750		**£51,393**
Deposit a/c in AS Bank @ 0.97% pa				**£120,000**			£1,164	**£1,164**
Derivative also arranged with AS Bank								
	Contract	Closing	Gain					
	£148,148	£137,931	£10,217	**£137,931**			£10,217	**£10,217**
						TOTAL		**£353,923**

Marking scheme for calculations:

- ½ mark per calculation of fees per shareholding **(4½ marks)**
- ½ mark per calculation of dividend income per shareholding **(4½ marks)**
- Deposit account other income **(½ mark)**
- Calculation derivative **(1 mark)**
- Overall total **(½ mark)**

Restricted to (10 marks)

2. Compare expectation to actual

From performing substantive analytical procedures, the amount of revenue that GLOWS should be recognising for the year ended 30 June 20X1 is £353,921 which indicates that the amount supplied by the fund manager is overstated by £28,743 (8.1%) **(½ mark)**. This is above our tolerable error and requires further investigation. **(½ mark)**

3. Investigation

As part of the expectation of revenue, there is no income recognised for the index tracking fund **(½ mark)**. This data has not yet been made available and requires to be factored into our calculation. **(½ mark).** It is possible that the fund manager may simply have forgotten to supply this data **(½ mark)**. This is compounded by the fact that the fund manager appears to be experiencing some difficulties in producing the financial information required for the audit **(½ mark)**.

4. **Conclusion**
Based on investigations, the current charge does not appear reasonable. Further substantive audit work will be required before a conclusion can be reached. **(½ mark)**

Total marks available (13½ marks)

Restricted to (13 marks)

Requirement 2 - Materiality

For an investment management company, the profit earned by the business is likely to be of less interest to investors than the ability to maintain value, hence some measure of assets may be a good benchmark **(1 mark)**. Planning materiality should therefore be based on total assets. **(½ mark)**

Materiality based on total assets would be calculated within the range of 0.5 to 2% **(½ mark)**

As there have been fluctuations over the last four years an average of total assets may be suitable. **(½ mark)** This also considers that the forecast figures for 31/10/20X1 may include an artificial inflation. **(½ mark)**

The average asset values are calculated as follows:

£'000	Year ended 31/10/20X1 (forecast)	Year ended 31/10/20X0 (actual)	Year ended 31/10/20W9 (actual)	Year ended 31/10/20W8 (actual)	Average
Total assets	14,658,000	11,826,000	12,334,000	13,097,000	12,978,750 **(½ mark)**

The range for materiality will therefore be between 64,893 and £259,575. **(½ mark)**

Due to the number of significant audit risks identified as part of planning the audit, the lower end of the range should be selected for materiality**.** Overall materiality is therefore set at £70,000. **(1 mark)**.

Total marks available (5 marks)

Question 14 - Rest and Be Thankful Ltd

Requirement 1 – Paragraphs for inclusion in a letter to the board identifying the weaknesses, analysing the implications and recommending improvements in the payroll system.

	Weakness	Implications	Recommended improvements
1	Jennifer Weeks (payroll clerk) has not kept up to date with any training around payroll calculation and may not be familiar with current payroll, pension and tax requirements. **(½ mark)**	Payroll calculations may be inaccurate resulting in incorrect payments to employees and incorrect recording of payroll costs by the company. There is also a risk of financial loss to the company from fines or additional employer liability payments. **(1 mark)**	Jennifer Weeks or any new payroll clerks should receive up to date training on all payroll requirements at least annually. **(1 mark)**
2	There is no formal process for employees to make changes to standing payroll data as this is carried out on an informal basis by email or notes sent via HR or directly to the payroll clerk. **(½ mark)**	Changes to employee details may not be recorded resulting in inaccurate payments being made due to changes to pay rates not being adequately identified or payments may be made to incorrect bank accounts resulting in loss to the company. **(1 mark)** OR Amendments, such as changes in bank details, or to employee details may be made that are not genuine resulting in misappropriation of company funds. **(1 mark)**	Changes to standing payroll data should only be made based on a pre-approved form signed by the employee and their line manager. In addition, a report of standing data changes should be produced each month and reviewed and signed off by management. **(1 mark)**
3	The hotel employs many school children and casual staff of a young age at National Minimum Wage which is not reviewed for periods of at least 6 months in which time they may have moved age bracket. **(½ mark)**	The company may be in breach of National Minimum Wage legislation resulting in the risk of financial penalties being imposed. **(1 mark)**	All hourly paid staff should have their rates of pay reviewed on a monthly basis to ensure they are being paid the correct National Minimum Wage for their age. **(1 mark)**

