CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

AUDITING

PROFESSIONAL 1 EXAMINATION - AUGUST 2015

NOTES:

Section A - You are required to answer Questions 1, 2 and 3.

Section B - You are required to answer any **two** out of Questions 4, 5, 6 and 7. Should you provide answers to more than two questions in this section, you must draw a clearly distinguishable line through the answer(s) not to be marked. Otherwise, only the first two answers to hand for these four questions will be marked.

TIME ALLOWED:

3 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:

During the reading time you may write notes on the examination paper but you may not commence writing in your answer book.

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

AUDITING

PROFESSIONAL 1 EXAMINATION - AUGUST 2015

Time Allowed: 3 hours, plus 10 minutes to read the paper.
Section A - You are required to answer Questions 1, 2 and 3.
Section B - You are required to answer any **two** out of Questions 4, 5, 6 and 7. Should you provide answers to more than two questions in this section, you must draw a clearly distinguishable line through the answer(s) no to be marked. Otherwise, only the first two answers to hand for these four questions will be marked.)

SECTION A - Questions 1, 2 and 3 are compulsory.

1. You are the auditor of Mystery Ltd and in the course of the statutory year end audit you identified the following significant points in regards to the purchases control system:

(i) Amendments to the payables master file can only be made by the Managing Director (MD). Access to the master file is restricted to the MD by password protection.

(ii) A print out of the master file is periodically extracted by the MD and compared to the underlying system data to ensure that it has not been amended without authorisation.

(iii) The payables ledger balances are reconciled to the supplier statements by Mr Straight who is responsible for processing purchasing and payables. All reconciliations are retained on file to assist with the preparation of year-end accruals and in cases of disputed payments.

(iv) At month end Mr Straight prints off an aged payables ledger and writes cheques to all suppliers with amounts in the '70 days and older' column. He then presents the cheques to the MD along with a copy of the aged payables ledger. The MD scrutinises the cheques and relates the payables back to the authorised list of suppliers on the master file. The MD then signs the cheques, and Mr Straight mails them to suppliers.

(v) All expense claims are supported by receipts, as required by company policy. All claims are authorised by the MD, who checks that the receipts are sufficient evidence and that claims are relevant to the business.

REQUIREMENT:

(a) Discuss the strengths in the purchases and payables control system of Mystery Ltd. (6 marks)

(b) Outline tests of controls that you as auditor of Mystery Ltd should perform to assess if the controls are operating effectively.
(6 marks)

(c) Describe the overall objectives of the auditor, when conducting an audit in accordance with ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.
(4 marks)

(d) State the legal rights of auditors as set out in the companies acts (1963-2014). (4 marks)

[Total: 20 Marks]

2. Intransglobal Ltd (Intransglobal) is a client of your firm. The company has experienced significant trading difficulties in recent years. The audit fieldwork for the year ended 31 December 2014 has been completed and the following matters have been noted.

(i) Intransglobal was in breach of its bank covenant arrangements at the year end. Management indicated that a meeting has been held with the company's bankers at which it received assurances from the bank that none of the financing facilities of the company would be withdrawn. Intransglobal has a five-year term loan of €600,000 and an overdraft facility of €250,000.

(ii) Intransglobal has a financial investment of €50,000 in a company called Vista Ltd (Vista). The investment does not qualify Vista to be treated as a subsidiary of Intransglobal. The client is unable to provide evidence to support the carrying value of the investment.

The draft results of Intransglobal for the year ended 31 December 2014 highlight revenue of €9.5 million, a loss before tax of €500,000, and net assets of €2.5 million.

There were no other matters noted from the audit work performed.

REQUIREMENT:

(a) Draft a memorandum to the audit partner setting out the audit evidence that should be obtained in respect of the matters noted above and outlining the potential impact on the audit report.

(12 marks)

(b) At the planning meeting for this engagement, the audit partner noted that the standard of audit reports being drafted by the audit seniors was poor. Recommend a number of checks that should be performed on audit reports prior to signing.

(5 marks)

(c) As per ISA 706 - *Empasis on matter paragraphs and other matter(s) paragraphs in the Independant Auditors' Report*, list three instances which may give rise to an "emphasis of matter" paragraph.

