Answers

1 (a) Tests of control and objective of each test for the sales cycle of Tinkerbell Toys Co (Tinkerbell)

Test of control	Objective of test
The auditor should attempt to enter an order for a fictitious customer account number. The system should not accept this order.	To ensure that orders are only accepted and processed for valid customers.
With the client's permission, attempt to enter a sales order which will take a customer over the agreed credit limit, the system should reject the order.	To ensure that goods are not supplied to poor credit risks.
Inspect a sample of processed credit applications from the credit agency and follow through the credit limit agreed to the sales system.	To ensure that goods are only supplied to customers with good credit ratings.
Obtain a copy of the current price list and agree for a sample of invoices that relevant/current prices have been used.	To ensure that goods are only sold at authorised prices.
Confirm discounts applied to invoices agree to the customer master file.	To ensure that sales discounts are only provided to valid customers.
Attempt to process an order with a sales discount for a customer not normally entitled to discounts to assess the application controls.	
Inspect a sample of orders to confirm that an order acceptance email/letter has been generated.	To ensure that all orders are recorded completely and accurately.
Observe the sales order clerk processing orders and assess whether the order acceptance is automatically generated.	
Visit a warehouse and observe the goods despatch process to assess whether all goods are double checked against the goods despatch note (GDN) and the despatch list prior to sending out.	To ensure that goods are despatched correctly to customers and that they are of an adequate quality.
Inspect a sample of GDNs and agree that a valid sales invoice has been correctly raised.	To ensure that all goods despatched are correctly invoiced.
Review the last system generated sequence check of sales invoices to identify any omissions.	To ensure completeness of income for goods despatched.

(b) Substantive procedures to confirm receivables balance for Tinkerbell

- Perform a positive trade receivables circularisation of a representative sample of Tinkerbell's year-end balances, for any non-replies, with Tinkerbell's permission, send a reminder letter to follow up.
- Review the after date cash receipts and follow through to pre-year-end receivable balances.
- Calculate average receivable days and compare this to prior year, investigate any significant differences.
- Review the reconciliation of sales ledger control account to the sales ledger list of balances.
- Select a sample of goods despatched notes (GDN) before and just after the year end and follow through to the sales invoice to ensure they are recorded in the correct accounting period.
- Inspect the aged receivables report to identify any slow moving balances, discuss these with the credit control manager to assess whether an allowance or write down is necessary.
- For any slow moving/aged balances review customer correspondence to assess whether there are any invoices in dispute.
- Review board minutes of Tinkerbell to assess whether there are any material disputed receivables.
- Review a sample of post year-end credit notes to identify any that relate to pre-year-end transactions to verify that they have not been included in receivables.
- Review the sales ledger for any credit balances and discuss with management whether these should be reclassified as payables.
- Select a sample of year-end receivable balances and agree back to valid supporting documentation of GDN and sales order to ensure existence.

(c) Controls to reduce the risk of fraud occurring again

Tutorial note: *This type of fraud is known as a teeming and lading fraud.*

Control	Mitigate risk
Members of staff who are related should not be permitted to work in the same department whereby they can breach segregation of duty controls.	This should reduce the risk of staff colluding and being able to commit a fraud without easily being discovered.
Cash receipts should be processed by two members of staff.	This should reduce the risk of one person being able to steal cash receipts. In order to commit the fraud these two members of staff would need to collude and to avoid detection, also collude with other members of the finance team.
Monthly customer statements should be sent out promptly to all customers. The sales ledger supervisor should review to ensure that all customers have been sent statements.	If customers receive regular statements then they would be in a position to flag to Tinkerbell that there was a delay in their payments being credited to their accounts. This should then flag a possible 'teeming and lading' fraud.
Bank reconciliations should be reviewed by a responsible official (different to the preparer of the reconciliation) on a regular basis. Any unreconciled amounts should be promptly investigated and resolved.	A small unreconciled amount can actually represent two large balances which almost cancel each other out and hence could indicate significant problems with cash and bank. Where fraud arises it can often be quickly spotted by performing and reviewing a bank reconciliation.
On a regular basis staff within the finance department should rotate duties.	If staff members know that they will need to rotate their roles then they will be less inclined to commit fraudulent activities, as the chances of them being caught increase significantly.
The sales ledger should be reconciled to the sales ledger control account on a monthly basis, and this reconciliation should be reviewed by a responsible official.	This will increase the likelihood of spotting errors in the receivable balances and help to create an environment of controls, which will decrease the likelihood of frauds occurring.
Management should consider establishing an internal audit department which could assess the effectiveness of controls and identify areas of weaknesses, as well as perform specific fraud investigations.	As there has been a significant breakdown in the internal controls then the mere presence of an internal audit department would help to deter employees committing fraud. In addition, fraudulent activities would be more likely to be identified quicker as internal controls would be tested.