4	It is common practice for casual waiting staff employed to cover large functions such as weddings to be paid in cash at the end of a shift. **(½ mark)**	There is a risk of misappropriation of company funds if this cash is lost or stolen prior to the end of the shift. There is also a risk that payroll transactions are not accurately recorded in the company's financial ledgers due to a potential lack of audit trail. **(1 mark)**	All employees should receive payment to their bank account through the company's monthly payroll run. **(1 mark)**
5	There is no method to independently verify the number of actual hours worked by employees due to the self-recording of hours by the employees. This is particularly an issue for certain employees who work early mornings or late nights, as there is no management presence during these hours. **(½ mark)**	Employees may be being paid for work not performed resulting in financial loss to the company. **(1 mark)**	All payroll sheets should be reviewed by the department manager and signed to authorise the time recorded. **(1 mark)** OR Consideration should be given to introducing a time recording system such as clocking-in machines to validate the recording of hours worked by employees. **(1 mark)**
6	The payroll clerk manually calculates the gross salary for each employee using a spreadsheet with embedded formulae and standing data. However, there is no procedure in place for checking the accuracy of the formulae or that changes to details such as salaries are processed correctly. **(½ mark)**	There is a risk that formulae and standing data are not updated in line with changes to employee details resulting in inaccurate payroll calculations being produced. **(1 mark)**	The standing data and formulae should be subject to periodic review by a designated responsible person to ensure that the information and formulae being used are correct. **(1 mark)** OR The company should utilise the payroll package fully to calculate all aspects of the monthly payroll run. **(1 mark)**
7	Jennifer has sole control for the calculation and payment of payroll, including her own salary, and also provides cover for the HR manager when absent. **(½ mark)**	Payroll transactions may be manipulated or Jennifer may make errors that remain undetected, leading to company funds being lost. **(1 mark)**	Jennifer should not provide cover for the HR manager and the company should ensure that another responsible person is available in the event that HR cover is required. **(1 mark)**

8	All employees are paid monthly through individual online transfers and no review of the reasonableness of payroll payments is carried out as part of the monthly process prior to payments being made. **(½ mark)**	Any errors in payments to employees may not be identified resulting in over or underpayments to employees. **(1 mark)**	The company should make use of the BACs run feature within the payroll package which will ensure that the payment run is consistent with the net pay calculated by the system. **(1 mark)**
9	Payment of PAYE and NI is processed by the company's accounts department with no confirmation received by Jennifer that this has been submitted. **(½ mark)**	There is a risk that the accounts department fails to make payment in line with statutory deadlines which could leave Thankful open to penalties and interest. **(1 mark)**	Payment of PAYE and NI to HMRC should be made by the payroll department when processing payments to employees and other external parties to ensure that it is processed in a timely manner. **(1 mark)**

Total marks available (22½ marks)

Restricted to (20 marks)

Requirement 2 – Explain the controls the company should have in place should the payroll be outsourced.

(Note to markers: The solutions below are in more detail than is expected of candidates. Up to 1 mark to be awarded for each relevant control that would be suitable for Thankful to put in place to confirm that the work carried out by the service provider has been completed correctly and in line with Thankful's expectations.)

Should outsourcing be the board's preferred direction, there are a number of controls that require to be in place within Thankful to ensure this is a successful decision and achieves the required objectives for the company.

- *Define a clear scope for the service* – Terms of Reference or a Service Level Agreement should be agreed with the service organisation prior to the start of the contract to ensure that the correct information is submitted at the correct time. This should specify the service to be provided, start and end dates, scope of work, deliverables (by Thankful and by the service organisation), timetable, costs, dispute procedure, cancellation procedure and details of the system to be used and any requirements for the hotel. **(1 mark)**

- *Authorisation of data prior to submission* – There should be an agreed process whereby the data required by the service organisation is reviewed by a pre-determined named contact in Thankful and approved by management prior to submission. The service organisation will then only accept information if it has been sent by a named/agreed contact, has evidence of management authorisation and is in the correct format. **(1 mark)**

- *Check of data from service organisation prior to payment being made* – A comparison should be performed between the data submitted to the service organisation with reports received from the service organisation after the data has been processed. This should include recomputing a sample of payroll amounts for accuracy and reviewing total payroll for reasonableness. **(1 mark)**

- *Monthly analytical review of payroll costs* – Work should be undertaken each month to identify trends in payroll costs and understand variances from expectation/prior months. This should be completed on receipt of reports from the payroll provider and prior to payments being made to employees to ensure any errors/anomalies are identified and explained. **(1 mark)**

- *Understanding of controls in operation at service organisation* – Obtain a copy of the report on the adequacy of the controls at the service organisation carried out by independent auditors. This will provide comfort that the systems are operating correctly in the service organisation and that the processes are in line with HMRC statutory requirements. **(1 mark)**

  OR

  Obtain a report produced by management of the service organisation which describes the internal controls with a report from their auditors giving an opinion on the description and suitability of the design of the controls. **(1 mark)**

