AUDIT PRACTICE & ASSURANCE SERVICES

PROFESSIONAL 2 EXAMINATION - AUGUST 2015

NOTES:
SECTION A: Answer Question 1, and
SECTION B: Answer any **two** from Questions 2, 3 and 4.
Should you provide answers to more questions than required in Section B, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first two answers provided will be marked.

Time Allowed
3.5 hours, plus **20 minutes** to read the paper.

Examination Format
This is an open book examination. Hard copy material may be consulted during this examination, subject to the limitations advised on the Institute's website.

Reading Format
During the reading time you may write notes on the examination paper, but you may not commence writing in your answer booklet.

Marks
Marks for each question are shown. A mark of 50 or more is required to achieve a pass in this paper.

Answers
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.

Answer Booklets
List on the cover of each answer booklet, in the space provided, the number of each question attempted. Additional instructions are shown on the front cover of each answer booklet.

AUDIT PRACTICE & ASSURANCE SERVICES

PROFESSIONAL 2 EXAMINATION - AUGUST 2015

Time allowed: 3.5 hours plus **20 minutes** to read the paper.
Section A: Answer Question 1 **and**
Section B: Answer any **two** from Questions 2, 3 and 4.

Section A: Question 1 is compulsory.

1. Frat plc is the holding company of the Frat group. You are the audit manager with responsibility for the audit of both the holding company and the consolidated financial statements.

You are currently planning the audit for the year ended 30 June 2015. You have just had a meeting with the Group Finance Director at which she presented summarised information on the financial performance of the group during the year and other relevant details as follows:

Statements of Financial Performance

Income Statement - year ended 30 June 2015

	Continuing operations	**Discontinuing Operations**	**Total**
	€m	**€m**	**€m**
Revenue	1,400	140	1,540
Cost of Sales	(728)	(98)	(826)
Gross Profit	672	42	714
Other operating expenses	(280)	(56)	(336)
Profit / loss from operations	392	(14)	378
Loss on disposal of discontinuing operations		(42)	(42)
Profit / loss before finance costs	392	(56)	336
Finance Costs			(77)
Profit before tax			259
Corporation tax			(77)
Profit after tax			182
Non-Controlling Interests			(63)
Group Profit for Period			119
Earnings per equity Share			59.13 cent

Statement of changes in equity - year ended 30 June 2015

	€m	**€m**
Balance at 1 July 2014		378
Profit for the financial year		119
Unrealised surplus on the revaluation of properties		30.8
Currency translation differences on foreign currency net investments	16.8	
Less: exchange losses on foreign currency loans	(12.6)	4.2
Dividends (all equity)		(70)
Issue of share capital		84
Balance at 30 June 2015		546

Notes to the Consolidated Financial Statements:

1. Under their contracts of employment the executive directors receive a bonus if the earnings per share (EPS) exceed a certain level. EPS is, therefore, considered a critical Key Performance Indicator (KPI) and the non-executive directors carefully verify the calculation of EPS in the financial statements.
2. During the year, Frat plc disposed of a subsidiary. This gave rise to a €63 million loss, being the disposal proceeds less related net assets less related goodwill, which was partially offset by a €21 million gain arising from the curtailment of retirement benefits related to the disposal.
3. On 1 July 2014, Frat plc had 168,000,000 equity shares in issue with a nominal value of €1 each. On 1 July, Frat made a rights issue to existing shareholders of one share for every four held at €2 per share. The market value of each share immediately prior to the rights issue was €2.50.
4. The following was noted in relation to the defined benefit pension scheme:

	30 June 2015 €m	**30 June 2014 €m**
Present value of funded obligations	7,000	6,300
Fair value of plan assets	(3,640)	(3,780)
Unrecognised actuarial losses	(532)	(490)
Net liability in Statement of Financial Position	2,828	2,030

The Group Finance Director also informed you that she has just returned from investigating a fraud at the group's subsidiary in Amsterdam where the financial controller misappropriated approximately €1.7 million by using company cheques and bank transfers to enable him to live "in some splendour". These were reported as company expenses in the returns submitted to the group's Head Office. Whilst the amount involved is not material to the group as a whole, there is concern among those charged with the governance of the group that the audit work performed in previous years did not uncover the fraud and the Chair of the Audit Committee has asked for a meeting with the audit partner to discuss this.

REQUIREMENT:

(a) Recommend the principal audit procedures which should be performed in respect of:
(i) the disposal of the subsidiary, and
(ii) the non-controlling interest charge in the Group Income Statement. (12 marks)

(b) Evaluate the audit risks in relation to the following aspects of the audit of the Frat Group for the year ended 30 June 2015:

(i) The Earnings per Share
(ii) The unrealised surplus on the revaluation of properties
(iii) The currency translation differences
(iv) The issue of share capital. (16 marks)

(c) Discuss any concerns the auditor might have about the decision of the Group to credit the "gain on curtailment of retirement benefits" to the income statement as distinct from actuarial losses which are included in the pension plan liability figure within the Statement of Financial Position.