(3 marks)

[Total: 20 Marks]

3. Due to increased workload, your firm has just recruited a new junior audit staff member, Patricia, who has joined the practice directly from college and so has no previous experience. You have been assigned as her training manager.

Patricia is now looking at summarised material given to her by the audit partner on some of the auditing standards, namely ISA 210 and ISA 260.

ISA 210 - *Agreeing the terms of audit engagements* deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and those charged with governance.

ISA 210 outlines the following points:

- an auditor shall establish whether the preconditions for an audit are present;
- an auditor shall confirm that there is a common understanding between the auditor and management or those charged with governance of the terms of the audit engagement".

ISA 260 - *Communication with those charged with governance* deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. It focuses primarily on communications from the auditor to those charged with governance. Nevertheless, effective two-way communication is important".

Patricia would like you to explain in more detail what she has read.

REQUIREMENT:

(a) In relation to Patricia's request, regarding the provisions set out in ISA 210 - *Agreeing the Terms of Audit Engagements*:

(i) Describe the main actions an auditor should take in order to establish whether the preconditions for an audit are present.

(4 marks)

(ii) The ISA states that the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate, and these terms can be recorded in an audit engagement letter or other suitable form of written agreement.

State the common items that such an agreement/engagement letter should include? (4 marks)

(iii) Outline when an auditor should change the terms of the audit engagement in relation to a recurring audit.

(4 marks)

(b) In relation to Patricia's request, detail the provisions set out in ISA 260 - *Communications with those charged with Governance* in relation to the following:

(i) The main objectives of the auditor in communicating with those charged with governance. (4 marks)

(ii) The significant matters the auditor should communicate with those charged with governance about the responsibilities of the auditor in relation to the audit of the financial statements.

(4 marks)

[Total: 20 Marks]

SECTION B – Answer only 2 questions from this section.

4. You have recently been appointed the audit senior for Hamilton Computers Ltd, a technology company involved in the development of computer software and the manufacture of information technology (IT) hardware. The audit will commence shortly.

The Company relies heavily on its IT systems to manage and operate the business. The company has just implemented a new accounting IT system to support and record all of its financial transactions.

At a recent meeting with the company's chief financial officer (CFO), the audit partner informed the CFO that an audit of the new accounting IT system will be conducted this year, focusing largely on the general and application controls in the new system.

REQUIREMENT:

(a) The audit partner has asked you to brief him on the key aims and objectives of the audit of the new accounting IT system for the CFO.

(5 marks)

(b) As part of the discussions at the meeting, the audit partner mentioned that there are three main areas upon which the audit of general controls will focus, namely:

(i) IT Information security
(ii) IT systems change control
(iii) IT operations.

The audit partner has requested that you to assess the key risks and controls in each area. (12 marks)

(c) The audit partner has also noted that the team will use computer assisted audit techniques (CAATs) as part of this year's audit and would like you to briefly explain the benefits of using CAATs.

(3 marks)

[Total: 20 Marks]

5. Irish Bus Tours (IBT) is an Irish-registered company that offers premium coach tours around Ireland. Your firm has recently been appointed auditor for IBT.

You as audit senior are now preparing an overall audit strategy, with one of its principal sections being an overview of IBT's business and the tourism industry.

REQUIREMENT:

(a) Describe THREE benefits an auditor derives from planning audits. (3 marks)

(b) Outline the responsibilities of the new and previous auditors when a company is changing auditors.

(4 marks)

(c) According to ISA 220 - *Quality Control for an Audit of Financial Statements*, the auditor should consider certain factors before accepting a new engagement or continuing an existing engagement. Discuss three such factors.

(9 marks)

(d) As per ISA 320 - *Materiality in Planning and Performing an Audit*, briefly set out the following:

- What constitutes a material misstatement?
- How the auditor might calculate 'materiality'? (4 marks)

[Total: 20 Marks]

6. You are the external auditor of Corner Stores Ltd (CS) for the year ended 31 March 2015. CS operates 12 convenience stores in the greater Dublin area:

- Each store sells food, contains a deli section and an off-licence.
- Each store is responsible for its own inventory procurement and produces monthly management accounts which are sent to the centralised accounting department at CS head office.

CS is financed by a €250,000 bank loan which is repayable at a rate of €50,000 per annum over each of the next 5 years starting on 31 October 2015.

It also has an overdraft facility of €100,000 which it uses in full. The bank overdraft facility is due for renewal on 1 May 2016.