Tutorial note: *Marks will be awarded for any additional general fraud points made.*

(d) Substantive procedures to confirm Tinkerbell's revenue:

- Compare the overall level of revenue against prior years and budget and investigate any significant fluctuations.
- Obtain a schedule of sales for the year broken down into the major categories of toys manufactured and compare this to the prior year breakdown and for any unusual movements discuss with management.
- Calculate the gross margin for Tinkerbell and compare this to the prior year and investigate any significant fluctuations.
- Select a sample of sales invoices for larger customers and recalculate the discounts allowed to ensure that these are accurate.
- Recalculate for a sample of invoices that the sales tax has been correctly applied to the sales invoice.
- Select a sample of customer orders and agree these to the despatch notes and sales invoices through to inclusion in the sales ledger to ensure completeness of revenue.
- Select a sample of despatch notes both pre and post the year end, follow these through to sales invoices in the correct accounting period to ensure that cut-off has been correctly applied.
- Select a sample of credit notes issued after the year end and follow through to sales invoice to ensure the returns were recorded in the proper period.

2 (a) Advantages and Disadvantages of methods of recording the system

Narrative Notes

Advantages

The main advantage of narrative notes is that they are simple to record, after discussion with the company these discussions are easily written up as notes.

Additionally, as the notes are simple to record, this can facilitate understanding by all members of the team, especially more junior members who might find alternative methods too complex.

Disadvantages

Narrative notes may prove to be too cumbersome, especially if the system is complex.

This method can make it more difficult to identify missing internal controls as the notes record the detail but do not identify control exceptions clearly.

Questionnaires

Internal control questionnaires are used to assess whether controls exist which meet specific objectives or prevent or detect errors and omissions.

Advantages

Questionnaires are quick to prepare, which means they are a cost effective method for recording the system.

They ensure that all controls present within the system are considered and recorded; hence missing controls or deficiencies are clearly highlighted.

Questionnaires are simple to complete and therefore any members of the team can complete them and they are easy to use and understand.

Disadvantages

It can be easy for the company to overstate the level of the controls present as they are asked a series of questions relating to potential controls.

Without careful tailoring of the questionnaire to make it company specific, there is a risk that controls may be misunderstood and unusual controls missed.

(b) (i) Purpose of an engagement letter

An engagement letter provides a written agreement of the terms of the audit engagement between the auditor and management or those charged with governance.

Confirming that there is a common understanding between the auditor and management, or those charged with governance, of the terms of the audit engagement helps to avoid misunderstandings with respect to the audit.

(ii) Matters to be included in an audit engagement letter:

- The objective and scope of the audit;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the financial reporting framework for the preparation of the financial statements;
- Expected form and content of any reports to be issued;
- Elaboration of the scope of the audit with reference to legislation;
- The form of any other communication of results of the audit engagement;
- The fact that some material misstatements may not be detected;
- Arrangements regarding the planning and performance of the audit, including the composition of the audit team;
- The expectation that management will provide written representations;
- The basis on which fees are computed and any billing arrangements;
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement;
- Arrangements concerning the involvement of internal auditors and other staff of the entity;
- Any obligations to provide audit working papers to other parties;
- Any restriction on the auditor's liability;
- Arrangements to make available draft financial statements and any other information;
- Arrangements to inform the auditor of facts that might affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.

3 (a) Procedures to obtain evidence and an audit test relevant to purchases and other expenses:

Inspection

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

- Inspect a sample of purchase invoices and agree the amount is included correctly within the purchase ledger.
- Inspect purchase orders for evidence of authorisation by a responsible official.

Observation

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

- Observe the process for logging purchase invoices into the system to ensure that all invoices are entered completely and accurately.

– Observe the goods received department to assess whether goods received are checked against purchase orders and reviewed for adequate quality.

Analytical procedures

Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

– Calculate the operating profit margin/overhead ratio and compare it to last year and budget and investigate any significant differences.
– Review monthly other expenses to identify any significant fluctuations and discuss with management.