(8 marks)

(d) Prepare a briefing note for your team on the most important controls that the Frat Group should have in place to prevent and detect the misappropriation of funds by management and employees at the group's subsidiary companies.

(8 marks)

(e) Discuss the adequacy of the guidance provided by ISA 600 *Special Considerations - Audit of Group Financial Statements* in relation to the issue of non-consolidated entities under common control.

(6 marks)

[Total: 50 Marks]

SECTION B - ANSWER TWO QUESTIONS ONLY

2. You work in the Quality Control depatment of CPA Ireland. You are contacted by a member in practice, Bobby Salter, about what he feels is an ethical dilemma he is facing. Bobby has recently been appointed as a partner of Murphy & Co, a medium-sized firm of Certified Public Accountants and Registered Auditors. He has been a close personal friend of Adam Murphy, the firm's managing partner for many years. Bobby was previously training manager in the firm and he has now been asked to act as training partner. This is the first time Murphy & Co have designated a particular partner as having responsibility for training.

As part of their professional development, trainees are expected to keep a 'learning log' - a kind of professional diary - which Bobby reviews periodically. During a recent review, one of the trainees, Sarah Costigan, noted that she was disturbed by something that had happened on an audit of a company called Smiggy Ltd, a medium-sized family-run business and longstanding client of Murphy & Co.

Sarah was auditing purchases of non-current assets when she noticed a transaction that she thought might be suspicious. There was a charge of €175,000 (an individually material amount) for a sophisticated IT video conferencing system for an address in a rural area with no obvious link to the company. When she asked Smiggy's financial controller about the matter she was told it referred to the installation of such a system in a second home owned by the CEO. This was to facilitate excellent communications and interaction with the CEO especially during the summer period when he liked to reside there with his family. She further explained that part of the cost was attributed to having to pay for a personal broadband connection since the house was in an isolated area where normal broadband connections were unavailable.

The financial controller appeared surprised and even irritated by the queries about the matter and said that auditors had not previously been concerned about the company being charged for non-current assets and operational expenses at properties owned by the CEO.

The engagement partner on the assignment happened to be the managing partner, Adam Murphy. Sarah told him what she had found and Adam simply said that the charge could probably be ignored. He did, however, say that he would include a reference to the matter in the written representations letter required by ISA 580 - *Written Representations* adding with a smile that "paper never refused ink". About two months later, Sarah looked at the completed files and the letter of representation in which there was no reference to the matter. When Sarah asked Adam about it he said "*Oh dear! Must have slipped my mind. Sorry. I really must get into the habit of writing things down. Still – nothing we can do about now. All's well that ends well!*"

When Bobby Salter read about Sarah's concerns and spoke to her directly, he realised that there was an ethical issue. At the very least the transaction should have been disclosed as a related party transaction under IAS 24 *Related Party Disclosures* but the situation was made more complicated by the fact that Adam Murphy was (for all practical purposes) still Bobby's boss in Murphy & Co.

REQUIREMENT:

Draft a letter to Bobby in which you:

(a) Discuss the meaning of 'integrity' and its importance in professional relationships such as those described in the above scenario.

(4 marks)

(b) Critique Adam Murphy's ethical and professional behaviour. (9 marks)

(c) Critically evaluate the alternatives available to Bobby Salter with regard to his ethical dilemma. (9 marks)

(Format and Presentation 3 marks)

[Total: 25 Marks]

3. Rua Sionnach the managing partner of your firm, Fox and Geese Registered Auditors, has sent you an e-mail following a meeting earlier today with the chairman of a board of governors of a large school. The school wishes to participate in a new scheme that will be run on a pilot basis in the region by the Department of Education & Science. An extract from Rua's email follows:

"The Department of Education and Science (DES) has invited the school to apply for inclusion in a pilot scheme 'Schools Eligible for Special Assistance' (SESA). All applicants will not be successful. Schools that will be selected for inclusion in the SESA scheme will be allocated enhanced resources according to their perceived needs. These resources may vary from school to school but will include enhanced counselling services, funding for homework clubs, extra physical education teachers and coaches, improved internet access, more English teachers for students for whom English or Irish is not a first language, and other similar measures. Free school meals, books and uniforms will be provided to some students identified by DES as especially disadvantaged.

As a result of these measures, SESA schools will be required to report formally to DES periodically on their performance in meeting these KPIs. This performance report will have to be accompanied by an independently-prepared Assurance Report which attests to its varacity.