The bank has already told the company that it will need to prepare a cash flow forecast for the two years from 1 February 2016 in order for the bank to decide whether or not the overdraft facility will be renewed. The bank has also said it will require a report from the external auditors to confirm the accuracy of the forecast.

REQUIREMENT:

Prepare notes for the new trainee audit staff on your team which:

(a) Defines the term 'analytical procedures'; and (3 marks)

(b) In relation to the work of an external auditor:

(i) Describes FOUR analytical procedures that should be performed to confirm CS's revenue and profit. (4 marks)

(ii) Outlines substantive procedures that should be adopted to verify each of the following assertions:

- The valuation of inventory. (5 marks)
- The completeness of payables. (4 marks)

(iii) Reccomends appropriate substantive procedures that should be performed to confirm CS's bank loan.

(4 marks)

[Total: 20 Marks]

7.

(a) The CPA Ireland Code of Ethics identifies that threats to practitioners may be created by a broad range of relationships and circumstances. Discuss the following:

(i) Self-interest threat
(ii) Self-review threat
(iii) Advocacy threat
(iv) Familiarity threat
(v) Intimidation threat. (10 marks)

(b) At times, a practitioner may be required to resolve a conflict in complying with the fundamental principles of the CPA Ireland's Code of Ethics. Discuss the steps a practitioner should consider in order to ensure compliance with the Code when initiating either a formal or informal conflict resolution process.

(6 marks)

(c) The CPA Ireland Code of Ethics states that professional fees shall be a fair reflection of the value of the professional services performed for the client. Outline the factors which should be considered when setting the fee for an audit engagement in order to comply with the Code.

(4 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

AUDITING

PROFESSIONAL 1 EXAMINATION - AUGUST 2015

SOLUTION 1

Purchases

(a) Strength: 6 marks	**(b) Test of Control: 6 marks**
Amendments to payables master files can only be performed by the MD. This prevents unauthorised amendments to the master file, e.g. the setting up of a fake supplier.	The auditor should use test data and enter a 'dummy' password into the payables master file to ensure access is not granted.
The masterfile data is reviewed by the MD periodically to ensure that it has not been amended. This ensures that unauthorised amendments are identified and resolved on a timely basis.	For a sample of months, inspect the masterfile printout and for a sample of amendments ask the MD to explain the reason for the amendment.
Mr Straight performs supplier statement reconciliations and prepares cheques but does not sign cheques. Segregation of duties significantly prevents fraud and error.	Observe the process of performing supplier reconciliations ensuring that it is performed by Mr Straight. Alternatively, inspect a sample of supplier reconciliations for evidence of Mr Straight signature confirming that it was performed by him.
Supplier statements (and the consequent reconciliations) are retained on file. This creates an audit trail to confirm the completeness and accuracy of payables balances at the year-end.	Ask to inspect the file of reconciliations to ensure they are being retained.
The MD scrutinises the cheques before signing them and checks them back to the authorised list of suppliers. This prevents payments being made to false suppliers or for incorrect amounts and ensures that full credit terms are taken advantage of.	Observe the process of raising cheques ensuring that Mr Straight attaches the payables ledger to the cheques and the MD reviews this. For a sample of payments made to suppliers during the year, compare to the authorised list of suppliers to ensure that only valid suppliers are being paid.
Expense claims are always supported by receipts and all claims are authorised by the MD. This prevents fraudulent claims being processed.	For a sample of expense payments recorded on the payroll system, inspect the related receipts and supporting documents signed by the MD to authorise the payment as a valid business expense.

(c)

– Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

– Express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable reporting framework.

– Report on the financial statements, and communicate as required by ISA's, in accordance with the auditor's findings.

(4 marks)

(d)

- access the books and accounts of the company and its subsidiaries;
- access information and explanations from the company's directors and employees;
- be notified of company general meetings and attend and address the meetings;
- explain at a general meeting the circumstances of any proposal to remove them as auditor and to contest that removal.