- *Visits to service provider* – Management from Thankful should make regular visits to the service organisation to understand controls and obtain assurance over operation of controls. Copies of minutes of meetings should be retained and action points followed up between visits. **(1 mark)**

Total marks available (6 marks)

Restricted to (5 marks)

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Question 15 - Jolly Builders Ltd

Requirement – Explain key elements that would have to be considered when concluding whether this could be classified as an assurance engagement and recommend, with explanation, the most suitable type of engagement that the auditor could carry out for the proposed work

Elements

An engagement is an assurance engagement when it has each of the following elements:

A three party relationship involving a practitioner, a responsible party and an intended user is required. **(½ mark)** Here the practitioner is our firm, the responsible party is Jolly and the intended user is the grant awarding body. **(½ mark)**

Appropriate underlying subject matter is required either at a point in time or covering a period of time. **(½ mark)** In this case the subject matter is the expenditure incurred by Jolly over the 12 months to 31 December 20X7. **(½ mark)**

Suitable criteria or benchmarks are required to evaluate or measure the subject matter. **(½ mark)** In this case the expenditure incurred is being evaluated against the terms of the government grant. **(½ mark)**

Sufficient, appropriate evidence is required to be gathered by the practitioner in order to properly evaluate the subject matter against suitable criteria. **(½ mark)** In this case be expected to:

- review the nature of the expenditure with reference to the terms of the government grant; **(½ mark)**
- review support for the expenditure, e.g., invoices; and **(½ mark)**
- review the date the expenditure was incurred (i.e., pre 31 December 20X7). **(½ mark)**

The assurance engagement should have an *assurance report* **(½ mark)**, that is a conclusion provides a level of assurance to whether the subject matter conforms in all material respects with the identified suitable criteria. **(½ mark)**

Recommendation

Here, as the assurance practitioner has to verify each item of expenditure against set criteria, there is sufficient level of assurance given to conclude that this would be classified as an assurance engagement. **(½ mark)**

The most suitable option would be a limited assurance engagement. **(½ mark)** This would involve reporting a negative opinion over the appropriateness of the expenditure recorded on the return. **(½ mark)** This would involve a lower level of assurance, but would result in a lower cost for the engagement in line with the client's expectations. **(½ mark)**

Total marks available (8 marks)

Restricted to (6 marks)

Question 16 - Brandalytics Ltd

Requirements 1 (a) planning analytical review and 1 (b) audit approach

	(a) Planning analytical review	(b) Audit approach (1 mark)
1	*Revenue* Revenue from retail clients has increased 26% on prior year and is ahead of budget by 5%. This is in line with marketing targets and expected to be due to the new contracts won during the year as a result of the successful marketing and business development campaign. **(1 mark)** Revenue from data analytics provided to consumer goods manufacturers has decreased 30% on prior year and is also behind budget by 40%. This is likely due to the reduction in market share as a result of the increased competition from a new competitor entering the market in Scotland. **(1 mark)** Part of the reduction will also likely be a result of one of its customers entering administration in 2X19. **(½ mark)** Data consultancy is a new service line which when extrapolated is £3,467k and is in line with the budget and expectations. **(½ mark)**	N/A
2	*Gross profit margin* Gross profit margin at Brandalytics is 44% and this is behind both budget and prior year (budget 47%, prior year 50%). This fall in gross margin could be attributable to the fall in gross margin in the retail client data analytics service line, which is down 3% as a result of pricing to win additional contracts with new customers along with the impact of incorrectly classified travel costs. **(1 mark)** However, it would have been expected that these reductions would have been offset by the increase in the data consultancy service line which earns higher margins. **(1 mark)**	Obtain an understanding of the controls used to correctly classify expenses within the financial statements and perform tests of control to confirm their operating effectiveness. Obtain breakdowns of cost of sales and other operating costs and review for any unusual items or costs allocated in error.