The proposed KPIs are shown below:

Area measured	**KPI**
Academic Performance	Number of students achieving 500 or more points in the Leaving Certificate; or 6 more "A" grades in the Junior Certificate.
School Attendance	Percentage of students present for the roll-call at 09:00 each morning.
Participation in sports and other inter-school competitions e.g. music and debating	Number of trophies won by individuals and teams in SESA schools.
Complaints received students	Number of complaints received from members of the public about the students in SESA schools misbehaving or the like when they are in school; or at times when they are supposed to be in school, including reports of playing truant.
Uniform	Percentage of students whose uniform is in line with regulations based on an inspection carried out at roll-call time each Monday morning.

The chairman has advised that his board wishes to respond constructively to the consultation on the KPIs in the hope that this will assist in its application for inclusion in the final list of 'SESA' schools.

As you are aware, I will be away at a residential conference for CPA Practitioners for the next two days and I would like you to prepare briefing notes for me for my next meeting with the chair of the board of governors, which is scheduled for next Monday."

REQUIREMENT:

(a) Distinguish between the types of services typically provided by auditors to clients. (5 marks)

(b) Prepare a briefing note for Rua Sionnach in which you critically access the difficulties your firm would be likely to experience in the event that Fox and Geese were required to produce an assurance report based upon the KPIs listed above.

(10 marks)

(c) Suggest how these KPIs could be improved and recommend alternative KPIs that would enhance performance measurement in each area.

(10 marks)

[Total: 25 Marks]

4.

(a) Distinguish between the following pairs of terms as used in: ISA 700 *The Independent Auditor's Report on Financial Statements*; ISA 705 *Modifications to the opinion in the Independent Auditor's Report*; and ISA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report,* and give one example of how each might be used in practice.

(i) Disclaimer of Opinion versus Adverse Opinion

(ii) Emphasis of Matter paragraph versus Other Matter paragraph

(iii) Unmodified Report versus Unmodified Opinion. (9 marks)

(b) You are the audit manager of Razzle Ltd, a private company that retails furniture. Summary draft and audited results show the following:

	2015 (draft) €m	**2015 (audited) €m**
Revenue (for the year to 30 June)	45.0	43.0
Profit before taxation (for the year to 30 June)	2.0	1.5
Total assets (as at 30 June)	31.0	24.0

The following points should be considered in the drafting of the Audit Report.

1. Razzle Ltd leases one of its main retail facilities from a partnership controlled by its Chief Executive Officer (CEO). Your review of the lease indicates that the lease costs Razzle about €50,000 more per annum than would normally be expected in an 'arm's length' transaction. Razzle refuses to disclose this related-party transaction in the notes to the financial statements for the year ended 30 June 2015.

2. Razzle has one small subsidiary in an Eastern European country. Restrictions on the repatriation of earnings from this country were introduced in July 2014 and remain in place. As a result, Razzle has decided to account for the subsidiary on an equity basis this year. You are satisfied as to the appropriateness of this change and it is fully disclosed in the financial statements.

3. During the audit, you discovered that inventory to the value of approximately €1 million had been excluded from the financial statements of the company. After discussing this with management, you are satisfied that it was an unintentional oversight. The error was corrected prior to the conclusion of the audit.

REQUIREMENT:

Evaluate the implications of these three matters for:

(i) The Audit Report for the Year Ended 30 June 2015. (14 marks)

(ii) Your continuing relationship with Razzle Ltd. (2 marks)

[Total: 25 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

AUDIT PRACTICE & ASSURANCE SERVICES

PROFESSIONAL 2 EXAMINATION - AUGUST 2015

SOLUTION 1

(a)

(i) Procedures to be performed on the disposal of the subsidiary:

- Obtain the statement of financial position of the subsidiary as at 1 July 2014 to confirm the value of assets and liabilities which have been derecognised from the group.
- Review prior year group financial statements and audit working papers to confirm the amount of goodwill that exists in respect of the subsidiary and trace to confirm it is derecognised from the Group on disposal.
- Confirm that the Frat Group is no longer listed as a shareholder of the company.
- Obtain legal documentation in relation to the disposal to confirm the date of the disposal and confirm that the subsidiary's profit has been consolidated up to this date only.
- Agree or reconcile the profit recognised in the group financial statements to the subsidiary's individual accounts as at 1 July 2014
- Perform substantive analytical procedures to gain assurance that the amount of profit consolidated from the date of disposal to the financial year-end appears reasonable and in line with expectations based on prior year profit.
- Re-perform management's calculation of profit on disposal in the group financial statements.
- Agree the proceeds received to legal documentation, and to cash book/bank statements.
- Confirm the fair value of proceeds on disposal and that no deferred or contingent consideration (if applicable) is receivable in the future.
- Review the group statement of profit or loss and other comprehensive income to confirm that the profit on disposal is correctly disclosed as part of profit for the year (not in other comprehensive income) on a separate line.
- Using a disclosure checklist, confirm that all necessary information has been provided in the notes to the group financial statements.
- Obtain the parent company's statement of financial position to confirm that the cost of investment is derecognised.
- Using prior year financial statements and audit working papers, agree the cost of investment derecognised to prior year's figure.
- Re-perform the calculation of profit on disposal in the parent company's financial statements.
- Reconcile the profit on disposal recognised in the parent company's financial statements to the profit recognised in the group financial statements.
- Obtain management's estimate of the tax due on disposal, re-perform the calculation and confirm the amount is properly accrued at parent company and at group level.
- Review any correspondence with tax authorities regarding the tax due.