(4 marks)

SOLUTION 2
(a)
Memo to: Audit partner
From: A. Senior
Re: Intransglobal Limited
Year ended 31/12/14 Date: 08/04/15

(1 mark report format)

The following is the audit evidence I require and the implication that I see tor the audit opinion in respect of the matters raised regarding the above company:

(i) **Breach of Covenants** Management has indicated that they have received assurances from its bank that none of the financing facilities would be withdrawn. With the clients permission, I propose communicating with the bank directly and requesting it to confirm this to us in writing. Should we receive such confirmation, this would form part of the basis for our conclusion as to whether the entity is a going concern. The net assets of the company are €2.5 million. Whether the entity can continue as a going concern in the foreseeable future will depend on the working capital of the entity which I will investigate further. Provided that this investigation proves positive, then the matter will have no implications for our audit report.

If no confirmation is received from the bank and it states that it has not given assurances that none of the financing facilities would be withdrawn, then a going concern issue exists and requires further consideration.

If we conclude, post our analysis of all the pertinent facts, that it is appropriate to prepare the financial statements on a going concern basis and the relevant disclosures in the financial statements are adequate, then an explanatory paragraph should be given in the audit report referring to the relevant disclosures.

If we consider the disclosures to be inadequate but that the entity is a going concern, we should qualify the audit report on the basis of an except for disagreement type qualification as well as giving an explanatory paragraph outlining the going concern uncertainty.

If the financial statements are prepared on a going concern basis and we disagree with that basis and the effect of using that basis is so material or pervasive that the financial statements are seriously misleading, an adverse audit qualification should be given.

(ii) **Carrying Value of Investment** The company cannot provide us with the evidence we require to support the carrying value of the investment in Vista Limited. We need to establish if there is any alternative evidence we can use to support the carrying value. I will try to obtain the last financial statements issued by Vista and review the net asset position of the company. If there is no alternative evidence available then there is a potential limitation of scope issue. The maximum impairment is €50,000 which would reduce the net assets of the company and increase the loss by that amount. Given the loss-making nature of the entity, it could be argued that the amount is material and if we conclude this to be the case then this would lead to an "Except for" limitation in scope qualification.

(8 marks)

Qualification

- the evidence available was limited hence insufficient appropriate audit evidence regarding the carrying value of the financial investment in the balance sheet amounting to €50,000. Any adjustment to this figure would have a consequential effect on the loss for the year. There is little to suggest that other satisfactory audit procedures could be adopted to confirm that the carrying value of the financial investment was correct.

- Qualified opinion arising from Limitation in Audit Scope

(3 marks)

(c) The following are the checks that should be performed on audit reports prior to signing -

- ensure legal references are correct,
- ensure the page references refer to the actual pages of the financial statements being audited,
- the correct result is reflected in the opinion paragraph, i.e. a profit or a loss,
- ensure consistency with relevant GAAP,
- check name of company being audited and year end is correct,
- ensure final audit opinion is correct, i.e. unqualified or qualified,
- ensure consistency with audit firm's standard audit report wording,
- two members of staff should "call over" the audit report to ensure the wording is correct.

(5 marks)

(d) ISA 706 paragraph A1
Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- Early application (where permitted) of a new accounting standard (for example, a new International Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

(3 marks)

[Total: 20 marks]

SOLUTION 3

(a)

(i) Preconditions for an Audit.
In order to establish whether the preconditions for an audit are present, the auditor shall firstly:

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility for:
- the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- providing the auditor with:
  - ➢ Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - ➢ Additional information that the auditor may request from management for the purpose of the audit; and
  - ➢ Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

(c) The auditor should establish if the management or those charged with governance have imposed a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

(d) If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

(ii) Agreement on Audit Engagement Terms
The agreed terms of the audit engagement should be recorded in an audit engagement letter or other suitable form of written agreement and these terms should include:

- The objective and scope of the audit of the financial statements;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the applicable financial reporting framework for the preparation of the financial statements;
- Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

If law or regulation prescribes in sufficient detail the terms of the audit engagement the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

(iii) Recurring Audits
In the event of a recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

When accessing the rationale to agree to a change in the terms of the audit engagement the following should be considered:

- The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

- If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

- If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

- If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

  - ➢ Withdraw from the audit engagement where possible under applicable law or regulation; and

  - ➢ Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

(b)
(i) The objectives of the auditor in communicating with those charged with governance are:

- To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

- To obtain from those charged with governance information relevant to the audit;

- To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

- To promote effective two-way communication between the auditor and those charged with governance.