	In the period, travel costs of £237,000 for client meetings have been included in error in cost of sales, rather than other operating costs. **(1 mark)** This indicates a misclassification between cost of sales and other operating costs and, given the fall in gross profit margin, there may be further costs misclassified. **(1 mark)**	
3.	*Marketing and business development costs* Marketing and business development costs are behind prior year and behind budget. The decrease appears unusual as Brandalytics has been focusing upon marketing activities on the data analytics for retail clients service line and has undertaken a successful campaign. **(1 mark)** Therefore, there is a risk that these costs may be understated. **(1 mark)**	Obtain a breakdown of the marketing and business development costs and discuss with management the costs of the campaign undertaken. Compare the costs included in the breakdown to breakdowns from the prior year and budget to identify any costs which may be omitted or wrongly classified.
4.	*Depreciation and amortisation* There has been a decrease from prior year of 3% and a decrease of 50% from budget. At the start of the year, £450,000 of leasehold improvements were capitalised. As a result, additional extrapolated depreciation should have been charged at £45,000 and the reduction appears unusual. **(1 mark)** The budget may recognise expected amortisation on the new internally developed analytics software which is amortised from 1 April 2X20, **(½ mark)** but there is a risk that depreciation and amortisation may be understated. **(1 mark)**	Obtain detailed non-current asset and intangible asset listings to ensure that there have been no significant disposals in the period or any other transactions which would impact on the depreciation and amortisation charge. Recalculate the depreciation and amortisation charge based on the cost and useful lives of each of the assets.
5.	*Finance costs* Finance costs are ahead of the prior year and in line with budget. This appears unusual as although the additional borrowings of £0.5m relate to loans obtained to fund the further development of internally developed software. **(1 mark)** This interest should have been charged to ‘development costs – assets under construction’ and included within the costs capitalised on 31 March 2X20. **(1 mark)** Management had included the	Obtain the loan agreement and copies of bank statements to show the finance charge payable and the terms of payment. Recalculate the finance charge payable based on the source documents ensuring it is in line with actual costs recorded and that this has been included in capitalised costs of the new analytics software capitalised on 31 March.

	finance costs within the budget figures, but had identified this as incorrect. **(½ mark)** However, the actual figures may still recognise interest on the loan and there is a risk that finance costs are misclassified. **(1 mark)**	
6.	*Plant, property and equipment ('PPE')* PPE has more than doubled during the year. This is expected to be a result of the leasehold improvements capitalised during the year of £450,000, the upward revaluation of the HQ building of £830,000 and other minor additions to PPE. **(1 mark)** However, the valuation increase appears unusual given the falling property prices in the local area. **(1 mark)** There is a risk that the client specialist is not appropriately qualified to conduct the valuation or that the valuation is incorrect leading to an overstatement of the PPE. **(1 mark)**	Obtain confirmation from the external valuer of their independence, qualifications and competence. Obtain an understanding of the source of information used in the property valuation and determine whether this is reasonable and the outputs suitable for reliance as audit evidence. OR Engage an auditor's expert to undertake valuation of PPE as at 30 June 2X20.
7.	*Trade receivables days* Receivables days are 56 days which is greater than both the prior and budget. This increase is likely to be due to extended credit terms offered to new data consulting customers **(½ mark)** and the unprovided balance for the £270,000 owed by the soft drinks manufacturer which entered administration during the year. **(½ mark)** There is a risk that the some of trade receivables may not be recoverable. **(1 mark)**	Review correspondence from the administrator confirming the amount owed and the amount to be paid and trace receipt of payment to bank statements. Confirm the remaining 40% has been written off from the trade receivables in Brandalytics nominal ledger.

Requirement 1(a) Total marks available (20 marks)

Restricted to (19 marks)

Requirement 1(b)Total marks available (6 marks)

Restricted to (6 marks)

Requirement 2 – (a) evaluation of additional audit risks and (b) audit approach

	Additional audit risks	*Audit approach (1 mark, unless otherwise noted)*
1.	*Redundancies* This is the first time Brandalytics has undertaken a redundancy consultation process at its Edinburgh and Birmingham offices and plans to undertake further redundancies in Exeter before the year end. **(½ mark)** As this is the first time Brandalytics has paid redundancy costs, there is a risk that the redundancy packages are not calculated in line with the appropriate statutory requirements or provided for incorrectly in the financial statements resulting in the provision and corresponding expenses being misstated. **(1 mark)**	Discuss with management the redundancies undertaken and the likely uptake for any staff redeployment to other offices. Recalculate a sample of redundancy packages to ensure that any calculations have been performed in line with the appropriate legislation.
2.	*Valuation of intangible asset* During the year there was an increase of £3.5m in the value of the intangible assets relating to software development costs which was higher than initial budgets. **(½ mark)** This is a complex area and there is a risk that these costs are not appropriately capitalised in the financial statements and that the value of intangibles is overstated. **(1 mark)**	Review the company's policy for capitalising intangible assets to confirm reasonableness. Obtain a breakdown of the costs capitalised and review for reasonableness against the criteria of IAS 38 *Intangible Assets* to identify any costs which should be expensed rather than capitalised.
3.	*Bank covenants – manipulation of financial statements* The secured bank loan includes a covenant to maintain a net debt ratio of below 0.80 and, at 31 March, the company is currently close to breaching. **(½ mark)** There is a risk that management may look to manipulate the financial statements in order to present the covenant as being achieved. **(1 mark)**	The audit team should increase its level of professional scepticism, **(½ mark)** be more unpredictable in the selection of procedures, **(½ mark)** put more experienced team members onto the audit **(½ mark)** and increase supervision of the audit team. **(½ mark)**
4.	*Going concern* The shareholders have provided a loan and although Michael Ackerman has verbally confirmed that it will be available for 24 months and will not be recalled, this has not	Evaluating management's method to assess the entity's ability to continue as a going concern. **(½ mark)** Evaluating the relevance and reliability of