(ii) In relation to non-controlling interest charge in the group Income Statement, carry out the following procedures:

- Confirm the understanding of the group structure.
- Confirm the opening balance on non-controlling interests account to the previous financial statements and to the previous consolidation schedule.
- Ensure that all inter-company dividends have been properly dealt with.
- Obtain the current consolidation schedules and check the calculations of non-controlling interest noting in particular the calculation of the minority share of the current revenue reserves.

(b) The audit risks in relation to the specified features of the financial statements are as follows:

(i) Earnings Per Share: EPS would not normally be considered a risky element of the financial statements. This is because the calculation of EPS is set out in some detail in IAS 33 and the audit work would normally be confined to checking the calculation. The numerator would be readily available from the Income Statement and it should be reasonably easy to ascertain the denominator from the section of the audit file dealing with equity.

In this case EPS is considered a KPI so the auditor should be aware that there may be an effort to manipulate it: albeit that risk is mitigated somewhat by the fact that the NEDs check the figure in detail.

It remains the case, however, that it is the profit figure (the numerator in the EPS calculation) that is susceptible to manipulation and that should be considered high risk.

(ii) The Unrealised Surplus on the Revaluation of Properties is generally considered a risky balance because:

- It is, almost by definition, an estimate and so the provisions of ISA 540 will need to be applied.
- The auditor will need to ensure that the provisions of IAS 16 in relation to revaluations are followed e.g. all assets of the "same class" must be revalued together but there may be ambiguity about what "same class" means in particular circumstances.
- The auditor will need to ensure that the revaluation is correctly recorded and presented in the books of account and financial statements and that any subsequent adjustments are properly shown e.g. to depreciation.
- The auditor will need to ensure the reasonableness of the quantum of any such revaluation and may need an expert opinion in that regard. If so, the provisions of ISA 620 will need to be considered.
- We do not have enough information to make a conclusive assessment on materiality in this case but on the basis that the revaluation surplus equals nearly 12% of profit before tax it does appear material.

(iii) The currency translation differences (although offsetting) appear to be individually arguably material at 6.5% and 4.9% of profit before tax respectively. The fact that they are offsetting does not reduce their materiality. [It could be argued that PBT is not the correct benchmark against which to judge materiality in this instance but it is the only information in the scenario].

Again these are relatively high-risk balances because the calculations are complex and may be prone to error.

The auditor will need to establish how these are calculated and if the group has adequate systems in place for reporting such fluctuations.

In assessing the risk a lot will depend on the number of investments and loans and the currencies in which they are denominated . Complications may also arise if there are currencies which are restricted in some way in terms of international tradability or where unofficial exchange rates are widely used.

(iv) In auditing the issue of share capital the auditor should:

1. Agree share capital issue with Board of Directors' minutes and verify that it is within the terms of the constitution of entity.
2. Trace net proceeds of share capital issue to brokers' remittances, bank deposit slip and inclusion on bank statement and trace number of shares issued to share register.
3. Agree share capital stated in the accounts with the total in the share register.
4. Tot the share capital to ensure accuracy.

Since none of these steps is likely to provide any particular difficulty this area of the audit would be considered relatively low risk.

(c) The effect of this entry is to reduce the loss on the sale of the subsidiary by €21 million. This is 8.1% of the profit before tax and is thus an individually material amount. The auditors concerns include ensuring that the disposal does actually give rise to a curtailment of retirement benefits. This essentially means that the group is now released from whatever liability it previously bore in respect of the pension entitlement of the employees in the subsidiary. If this is, in fact, the case the proposed treatment would appear to be appropriate because a 'gain on a curtailment of benefits' is of a different nature than an actuarial gain. A curtailment of benefits implies that the pension liability is reduced; as the employees will be entitled to lower benefits from the group than the amount taken into account in the past, the pension's liability shall be less.

Since the liability has been built largely by charges to the Income Statement, it is logical to take the reversal to the Income Statement as well. A curtailment of benefits for the sponsoring employer can occurs in this case because of the disposal of the subsidiary.