(ii) The significant matters the auditor shall communicate with those charged with governance about the auditor's responsibilities in relation to the financial statement audit include:

- The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and

- The audit of the financial statements does not relieve management or those charged with governance of their responsibilities,

- The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit,

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures,

- Significant difficulties, if any, encountered during the audit,

- Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

SOLUTION 4

(a) The key aims and objectives of an IT audit are:

- The main aim of an IT audit is similar to Financial Statement Audit objective — to determine whether an organisation's financial statements and financial condition are presented fairly in accordance with generally accepted accounting principles (GAAP)

- The objective of an IT Audit is to review and evaluate an organisation's information system's availability, confidentiality, and integrity. This means access to the organisation's computer system to ensure it will be available for the business at all times when required (Availability). Reviewing the confidentiality of its information to understand if the information in the systems is only disclosed to authorised users.

- The final aim is to ensure the integrity of the information which means that the information provided by the system is accurate, reliable, and timely.

(5 marks)

(b) When conducting an IT Audit there are three main areas which IT auditors focus on, please list these three areas and outline the key risks and controls for one area.

The three main areas for IT Audit are:

- Information Security;
- IT Change Control; and
- IT Operations and Data Interfaces.

Information Security
In the area of Information security the key risks include allowing access to the information by more people than is necessary through a failure to implement appropriately logical security including user names and passwords or a failure to implement a secure user access management process including a process to approve the set up of new users and to remove access once a person leaves employment. It is also important to ensure that there is an appropriate segregation of duties.

The key controls include:

- implementing logical security tools, such as passwords, firewalls' virus protection to govern access;
- appropriate physical and environment security measures are taken; and introducing a process to govern the granting and removing of access to the systems, and a process to review access from time to time to ensure that any segregation of duties issues are identified

Change Control
The key risks associated with the area of IT change control include the risk that changes are not properly approved by management, that changes are not fully tested so that they deliver their objectives.

The key controls to address these risks include:

- the use of Formal Acquisition and Development Procedures, which ensure that before any changes begin they are fully approved by management to ensure that they are in line with the organisation's IT aims and objectives;
- a procedure to ensure that all which is converted from older systems is fully reviewed to ensure that it has been moved correctly;
- controls to restrict access and the ability to make changes so that changes cannot be commenced without approval;
- procedures to ensure that Formal Testing is carried out before the changes are imple-mented.
- This should include testing by users to ensure that they achieve their aims and by IT to ensure that the changes are correctly developed from a technical point of view.

IT Operations and Data Interfaces
The main risks in the area of IT operations and interfaces are that all scheduled jobs do not run successfully, that data does not flow accurately from one application to another, that data is not appropriately backed up and that additional or unapproved tasks are run on the systems.

The key controls include:

- a process to monitor all overnight or batch jobs to ensure that these have completed successfully;
- controls to restrict the ability to make changes to scheduled jobs;
- a process to identify and follow up on any jobs which fail to run correctly.

(12 marks)

(c) The benefits of using CAATs:

The main advantage of computer-assisted audit techniques (CAATs) is the ability to test 100% of the transactions under review rather than the normal sampling approach. The use of CAATs is also more effective and efficient than a manual approach. In addition when using CAATs software it is possible to define scripts or commands which can be re-run multiple times and used when tests are repeated thus bringing greater efficiencies.

(3 marks)

SOLUTION 5

(a) Benefits from planning audits

There are three main benefits from planning audits:

- it helps the auditor obtain sufficient appropriate evidence for the circumstances,
- helps keep audit costs at a reasonable level, and
- helps avoid misunderstandings with the client.

(3 marks)

(b) If the client has been audited previously, under ISA 300 the new auditor should contact the previous auditor, in compliance with relevant ethical requirements, in order to evaluate whether to accept the engagement. Permission must be obtained from the client by both the new auditor and the previous auditor before communication can be made because of the confidentiality requirement in the Auditors Code. The new auditor should be wary of accepting the client if the client does not give permission for this communication to the new auditor and/or the previous auditor. The previous auditor in compliance with relevant ethical requirements is required to respond to the new auditor's request for information if given permission by the client.