	been formally confirmed. **(½ mark)** Brandalytics has received a bank loan and is nearly breaching the threshold of the net debt ratio covenant set by the bank. **(½ mark**) The loan could be recalled as the company is in breach of the loan conditions. **(½ mark)** These subsequently could impact the company's going concern status. **(1 mark)** **(Restricted to 2 marks)**	the underlying data and assumptions used by management to assess going concern. **(½ mark)** Obtain formal written confirmation from the shareholder that the loan will not be recalled in the next 12 months. **(½ mark)** Obtain confirmation for the bank that the loan will not be recalled as a result of the breach **(½ mark)** and evaluate any plans by management to address the falling liquidity position. **(½ mark)** Obtain written representations regarding management's future plans and actions. **(½ mark)** **(Restricted to 2 marks)**
5.	*Use of a service organisation – payroll* Brandalytics has outsourced its monthly payroll processing during the year to Prosperity Payroll. **(½ mark)** There is a risk that the service organisation may not have appropriate resources, processes and controls to provide this service resulting in payroll not being processed correctly and a misstatement in the financial statements. **(1 mark)**	Obtain an understanding of the extent of the use of the service organisation including interaction between Brandalytics and Prosperity Payroll. Obtain appropriate evidence regarding the controls in place at Prosperity Payroll which may include obtaining a service auditor report, visiting the service organisation to test the controls or to engage another auditor to test the controls.

Requirement 2(a)Total marks available (8 marks)

Restricted to (8 marks)

Requirement 2(b)Total marks available (7 marks)

Restricted to (7 marks)

Question 17 - You R Fashion Ltd

Requirement - Paragraphs for inclusion in a letter to the board identifying weaknesses in the sales system, evaluating implications and recommending improvements.

	Weakness	Implication	Recommendation
1.	No credit checks are performed on new customers. **(½ mark)**	Garments could be supplied to uncreditworthy customers increasing the risk of non-payment and bad debts, negatively impacting YF's cashflow. **(1 mark)**	Formal credit checks should be performed on all new customers. **(1 mark)**
2.	No review is carried out following price updates by the IT department. **(½ mark)**	Prices have been recorded incorrectly in the year resulting in the possibility of the company's revenue being reduced as inventory is sold at lower than expected prices. **(1 mark)**	All price updates processed by the IT department should be verified and signed off by the relevant head of division prior to the electronic catalogue being available to trade customers. **(1 mark)**
3.	Sales team members manually override customer credit limits to accept orders. **(½ mark)**	This increases the risk of bad debts and potentially reduces the profitability of the company and negatively impacts cashflow. **(1 mark)**	Where a credit limit will be breached by a sales order any override must be approved by the head of division before being released into the ERP system. **(1 mark)**
4.	Errors in picking in Milan are only noted once the garments have been received at the warehouse in Birmingham. **(½ mark)**	Receipt of incorrect goods may prevent the company from being able to dispatch goods to customers in a timely manner resulting in damage to the company's reputation and lost future revenue. **(1 mark)**	All goods should be checked for quality and quantities matched against the system-generated sales order before dispatch by the Milan factory to the warehouse in Birmingham. Any items unavailable should be notified to the Birmingham factory so that the customer may be advised of any delay to their order. **(1 mark)**
5.	'Surplus' inventory received from Milan may be sold at a reduced price due to limited storage space. **(½ mark)**	Selling 'surplus' inventory at reduced prices will result in reductions in the company's profit margins, potentially resulting in stock being sold below cost and therefore YF is not recovering its direct costs. **(1 mark)**	Any 'surplus' inventory should be reviewed and allocated, where possible, to new orders before submitting the weekly inventory to the Milan factory. **(1 mark)**

6.	Picked items for dispatch to customers in the warehouse are not checked against the good delivery note ('GDN') as a secondary review prior to dispatch. **(½ mark)**	Incorrect quantities or incorrect items may be sent to customers resulting in increased levels of goods being returned by customers, reducing customer satisfaction and increasing YF's costs. **(1 mark)**	A secondary check should be performed by a separate individual from the GDN to the physical items being shipped by the warehouse before dispatch to customers. **(1 mark)**
7.	The weekly exception report detailing partially filled orders is not reviewed. **(½ mark)**	Outstanding orders that have been fulfilled following receipt of inventory may not be updated in the system as completed resulting in invoices not being raised for customers and revenue/ trade receivables being understated. **(1 mark)**	The weekly exception report detailing GDNs 'awaiting item' should be reviewed by the warehouse manager and any orders still outstanding from the previous week investigated. **(1 mark)**
8.	After four weeks the accounts receivable team close any open sales orders. **(½ mark)**	Customer orders may not be fulfilled resulting in reputation damage to the company and reducing future revenue. **(1 mark)** OR An order may be closed that contains garments manually added to the following week's order to Milan by warehouse staff. This may result in surplus inventory which the company is unable to sell. **(1 mark)**	Orders should not be closed until it has been confirmed with the warehouse team and factory in Milan that the order cannot be fulfilled. **(1 mark)** OR Regular communication with the customer should be maintained to update on the status of their order. **(1 mark)**
9.	Goods that have been dispatched as part-fulfilled order may not be invoiced for up to four weeks. **(½ mark)**	This will result in a longer period before cash is received, negatively impacting YF's cashflow. Additionally, revenue may be understated if not accrued for. **(1 mark)**	A sales invoice is raised for all goods dispatched and the customer advised of any outstanding items. Outstanding items should be invoiced to the customer once dispatched. **(1 mark)**