The auditor will be concerned to ensure that the gain on the curtailment of benefits is actually what it appears to be and that the employee benefits have been cut. This would probably have happened as a result of some deal with the employees or their representatives and the auditor would need to examine this closely to show that it was properly implemented and that all the consequences of it are properly reflected in the financial statements.

(d) Briefing Note
To: Audit Team for Frat plc and Frat Group Audit
From : A. N. Accountant
Re: Controls Frat Group should have in place to prevent/detect fraud at overseas subsidiaries.

We have been made aware that a substantial fraud has been perpetuated on the Frat Group by the Financial Controller of their Amsterdam division. Consequently, we have been asked to recommend the most important controls the Group should have in place to prevent and detect misappropriation of funds by management and employees at the group's subsidiary companies. These controls should incorporate, at a minimum the following:

Authorisation of expenditure
Group authorisation for significant/unusual expenditure
More than one cheque signatory for large cheques
Review of supporting documentation by cheque signatories
Appropriate authorisation of electronic funds transfer
Password protection of electronic transfers
Controlled access to bank account details on supplier file
Review of changes to supplier files
Segregation of duties between invoice posting and payment to avoid payments being authorised on fictitious invoices
Proper bank reconciliations
Controls over access to payroll data
Review and authorisation of employees' expenses claims
Review of costs against budget, which is sufficiently detailed to pick up inappropriate expenditure, including obtaining explanations for variances and comparisons to other subsidiaries
Involvement of personnel department: to ensure that, staff take holidays, to encourage staff rotation around subsidiaries and to ensure that adequate references are obtained on recruitment

Proper and consistent application of these controls at all the overseas divisions will minimise the chances of a recurrence of this type of fraud.

(e) Non-consolidated entities under common control refers to businesses or (in the language of ISA 600) "components" which are all controlled by common individuals or under a common board. They are not, however, constituted as a group of entities and, in some cases, may not be incorporated entities. They are sometimes referred to as "Business Empires". The accounting guidance suggests that such groups should be recognised and such entities are likely to fall within the definition of ISA 550. However, ISA 600 does not address the issue in much detail and more guidance is probably required on the topic.

MARKING SCHEME

SOLUTION 1

(a)	One mark each for any of the points made in the solution to a maximum of 9 (9 X 1)	9
	One mark each for any of the points made in the solution to a maximum of 3(9 X 1)	3
	Other relevant points (maximum)	3
	Maximum for part (a)	**12**
(b)		
(i)	Would not normally be considered high risk	1
	Mention of how to calculate and reference to IAS 33	1
	In this case, considered a KPI	1
	Possibility of manipulating underlying figures	1
	Other relevant points	2
(ii)	One mark for each of the five points mentioned in the solution (5 X1)	5
	Other relevant points	2
(iii)	Materiality	1
	Need to establish how calculated	1
	Calculations complex and prone to error	1
	Complications due to restrictions or unofficial rates	1
	Other relevant points	2
(iv)	One mark for each of the four points mentioned in the solution (4 X1)	4
	Other relevant points	2
	Maximum for part (b)	**16**
(c)	Different nature	2
	Curtailment implies reduced pension liability	2
	Consequent effect on employee	1
	Largely built by charges to Income Statement	1
	Therefore logical to reverse to same account	1
	Normally occurs when subsidiary is disposed of	1
	Other relevant points – up to	3
	Maximum for part (c)	**8**
(d)	One mark each for any of the points made in the solution to a maximum of 8 (8 X 1)	8
	Format and presentation	1
	Other relevant points	2
	Maximum for part (d)	**8**
(e)	Description/ definition of non-consolidated entities – reference to “Business Empires” or the like	3
	Reference to ISA 550 and 600	2
	Conclusion	1
	Other relevant points	2
	Maximum for part (e)	**6**
	Total maximum for question	**50**

SOLUTION 2

CPA Ireland,

Practice Advisory Division,
Some address,
Somewhere.
Today's date

Mr. Bobby Salter,
Murphy & Co.,
Certified Public Accountants & Registered Auditors,
Any Street,
Any Town,
Co. Whatever

Private & Confidential

Dear Mr. Salter,

Thank you for coming to see me last week. I would now like to take the opportunity to briefly set out what I would see as the most salient points raised at our meeting and to offer you what I hope will prove to be some useful and practical advice. As discussed I will address each of the following points in turn:-

(a) The meaning of 'integrity' and its importance in professional relationships such as those arising in this situation.
(b) My analysis of Adam Murphy's ethical and professional behaviour in the case (based, of course, exclusively, on the information you have provided to me
(c) My evaluation of the alternatives that you have in this ethical dilemma.

(a) Integrity

The IESBA Code of Ethics for Professional Accountants says that "The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness".