(4 marks)

(c) As per ISA 220 – *Quality Control for Audits of Financial Statements*

Audit firms should only accept a new client or continue an existing client relationship where it;

- Has considered the "Integrity of the Client"
- Is "Competent to perform" the engagement (capabilities / time / resources)
- Is in compliance with "Ethical Requirements"

(3 marks)

Integrity of the Client

- Client Reputation
- Nature of Client Operations
- Attitudes of Key Players (Aggressive Standards Interpretation / internal controls / Low audit fees / limiting scope of work)
- Money Laundering
- Outgoing auditors (reason)

Competency of the Audit Firm to Perform the Engagement

- Knowledge of Industry / Subject Matter
- Experience with Relevant Statutory / Reporting Requirements
- Sufficient Personnel and Time / Capacity
- Experts where Necessary
- Ability to Perform Quality Control Review

Ethical Considerations

- Audit Firm and Individual Personnel - Independence
- No perceived Conflict of Interest with an existing audit client

(Any two total 6 marks)

(d) (ISA 320 para 2)
Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

(ISA 320 para 4)
The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements.

(4 marks)

[Total: 20 marks]

SOLUTION 6

(a) Analytical procedures involve evaluating financial and non-financial information and comparing actual results to expectations. They also involve identifying significant fluctuations and relationships that deviate from expecta-tions. Expectations should be developed based on the auditor's knowledge of the oper¬ations of the entity during the period under review and information obtained through performance of other audit tests.

(3 marks)

(b)

(i) Four analytical procedures

- Review monthly sales per outlet broken down per food products, deli and off licence
- Compare profit margins for sales across shops
- Review sales mark up on cost and compare to revenue
- Review average level of shop inventory wastage per outlet
- Compare actual levels of sale per shop to budget

(4 marks)

(ii) Substantive procedures (1 mark for each properly explained procedure)

Valuation of inventory

- Verify sample to supplier invoices to ascertain cost
- Discuss method of cost approximation with management and compare to current prices across the three areas of food products, deli and off licence
- Examine sales prices after year end to confirm NRV > cost for shop inventory
- Vouch a sample items held in shop inventory to purchase invoices to verify cost
- Consider the level of perishable inventory held at the inventory count and review the year end valuation

(5 marks)

Completeness of payables

- Analytically review the level of payables this year to prior year
- Circularise suppliers, review supplier statements
- Review cash book for payments made to suppliers post year end
- Calculate payables days and investigate significant differences

(4 marks)

(iii) Bank loan

- Inspect loan agreement for sum borrowed and evidence of any covenants/ conditions
- Direct confirmation from the lender re unpaid loan and interest/ security
- Ensure proper split between current and non-current liability
- Ensure interest charge and any accrued interest accurately recorded

(4 marks)

SOLUTION 7

(a) Threats and Safeguards

Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a member's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

(i) Self-interest threat – the threat that a financial or other interest will inappropriately influence the member's judgment or behaviour;

(ii) Self-review threat – the threat that a member will not appropriately evaluate the results of a previous judgment made or service performed by the member, or by another individual within the member's firm or employing organisation, on which the accountant will rely when forming a judgment as part of providing a current service;

(iii) Advocacy threat – the threat that a member will promote a client's or employer's position to the point that the member's objectivity is compromised;

(iv) Familiarity threat - the threat that due to a long or close relationship with a client or employer, a member will be too sympathetic to their interests or too accepting of their work;

(v) Intimidation threat – the threat that a member will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the member

(10 Marks)

(b) Ethical Conflict Resolution

A member may be required to resolve a conflict in complying with the fundamental principles.

When initiating either a formal or informal conflict resolution process, a member shall consider the following, either individually or together with others, as part of the resolution process:

CODE OF ETHICS FOR CERTIFIED PUBLIC ACCOUNTANTS:

(a) Relevant facts;
(b) Ethical issues involved;
(c) Fundamental principles related to the matter in question;
(d) Established internal procedures;
(e) Alternative courses of action

(6 Marks)

(c) CODE OF ETHICS FOR CERTIFIED PUBLIC ACCOUNTANTS

Section 240 Fees and Other Types of Remuneration 240.3 Professional fees shall be a fair reflection of the value of the professional services performed for the client, taking into account:

(a) The skill and knowledge required for the type of professional services involved.
(b) The level of training and experience of the persons necessarily engaged in performing the professional services.
(c) The time necessarily occupied by each person engaged in performing the professional services.
(d) The degree of responsibility that performing those services entails

(4 Marks)