10.	The company does not have a standard remittance form which has resulted in some payments from customers not being allocated against the invoices they relate to. **(½ mark)**	This will prevent the company from being able to accurately assess which receivables remain outstanding from customers. There is a risk that older receivables remain underpaid and any issues with non-receipt of payment are not investigated in a timely manner. **(1 mark)**	A standard remittance form should be issued with all invoices which should be sent electronically by customers to the company at the time of payment. Any payments received without a remittance form should be investigated and followed up with the relevant customer before processing. **(1 mark)**
11.	Follow-up of outstanding receivables and 'stopping' of customer accounts is undertaken by division heads rather than the accounts receivable team. **(½ mark)**	Sales teams are likely to be more concerned with revenue generation than collection, resulting in outstanding balances not being followed up in a timely manner increasing the chance of debts becoming irrecoverable. **(1 mark)** OR Garments may continue to be supplied to customers who have exceeded their payment terms and / or credit limit resulting in issues with debt recoverability. **(1 mark)**	The accounts receivable team should be responsible for reviewing and following up customer balances in excess of agreed credit terms. OR There should be a clear company policy stating the circumstances for when a 'stop' should be put on a customer account, for example when a customer has breached their credit limit or failed to pay within the agreed credit terms. **(1 mark)**

Total marks available (27½ marks)

Restricted to (25 marks)

Question 18 – Hobert Dairies Ltd

Requirement 1 - Test of controls for the purchasing system

Milk

1. Select a sample of new farmer contracts and inspect for evidence of sign off by the head of milk procurement and the farmer. **(1 mark)**
2. For a sample of contracts set up on the system, confirm that the supplier number is only valid for the duration of the contract. **(1 mark)**
3. Inspect a sample of exception reports for farmers with undefined contract durations and confirm that these have been resolved by the head of milk procurement. **(1 mark)**
4. For a sample of changes made to the system during the period, inspect a sample of 'changes to farmers standing data' forms for evidence of sign off of the amendments by a member of the creditors ledger department and confirm changes to details in the system. **(1 mark)**
5. Inspect a sample of daily reconciliations between the milk collected at the farms per the on-board collection meter printout and the 'milk receipt log' to ensure that the quantities agree and that any differences have been resolved. **(1 mark)**
6. Inspect a sample of farmer pro-forma invoice reconciliations with tanker and silo totals to confirm that these have been signed off by the milk procurement manager as evidence of review and authorising of PO. **(1 mark)**
7. For a sample of farmer supplier invoices, reperform the matching with the POs, confirming that any unmatched invoices were raised as such. **(1 mark)**
8. For a sample of unmatched farmer supplier invoices from the monthly exception report, inspect copies of the monthly interdepartmental meeting minutes for evidence of discussion and resolution of the discrepancies. **(1 mark)**

Polybottle

9. Inspect a sample of copies of the weekly bottle count total forms and confirm that these have been signed by the dairy managers and the Polybottle site managers for evidence of discussion and agreement of the bottle quantities. **(1 mark)**

Other

10. For a sample of purchase requisitions, confirm that all requisitions have received electronic approval and were raised only by approved individuals. (**1 mark)**
11. For a sample of purchases, confirm that it was accurately matched to the delivery note prior to the invoice being posted to the system. **(1 mark)**
12. Using test data for a sample of invoices with and without valid POs confirm that invoices are automatically matched when entered into the system or appear on the weekly 'unmatched invoice' report listing. **(1 mark)**
13. Inspect a sample of monthly interdepartmental meeting minutes for evidence of discussion and resolution of unmatched POs. **(1 mark)**
14. Inspect BACS run listings for evidence of sign off by the finance director. **(1 mark)**
15. Reperform a sample of supplier statement reconciliations ensuring that any reconciling items have been resolved. **(1 mark)**

16. Inspect supplier statement reconciliations for evidence of review by the accounts payable manager, Louis McGuire. **(1 mark)**

Total marks available (16 marks)

Restricted to (14 marks)