Therefore integrity implies an obligation to do right despite pressures or inducements to the contrary. Acting with integrity implies an ethical position consistent with highest standards of professionalism and probity. It underpins good professional practice and corporate governance. Agents are always required to act with integrity in respect of their principals.

Integrity is vital in professional relationships because:

- It provides assurance to colleagues of good intentions and truthfulness. It goes beyond any codes of professional behaviour and describes a set of character traits that mean a person of integrity can be trusted. In this particular case it means that Adam Murphy is obliged to do his best for his clients; for his fellow partners; and also for his staff. Conflicts will inevitably arise but they should be dealt with in an honest and straightforward way. From what you tell me, there is evidence of Adam Murphy not acting in this way and "fobbing off" Sarah when she raises important issues with him.
- Time and energy spent in monitoring can be reduced when integrity and openness can be assumed (the opposite of an audit situation where the professional scepticism should be exercised). Adam is the managing partner and, if he cannot be trusted, this undermines the control environment in the audit firm.
- It cultivates good working relationships in professional situations. It encourages a culture of mutual support that can have a beneficial effect on organisational effectiveness. Once again, Adam's apparent lack of professional integrity threatens to undermine this.

(b) The first point to be noted about Adam's behaviour in this case is that it gives the impression of unprofessionalism and possibly, even, of corruption. €175,000 is an individually material amount but notwithstanding the amount, the allocation of company funds on what could be little more than an expensive plaything for the CEO's children is something that should be challenged.

Adam's failure to act on the information strongly suggests that he has failed in his duty to other users of Smiggy's financial statements such as lenders and even the taxation authorities. Adam may not feel a duty of care towards, for example, Revenue but financial statements should not be signed off unless they show a "true and fair view". The risk of, for example, the practice being censured in some way by the Revenue may be low but that does not reduce the imperative to act with integrity.

Adam promised Sarah that he would, at least, get a written representation on the matter - albeit he seemed to downplay the significance of this - but in the end he apparently failed to do even that and again was dismissive of Sarah when she challenged him on the matter.

Adam, therefore, gave the appearance of a lack of objectivity in his actions, possibly as a result of the threats to independence.

This shows a lack of respect for Sarah's professionalism and could lead her to develop a "why bother?" attitude if a similar issue arises in the future. Sarah will therefore possibly be lead into a poor professional attitude herself or, alternatively, become disillusioned with the firm and will seek alternative employment as soon as she can.

Adam is complicit in a probable breach of IAS 24 on Related Party Transactions. There is a disclosure requirement of all related party transactions regardless of value, and concealment of this is both unprofessional and technically irregular. Lack of disclosure should have led to a qualified opinion on the basis of material mistatement in the audit report.

(c) As I see it, you may attempt to resolve his ethical dilemma in either of the following two ways. The two alternatives are:

- Confront Adam directly to see if the matter can be resolved in a professional manner between yourselves. If Adam doesn't respond to this, you should – in theory- take the matter higher up the organisation. In this case, of course, Adam is the managing partner so there is no "higher authority". One avenue that might be worth considering is discussing the matter with other partners in confidence.

- To take no further action and drop the matter. You could decide that the information provided by Sarah should not go any further and that any knowledge you have gathered from her and her achievement log should be kept confidential.

The evaluation should make reference to the following four issues that may be used to argue in either direction.

I. All professional accountants are required to comply in detail with the highest professional and ethical standards. In addition to the CPA and other professional codes of ethics, most audit decisions are underpinned by regulation and, in some cases, legislation. There are also issues relating to quality control within the audit firm that need to be adhered to as best professional practice.

II. Your leadership position in your role as training manager, partner and professional accountant. Your decision would be an important signal to Sarah over the acceptability of Adam's behaviour in a professional situation and the importance placed on the complaints of junior staff such as herself. Assuming that you recognised the non-compliance issue, this would also be a form of professional negligence on your part to ignore it.

III. Your confronting Adam would probably compromise your friendship and future professional relationship. It may also have an impact on your future career at the practise. Other factors may conflict, in your mind, with your duty of objectivity. It is important to develop harmonious relationships in professional situations as far as possible as they can be of benefit to both people involved and to the organisation itself but never at the expense of professional objectivity. Whistle-blowers, whether internal or external, usually experience considerable stress and you could possibly expect a certain amount of personal stress if you were to report Adam, for example to CPA Ireland. However, some protection is to be found in recent legislation which has been enacted to facilitate whistle-blowing. This is called the Protected Disclosures Act 2014 and if you consider reporting the matter outside the practice, you should take specialist legal advice first.

IV. There is an important issue over how determined Sarah Costigan is to take the matter further. To confront Adam would mitigate any risk that Sarah might take it further and compromise both you and Adam. Sarah could, for example, approach an outside body (or another partner in the practice) and implicate both Adam and yourself - Adam for the unprofessional behaviour and you for knowing about it but doing nothing.