Inquiry

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

– Discuss with management whether there have been any changes in the key suppliers used and compare this to the purchase ledger to assess completeness and accuracy of purchases.
– Inquire of department heads the process they follow in authorising orders to ensure that it follows the specified company authorisation process.

Recalculation

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

– Recalculate the accuracy of a sample of purchase invoices.
– Recalculate the prepayments and accruals charged at the year end to ensure the accuracy of the other expenses.

Reperformance

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

– Reperform the purchase ledger control account reconciliation to ensure accuracy.
– Select a sample of purchase orders and match them to the goods received notes and purchase invoices to ensure completeness of the purchase cycle.

Tutorial note: *Marks will be awarded for any other relevant purchases and expenses tests.*

(b) Audit risks and responses:

Audit risk	Audit response
Donald Co has ordered six planes which may not have been received by the year end. Only assets which physically exist at the year end should be included in property, plant and equipment.	Discuss with management as to whether the planes have arrived, if so then physically verify a sample of these planes to ensure existence.
The existing planes have been refurbished at a cost of \$15m. This expenditure needs to be reviewed to assess whether it is of a capital nature and should be included within assets or expensed as repairs.	Review a breakdown of the costs and agree to invoices to assess the nature of the expenditure and if capital agree to inclusion within the asset register and if repairs agree to the income statement.
Donald Co has applied for a loan of \$25m. It has not received this loan yet, but it has already ordered the planes and if it does not receive the money in time then it may struggle to pay for the planes ordered and this could result in going concern difficulties.	Discuss with management the status of the loan application and if still outstanding whether any other banks have been approached for the loan. Perform a detailed going concern review.
The travel agents who sell tickets on behalf of the airline are struggling to pay their outstanding balances to Donald Co. This could result in an increase in irrecoverable debts and receivables being overvalued.	Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation. An allowance for receivables to be discussed with management.
Donald Co's website has encountered difficulties with recording sales, this could lead to errors in relation to completeness of income.	Extended controls testing to be performed over the sales cycle to assess the extent of the errors. Detailed testing to be performed over completeness of income.
Due to the website errors tickets have been sold twice, therefore some customers will require refunds. At the year end there is a risk that the tickets to be refunded have not been removed from sales.	Review the cut-off of customer refunds around the year end to ensure that sales are complete and accurate.

Audit risk	Audit response
Donald Co is closing its call centre and making the workforce redundant; as it has announced this to the staff then under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* a redundancy provision will be required for any staff not yet paid at the year end.	Discuss with management the status of the redundancy programme and review and recalculate the redundancy provision.

4 (a) Safeguards to be adopted to address the conflict of interest of auditing both Goofy Co and Mickey Co:

- Both Goofy Co and Mickey Co should be notified that NAB & Co would be acting as auditors for each company and, if necessary, consent obtained.
- Advising one or both clients to seek additional independent advice.
- The use of separate engagement teams, with different engagement partners and team members; once an employee has worked on one audit such as Goofy Co then they would be prevented from being on the audit of Mickey Co for a period of time. This separation of teams is known as building a 'Chinese wall'.
- Procedures to prevent access to information, for example, strict physical separation of both teams, confidential and secure data filing.
- Clear guidelines for members of each engagement team on issues of security and confidentiality. These guidelines could be included within the audit engagement letters.
- Potentially the use of confidentiality agreements signed by employees and partners of the firm.
- Regular monitoring of the application of the above safeguards by a senior individual in NAB & Co not involved in either audit.

(b) Advantages of outsourcing Goofy Co's internal audit department

Staffing
Goofy Co needs to expand its internal audit department from five employees as it is too small; however, if they outsource then there will be no need to recruit as NAB & Co will provide the staff members and this will be an instant solution.

Skills and experience
NAB & Co is a large firm and so will have a large pool of staff available to provide the internal audit service. In addition, Goofy Co has requested that ad hoc reviews are performed and, depending on the nature of these, it may find that the firm has specialist skills that Goofy Co may not be able to afford if the internal audit department continues to be run internally.

Costs
Any associated costs such as training will be eliminated as NAB & Co will train its own employees. In addition, the costs for the internal audit service will be agreed in advance. This will ensure that Goofy Co can budget accordingly.