Requirement 2 – Methods of implementation

There are four main methods to consider for implementing the new milk procurement system:

Direct method **(½ mark)**

This is also known as the 'big bang' approach. The old system is turned off, data is transferred to the new system, and then the new system is turned on and ready for use. This is the lowest cost and quickest method of implementation. However, it also carries the highest risk, as if the new system does not work properly straight away, there could be a significant impact on company operations. **(½ mark)**

Given that this is the first major system development that the company has undertaken there is likely to be a higher risk of failure and, as a result, the direct method may not be suitable. **(1 mark)**

Phased method **(½ mark)**

This is when you introduce individual modules of the new system one at a time. This would allow the risks of implementation to be controlled and staff members to get used to the look and feel of the new system. **(½ mark)**

A phased implementation would not be suitable as the system Hobert is implementing does not consist of standalone modules such as, accounting, maintenance, or order fulfilment, but the whole milk procurement system. **(1 mark)**

Pilot method **(½ mark)**

This is where you trial the new system at a smaller site. This allows any problems with the entire new system to be monitored prior to implementation in the rest of a company. **(½ mark)**

As both dairies are of a similar size a pilot implementation would not be suitable. **(1 mark)**

Parallel method **(½ mark)**

This involves operating the new system alongside the old system, with real data and transactions being posted onto both systems for a period of time. This method of implementation is very flexible in terms of full changeover date. Unfortunately, this method increases the cost to Hobert as two systems are in operation. **(½ mark)**

This is the most suitable method as it would benefit Hobert to continue to perform the full reconciliation of the farmers' invoices and this would give the company a greater level of assurance that the milk procurement system was operating properly and all the data and postings were accurate. **(1 mark)**

Total marks available (8 marks)

Restricted to (7 marks)

Requirement 3 - Information in a suitable format for inclusion in a letter to Shona Scott re types of assurance engagements

As requested, please find below details of the various types of assurance that we can give you in relation to the testing of the upgraded bottle collection system.

- *Reasonable ('positive') Assurance* **(½ mark)**

  This is an engagement providing reasonable assurance and a positive opinion so we would state that, in our opinion, the controls around the upgraded system are working correctly. This form of report requires us to perform more detailed testing to obtain sufficient appropriate evidence and, as a result, would be more costly. **(½ mark)**

- *Limited ('negative') Assurance* **(½ mark)**

  This type of engagement provides more limited assurance as we would state that, in our opinion, nothing has come to our attention during our testing that causes us to believe that the controls around the upgraded system are not working correctly. This type of engagement is less expensive as our procedures are less extensive and less reliable than reasonable assurance. **(½ mark)**

- *Agreed-Upon Procedures* **(½ mark)**

  In this type of engagement the procedures to be performed are specified in a separate engagement letter. We would perform these procedures and report factual findings and the results to you. We would not provide an overall opinion and it would then be your responsibility to interpret the findings and draw your own conclusions. We do not make any judgments on the sufficiency or reliability of the procedures, we only carry out the work we have been asked to perform. **(½ mark)**

Recommendation

An agreed–upon procedures type of assurance is most appropriate as we are only looking at the recording of the bottles delivered and not the system as a whole. **(1 mark)**

Total marks available (4 marks)

Restricted to (4 marks)

Question 19 – Remote Vision Ltd

Requirement – Tests of control over sales system.

Orders

New customer approval

For a sample of customer accounts in the order management system, inspect documents to ensure satisfactory credit references obtained and new customer approval by credit controller. **(1 mark)**

Order acceptance

Select a sample of special orders (orders with discounts over 12% or breaching credit limit) and ensure that these have been approved by the sales director before processing. **(1 mark)**

Orders in breach of system parameters

With the client's permission, attempt to input sales orders which will take the customer over the agreed credit limit or have a discount greater than 12% and confirm system prevents processing without approval by sales director. **(1 mark)**

Delivery

Approved orders are accurately despatched

Visit the warehouse and observe the warehouse manager checking the picked goods against the despatch note, confirming quantities and description. **(½ mark)**

Inspect a sample of despatch notes for evidence of warehouse manager initials to confirm review of picked goods prior to despatch. **(1 mark)**

(Restricted to 1 mark)

Unfulfilled orders exception report

Inspect a sample of exception reports of unfulfilled orders for evidence of warehouse manager review and follow up. **(1 mark)**

Invoicing

Valid invoices

Confirm that invoices are automatically generated from approved orders and despatch notes by observing a sample of invoices being produced. Confirm the details of the invoice agree back to the order and despatch note, including the despatch note reference. **(1 mark)**

Accuracy of invoices

Reperform a price check on a sample of sales invoices to the authorised price list and original order to confirm invoices are generated using the Masterfile and approved order information. **(1 mark)**

Matching of despatches to invoices

Inspect the weekly exception report that details despatch notes not invoiced for evidence of invoicing supervisor review and investigation**. (1 mark)**