Although there are two theoretical alternatives in this dilemma, in my opinion your required course of action is clear. You should confront Adam with the allegation and then pursue whatever course of action may ensue to satisfactorily resolve the situation.

I hope this heps to resolve your dilemma. If you require any further information please contact me. I wish you well in your future career.

Yours sincerely,

Jim Ethics,

CPA Advisor

MARKING SCHEME

SOLUTION 2

(a)	Definition, reference to IESBA Code	1
	Assurance to colleagues	1
	Time spent in monitoring	1
	Promotes good working relationships	1
	Other relevant points (maximum)	2
	Maximum for part (a)	**4**
(b)	Impression of unprofessionalism	1
	Materiality of amount	1
	Possibility that expenditure is more personal in nature	1
	Duty to other users of financial statements	1
	Adam's promise to get written representation on matter	1
	Attitude dismissive of Sarah's professionalism/ giving Sarah "bad example"	2
	Complicit in breach of IAS 24	1
	Audit Report implications	1
	Other relevant points	3
	Maximum for part (b)	**9**
(c)	Up to 2 marks for discussion of each of the two alternatives – letting the matter drop or confronting Adam (2 x 2)	4
	Need to comply with ethical standards	1
	Leadership role within organisation	1
	Consequences of confronting Adam	1
	Exposure to possible action by Sarah	1
	Conclusion	1
	Other relevant points – up to	3
	Maximum for part (c)	**9**
	Professional marks	**3**
	Total maximum for question	**25**

SOLUTION 3

(a) The types of services provided by auditors to clients can be summarised as follows:

Summary of audit-related services:

Audit **Nature of service**	**Audit of historic FS**	**Audit–related services** **Review of FS (ISRE 2400)**	**Agreed-upon** **procedure (ISR 4400)**
Comparative level of assurance provided by the auditor	High, but not absolute, assurance	Moderate assurance	No assurance
Report provided	Positive expression of assurance on assertion(s)	Negative expression of assurance on assertion(s)	Factual findings of procedures

(Non- audit services such as compilations could also be provided but these could also be provided by accountants who are not auditors and so are not included here).

(b) & (c)
Briefing Note:

To: Rua Sionnach, Managing Partner, Fox and Geese, Certified Public Accountants and Registered Auditors

The table below considers the difficulties our firm would be likely to experience in the event that we were required to produce an assurance report based upon the suggested KPIs and how these KPIs could be improved; also what alternatives could be considered.

KPI	**(b) Difficulties we could experience**	**(c) How to improve; alternatives**
Academic performance	Since the Junior and Leaving Certificate are public examinations there should be no difficulty for us in securing good evidence in relation to this metric either from the school itself, or directly from the Department. It would be difficult for the school to manipulate this information.	It would be better to measure academic performance across the range. For example, the percentage of students continuing on to even take the Leaving Certificate might be a useful measure in some schools. The suggested KPI is unlikely to be a very useful measure because it concentrates too much on high achievers.
School Attendance	In this instance, our difficulty would be that we would be almost entirely reliant on documents produced by (or information supplied by) the school. We could possibly attend some of the roll-calls (preferably on a surprise basis) but even that would provide little evidence about days we did not attend. If the system for taking attendance was robust, or if, for example, some kind of swiping/clocking in was used this could enhance the evidence available to us.	A better practice would be for the school to take attendances periodically and unpredictably throughout the day so that students know they have to attend all classes to be assured of being recorded as present. This would be slightly more complicated for the schools to track and record and allowances would have to be made for students away on authorised activities such as School Trips but it would give a better measure.
Participation in competitions etc.	Again, we would be concerned that most of the information about this KPI would come from the School. However, we could confirm with competition organisers or third party websites, for example, that the school had participated. We are helped slightly by the fact that we not concerned about under-reporting – the School is unlikely top enter a competition and then not tell us about it.	It could be suggested that a measure of participation would be better than a measure of success. For example, the schools could be encouraged to put different teams at different levels into, for example, football competitions. Measuring participation by both sexes could also be useful as it is observed that, for example, female participation in sport often declines during the teenage years.

KPI	Difficulties we could experience	How to improve; alternatives
Complaints received	Assuming that there is some system (e.g. a committee) in the School for dealing with complaints we can review files or correspondence produced by/for such a committee. It would be difficult for the School to conceal serious compliants from us as they would probably also reflect on attendance, academic performance, and other issues.	It may be better to have some mechanism to investigate complaints initially before they are deemed valid and recorded.
Uniform	Our difficulties here would be similar to school attendance – inspections happen and are recorded entirely within the school and it would be possible to manipulate records if the School was determined to do so. However, we could gain some evidence with surprise attendences at some inspections although how realistic this is might be open to question. Certainly, our staff would need to be accompanied by school staff at all times or child protection issues might arise.	There is no one alternative that would necessarily improve on the current suggestion. For example, unpredictable inspections could be unfair to students whose uniforms have become damaged during the day or those who live away from home during the week etc.