As NAB & Co will be performing both the external and internal audit there is a possibility that the fees may be reduced.

Flexibility
With the department being outsourced Goofy Co will have total flexibility in its internal audit service. Staff can be requested from NAB & Co to suit Goofy Co's workloads and requirements. This will ensure that, when required, extra staff can be used to visit a large number of shops and in quieter times there may be no internal audit presence.

Additional fees
NAB & Co will benefit from the internal audit service being outsourced as this will generate additional fee income. However, the firm will need to monitor the fees to ensure that they do not represent too high a percentage of their total fee income.

Disadvantages of outsourcing Goofy Co's internal audit department

Knowledge of systems
NAB & Co will allocate available staff members to work on the internal audit assignment, this may mean that each month the staff members are different and hence they may not understand the systems of Goofy Co. This will decrease the quality of the services provided and increase the time spent by Goofy Co employees explaining the system to the auditors.

Independence
If NAB & Co continues as external auditor as well as providing the internal audit service, there may be a self-review threat, where the internal audit work is relied upon by the external auditors. NAB & Co would need to take steps to ensure that separate teams were put in place as well as additional safeguards.

Existing internal audit department
Goofy Co has an existing internal audit department of five employees. If they cannot be redeployed elsewhere in the company then they may need to be made redundant and this could be costly for the company. Staff may oppose the outsourcing if it results in redundancies.

Cost
As well as the cost of potential redundancies, the internal audit fee charged by NAB & Co may, over a period of time, prove to be very expensive.

Loss of in-house skills

If the current internal audit team is not deployed elsewhere in the company valuable internal audit knowledge and experience may be lost; if Goofy Co then decided at a future date to bring the service back in-house this might prove to be too difficult.

Timing

NAB & Co may find that Goofy Co requires internal audit staff at the busy periods for the audit firm, and hence it might prove difficult to actually provide the required level of resource.

Confidentiality

Knowledge of company systems and confidential data will be available to NAB & Co. Although the engagement letter would provide confidentiality clauses, this may not stop breaches of confidentiality.

Control

Goofy Co will currently have more control over the activities of its internal audit department; however, once outsourced it will need to discuss areas of work and timings well in advance with NAB & Co.

(c) Ethical threats and managing these risks

Ethical threat	Managing risk
A familiarity threat arises where an engagement partner is associated with a client for a long period of time. NAB & Co's partner has been involved in the audit of Goofy Co for six years and hence may not maintain her professional scepticism and objectivity.	NAB & Co should monitor the relationship between engagement and client staff, and should consider rotating engagement partners when a long association has occurred. In addition, *ACCA's Code of Ethics and Conduct* recommends that engagement partners rotate off an audit after five years for listed and public interest entities. Therefore consideration should be given to appointing an alternative audit partner.
The engagement partner's son has accepted a job as a sales manager at Goofy Co. This could represent a self-interest/familiarity threat if the son was involved in the financial statement process.	It is unlikely that as a sales manager the son would be in a position to influence the financial statements and hence additional safeguards would not be necessary.
A self-interest threat can arise when an audit firm has a financial interest in the company. In this case the partner's son will receive shares as part of his remuneration. As the son is an immediate family member of the partner then if he holds the shares it will be as if the partner holds these shares, and this is prohibited.	In this case as holding shares is prohibited by *ACCA's Code of Ethics and Conduct* then either the son should refuse the shares or more likely the engagement partner will need to be removed from the audit.
Fees based on the outcome or results of work performed are known as contingent fees and are prohibited by *ACCA's Code of Ethics and Conduct*. Hence Goofy Co's request that 20% of the external audit fee is based on profit after tax would represent a contingent fee.	NAB & Co will not be able to accept contingent fees and should communicate to Goofy Co that the external audit fee needs to be based on the time and level of work performed.

5 (a) Misstatements

ISA 450 *Evaluation of Misstatements Identified During the Audit* considers what a misstatement is and deals with the auditor's responsibility in relation to misstatements.

It identifies a misstatement as being: A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

It also then defines uncorrected misstatements as: Misstatements that the auditor has accumulated during the audit and that have not been corrected.

There are three categories of misstatements:

(i) Factual misstatements are misstatements about which there is no doubt.

(ii) Judgemental misstatements are differences arising from the judgements of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.

(iii) Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

The auditor has a responsibility to accumulate misstatements which arise over the course of the audit unless they are very small amounts.