Completeness of invoices
Using ADAs, perform a sequence check over invoice numbering investigating any breaks in sequence. **(1 mark)**

Accounting
Automatic posting to debtors ledger
For a sample of daily sales observe the supervisor reviewing the daily postings and enquire of the process performed when variances are identified. **(1 mark)**

Review of debtors ledger control account reconciliations
Review a sample of reconciliations and inspect reconciliation for evidence of finance manager review and follow-up. **(1 mark)**

Reperform a sample of reconciliations to confirm that they have been completed accurately, and that relevant items have been identified for follow up. **(1 mark)**

Review of aged accounts
Enquire with the credit controller regarding review of overdue accounts. Inspect evidence of credit controller's review of aged analysis and follow up with clients. **(1 mark)**

Aged receivables
Inspect the monthly report detailing invoices outstanding for more than 120 days for evidence of discussions between the finance manager and the credit controller and review by the finance manager.
(1 mark)

For a sample of invoices from the monthly report detailing invoices outstanding for more than 120 days, inspect correspondence with the debt collection agency for evidence of collection being pursued. **(1 mark)**

Banking
Bank reconciliations
Re-perform a sample of monthly bank reconciliations to confirm completed correctly **(1 mark)** and inspect for evidence of finance manager review and investigation and satisfactory follow up of selected reconciling items**. (1 mark)**

Total marks available (17 marks)

Restricted to (16 marks)

Question 20 – Go-Go Buses Ltd

Requirement 1(a) – Matters that the firm will have to consider regarding the reliability of the underlying data

As this is the first year the firm is using substantive analytical preview ('SAR') for property, plant and equipment ('PPE'), it has to consider the reliability of the underlying information. The assessment of the reliability of the information is critical to determine whether SAR is used. **(½ mark)**

1. *Source*
The auditor has to consider whether the PPE information that Go-Go has generated is reliable. **(½ mark)**

2. *Comparability*
The auditor has to consider whether data is comparable to similar external companies to assess reasonableness. **(½ mark)**

3. *Nature and relevance*
The auditor has to consider whether the data is relevant to the audit procedures to be performed. **(½ mark)**

4. *Prior year*
The auditor has to consider whether there were any findings in the prior year audit which may impact the audit procedures to be performed. **(½ mark)**

5. *Operating effectiveness of the controls*
The auditor has to consider testing and evaluating the operating effectiveness of the controls to ensure the completeness, accuracy and validity of the internally generated data prepared for the purpose of the SAR. **(½ mark)**

Total marks available (3 marks)

Restricted to (3 marks)

Requirement 1(b) – Specific procedures to confirm integrity of the data

1. Agree the opening cost and accumulated depreciation to the prior year audited financial statements. **(½ mark)**
2. Agree the value of the additions in the period to the detailed non-current asset register. **(½ mark)**
3. On a sample basis, vouch the additions to source documentation to confirm the date of acquisition **(½ mark)** and the purchase price. **(½ mark)**
4. Agree the value of the disposals in the period to the detailed non-current asset register. **(½ mark)**
5. On a sample basis, vouch the disposals to source documentation to confirm the date of disposal **(½ mark)** and the selling price. **(½ mark)**
6. Review the depreciation policy to ensure that it is consistent with the prior year and with similar competitors. **(½ mark)**
7. For a sample of additions and disposals, confirm that depreciation is charged in the month of acquisition and not in the month of disposal. **(1 mark)**
8. Review the listing of the fully depreciated assets and compare to the non-current asset register to ensure that only those assets which are fully depreciated are included in the listing **(½ mark)** and confirm the date at which it became fully depreciated during the period. **(½ mark)**

Total marks available (6 marks)

Restricted to (6 marks)

Requirement 2 – Design substantive audit procedures for the share capital and reserves balances

Ordinary share capital / share premium

- Agree shares issued during the year to board minute approval and the amount received to bank statements confirming amounts recorded are correct. **(1 mark)**
- Agree the share capital details to the company's statutory books and memorandum of understanding to ensure that the transaction is accurately reflected in the general ledger.
(1 mark)
- Recalculate the share premium on the issue of the new shares by recalculating the values, comparing to the client calculations and investigating any material differences. **(1 mark)**
- Review the board minutes for any other transactions which should be included within the share capital and reserves balances. **(1 mark)**
- Confirm that the company's accounting policy is to release the revaluation surplus upon disposal of the asset, and not annually. **(½ mark)**

Retained earnings

- Agree approval of dividends to board minutes and value of dividends paid to the bank statements. **(1 mark)**
- Agree the profit transferred for the year to the profit and loss account to ensure that the amount is accurate ensuring that any post year end or audit adjustments are accounted for. **(1 mark)**

Total marks available (6½ marks)

Restricted to (6 marks)