MARKING SCHEME

SOLUTION 3

(a)	For mention of the services as follows: Audit of historic FS Audit related services Agreed Upon Procedures	3
	For discussion, distinguishing between them	3
	Maximum for part (a)	**5**
(b)	For discussion of relevant difficulties for each of the KPI mentioned in solution (5 x 2.5)	12.5
	Other relevant points	2
	Maximum for part (b)	**10**
(c)	For discussion of improvements/alternatives for each of the KPI mentioned in solution (5 x 2.5)	12.5
	Other relevant points	2
	Maximum for part (c)	10
	Total maximum for question	**25**

SOLUTION 4

(a)

(i) A disclaimer of opinion is appropriate when an auditor decides that there is insufficient evidence on which to come to a conclusion on financial statements. This might happen, for instance, if there are fundamental or pervasive deficiencies in the record-keeping of the entity concerning, for example, transactions undertaken in cash.

On the other hand, an adverse opinion is given when the auditor concludes, on the basis of the available evidence, that the financial statements do not show a true and fair view. This usually comes about because of a fundamental or pervasive disagreement by the auditor with how, for example, an accounting standard has been applied e.g. the failure to take account of a very significant impairment in property values as required by IAS 36.

(ii) An emphasis of matter paragraph arises when an auditor wishes to emphasise a particular matter (which is appropriately disclosed in the financial statements) to the reader of the accounts. In practice, this usually arises when there is some doubt about an entity's ability to continue as a going concern but the auditor considers that, on the balance of probabilities, the entity will be able to so continue.

An Other Matter paragraph is used when the auditor wishes to, or is required to, refer to some other matter which would not be directly covered by an audit report modification, or an emphasis of matter. For example, the auditor might use an "other matter" paragraph to note that the corresponding figures for the previous period were unaudited.

(iii) An Unmodified Report is a completely standard report with no variations from the standard report in ISA 700 or, in the Irish case, Bulletin 1 (I). An Unmodified Opinion refers to a situation where there is no qualification of the auditors opinion or no disclaimer or adverse opinion. A report with an Emphasis of Matter or Other Matter paragraph would not be an Unmodified Report but would be an Unmodified Opinion.

(b)

1. In terms of the amount €50,000 is only 2.5% of the profit before tax and 0.11% of the Revenue so the "overpayment" can safely be stated to be quantitatively immaterial. However, that is far from the whole story. Firstly, even if no overpayment arose the entire transaction (of which we are not given the quantum) is a related party transaction and should be disclosed under IAS 24. A matter is considered immaterial under IAS 24 only if it is immaterial to both parties to the transaction. This alone might well be sufficient reason to qualify the audit report on this point.

   Secondly, the overpayment could be seen as extra director's remuneration the consequences of which would be twofold. Firstly, it would need to be disclosed as such under The Companies Acts and secondly it might have tax consequences. Again, these might be quantitatively immaterial but might need to be disclosed because of their nature.

   In any case, these transactions and the attitude of the directors towards them bodes ill for our continuing relationship with the client.

2. This would appear to require no adjustment to the audit report and would appear to have no consequences for our continuing relationship with the client. If this were a very significant subsidiary it might require an emphasis of matter paragraph but since we are told this is a "small subsidiary" this would appear not to be the case. Depending on how the corresponding figures are shown an "other matter" paragraph might be considered appropriate.

3. Given that the error was corrected before the financial statements are issued, it clearly has no impact on the audit report in spite of the fact that the issue is clearly material (at 50% of profit before tax and 2.22% of turnover). In terms of our continuing relationship with the client , again there would appear to be no issue but we would want to confirm how the error occurred in the first place and perhaps reassess control risk.

MARKING SCHEME

SOLUTION 4

(a)	Description of each pair of terms (2 X3)	6
	Example of when each might be used (1 X6)	6
	Maximum for part (a)	**9**
(b)		
1	Should be disclosed as RPT in any case	1
	Discussion of different aspects of materiality	2
	Potentially hidden directors remuneration; regulatory and legal consequences	2
	Impact on continuing relationship	2
	Other relevant points	2
2	Discussion of materiality	2
	No change required and reasons…	2
	Impact on continuing relationship	1
	Other relevant points	2
3	No impact on audit report and reasons	2
	Discussion of materiality	1
	Impact on continuing relationship including on assessment of control risk	2
	Other relevant points	2
	Maximum for part (b)	**16**
	Total maximum for question	**25**