Identified misstatements should be considered during the course of the audit to assess whether the audit strategy and plan should be revised.

The auditor should determine whether uncorrected misstatements are material in aggregate or individually.

All misstatements should be communicated to those charged with governance on a timely basis and request that they make necessary amendments. If this request is refused then the auditor should consider the potential impact on their audit report.

A written representation should be requested from management to confirm that unadjusted misstatements are immaterial.

Tutorial note: *The model answer is more comprehensive than would be expected for 4 marks; this is because ISA 450 is a relatively new auditing standard and the above has been presented as a teaching resource.*

(b) Reliance on the work of an independent valuer

ISA 500 *Audit Evidence* requires auditors to evaluate the competence, capabilities including expertise and objectivity of a management expert.

This would include consideration of the qualifications of the valuer and assessment of whether they were members of any professional body or industry association.

In addition, the auditor should meet with the expert and discuss with them their relevant expertise; in particular whether they have valued similar properties to Minnie Co in the past. Also consider whether they understand the accounting requirements of IAS 16 *Property, Plant and Equipment* in relation to valuations.

The expert's independence should be ascertained, with potential threats such as undue reliance on Minnie Co or a self-interest threat such as share ownership considered.

The valuation should then be evaluated. The assumptions used should be carefully reviewed and compared to previous revaluations at Minnie Co. These assumptions should be discussed with both management and the valuer to understand where the misstatement has arisen.

In order to correct the misstatement, it might be necessary for the valuer to undertake further work and this should be agreed.

Daffy & Co would not be able to state in their audit report that they had relied on an expert for the property valuation.

(c) (i) Depreciation on land and buildings

Depreciation has been provided on the land element of property, plant and equipment and this is contrary to IAS 16 *Property, Plant and Equipment*, as depreciation should only be charged on buildings.

The error is material as it represents 7% of profit before tax (0·7m/10m) and hence management should remove this from the financial statements.

If management refuse to amend this error then the audit report will need to be modified. As management has not complied with IAS 16 and the error is material but not pervasive then a qualified opinion would be necessary.

A basis for qualified opinion paragraph would need to be included explaining the material misstatement in relation to the provision of depreciation on land and the effect on the financial statements. The opinion paragraph would be qualified 'except for' – due to material misstatement.

(ii) Wages program

Minnie Co's wages program has been corrupted leading to a loss of payroll data for a period of two months. The auditors should attempt to verify payroll in an alternative manner. If they are unable to do this then payroll for the whole year would not have been verified.

Wages and salaries for the two month period represents 11% of profit before tax (1·1m/10m) and therefore is a material balance for which audit evidence has not been available.

The auditors will need to modify the audit report as they are unable to obtain sufficient appropriate evidence in relation to a material, but not pervasive, element of wages and salaries and therefore a qualified opinion will be required.

A basis for qualified opinion paragraph will be required to explain the limitation in relation to the lack of evidence over two months of payroll records. The opinion paragraph will be qualified 'except for' – due to insufficient appropriate audit evidence.

(iii) Lawsuit

The company is being sued by a competitor for breach of copyright. This matter has been correctly disclosed in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The lawsuit is for $5m which represents 50% of profit before tax (5·0m/10m) and hence is a material matter. This is an important matter which needs to be brought to the attention of the users.

An emphasis of matter paragraph would need to be included in the audit report, in that the matter is appropriately disclosed but is fundamental to the users' understanding of the financial statements; this will not affect the audit opinion which will be unmodified in relation to this matter.

An emphasis of matter paragraph should be inserted after the opinion paragraph, the paragraph would explain clearly about the lawsuit and cross references to where in the financial statements the disclosure of this contingent liability can be found.

			MARKS
1	**(a)**	Up to 1 mark per well explained control and up to 1 mark for each objective	
		Process order for fictitious order Sales order over credit limit Inspect credit applications Agree prices used to relevant price list Confirm discounts used on invoices agree to customer master file Attempt to process a discount for a small customer Inspect orders to confirm order acceptance generated Observe sales order clerk processing orders to see if acceptance generated Observe goods despatch process Agree goods despatch notes (GDN) to invoices Sequence checks over invoices	12
	(b)	Up to 1 mark per well explained procedure	
		– Trade receivables circularisation, follow up any non-replies – Review the after date cash receipts – Calculate average receivable days – Reconciliation of sales ledger control account – Cut-off testing of GDN – Aged receivables report to identify any slow moving balances – Review customer correspondence to assess whether there are any invoices in dispute – Review board minutes – Review post year-end credit notes – Review for any credit balances – Agree to GDN and sales order to ensure existence	8
	(c)	Up to 1 mark per well explained control and up to 1 mark for how it mitigates risk	
		Relatives not permitted to work in the same department Cash receipts processed by two members of staff Monthly customer statements sent Bank reconciliations reviewed by responsible official Rotation of duties within finance department Sales ledger control account reconciliation regularly performed Consider establishing an internal audit department	6
	(d)	Up to 1 mark per well explained procedure	
		Analytical review over revenue compared to budget and prior year Analytical review of major categories of toy sales compared to prior year Gross margin review Recalculate discounts allowed for larger customers Recalculate sales tax Follow order to goods despatched note to sales invoice to sales ledger Sales cut-off Review post year-end credit notes	4
			30

MARKS

2 **(a)** Up to 1 mark per valid point

Notes:
Simple to understand
Facilitate understanding by all team
Cumbersome especially if complex system
Difficult to identify missing controls
Questionnaires:
Quick to prepare and hence cost effective
All internal controls considered and missing controls identified
Easy to complete and use
Easy to overstate controls
Easy to misunderstand controls and miss unusual controls — 6

(b) **(i)** Up to 1 mark per valid point

Written agreement of terms of engagement
Avoid misunderstandings — 1

(ii) ½ mark per valid point

– Objective/scope
– Responsibilities of auditor
– Responsibilities of management
– Identification of framework for financial statements
– Form/content reports
– Elaboration of scope
– Form of communications
– Some misstatements may be missed
– Arrangement for audit
– Written representations required
– Fees/billing
– Management acknowledge letter
– Internal auditor arrangements
– Obligations to provide working papers to others
– Restriction on auditor's liability
– Arrangements to make draft financial statements available
– Arrangements to inform auditors of subsequent events — 3

10

3 **(a)** Up to 1 mark per well explained procedure and up to 1 mark for a valid audit test, overall maximum of 2 marks per type of procedure and test.

Inspection
Observation
Analytical procedures
Inquiry
Recalculation
Reperformance — 10

(b) Up to 1 mark per well explained risk and up to 1 mark per response, overall maximum of 10.

Planes ordered may not exist at year end
Refurbishment of planes – capital or repairs
Loan of $25m not received yet
Recoverability of receivables
Completeness of income
Customer refunds
Redundancy provision — 10

20

		MARKS
4	**(a)** Up to 1 mark per well explained safeguard	
	– Notify Goofy Co and Mickey Co – Advise seek independent advice – Separate engagement teams – Procedures prevent access to information – Clear guidelines on security and confidentiality – Confidentiality agreements – Monitoring of safeguards	4
	(b) Up to 1 mark per well explained advantage/disadvantage	
	Staffing gaps addressed immediately Skills and experience increased Costs of training eliminated Possibly reduced fees Flexibility of service Additional fees for NAB & Co Knowledge of systems reduced Independence issues NAB & Co Existing internal audit department staff, cost of potential redundancies Fees by NAB & Co may increase over time Loss of in-house skills Timing of work may not suit NAB & Co Confidentiality issues Control of department reduced	10
	(c) Up to 1 mark per well explained threat and up to 1 mark for method of managing risk, overall maximum 6 marks.	
	Familiarity threat – long association of partner Self-interest threat – son gained employment at client company Self-interest threat – financial interest (shares) in client company Contingent fees	6
		20

			MARKS
5	**(a)**	Up to 1 mark per well explained point	
		Definition of misstatements Definition of uncorrected misstatements Factual misstatements Judgemental misstatements Projected misstatements Auditor should accumulate misstatements Consider if audit strategy/plan should be revised Assess if uncorrected misstatements material Communicate to those charged with governance, request changes If refused then assess impact on audit report Request written representation	4
	(b)	Up to 1 mark per valid point	
		ISA 500 provides guidance Consider if member of professional body or industry association Assess whether relevant expertise Assess independence Evaluate assumptions Agree any further work required No reference in audit report of Daffy & Co	4
	(c)	Up to 1 mark per valid point, overall maximum of 4 marks PER ISSUE	
		Discussion of issue Calculation of materiality Type of audit report modification required Impact on audit report	12
			20