

Suggested solution

Section A

1 D

The breach should be reported to ACCA and those affected by it i.e. management of Galifrey Co.

The significance of the breach should be evaluated, and this is likely to depend on the type of information given to David's sister, therefore this should be considered.

R100.8 A professional accountant who identifies a breach of any other provision of the Code shall evaluate the significance of the breach and its impact on the accountant's ability to comply with the fundamental principles. The accountant shall also:

- (a) Take whatever actions might be available, as soon as possible, to address the consequences of the breach satisfactorily; and
- (b) Determine whether to report the breach to the relevant parties. 100.8 A1 Relevant parties to whom such a breach might be reported include those who might have been affected by it, ACCA or another professional or regulatory body or an oversight authority.

2 Statement 1 – False

Statement 2 – False

Statement 3 – True

Statement 1: all members of the engagement team are responsible for contributing to the management and achievement of quality at the engagement level, so it is false to say Avery has sole responsibility.

Statement 2: the audit engagement partner does not need to review all documentation. They are required to review documentation relating to significant matters, significant judgements and other matters deemed relevant so this statement is false.

Statement 3: the audit engagement partner shall determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, so this is true.

3 C

The initial course of action is to report the matter to the firm's money laundering reporting officer. When suspicions of money laundering are identified, the auditor must not tip-off the client. The matter should be raised specifically with the audit manager or audit engagement partner rather than waiting for the audit work to be reviewed.

4 Detection risk is the risk that procedure performed by the **EXTERNAL AUDITOR** will not detect a **MISSTATEMENT**.

5 B

Documentation of the client's accounting system will be relevant to future audits as well as the current audit and should therefore be included in the permanent audit file.

A, C and D should all be included in the current audit file as these are relevant to the current year audit only.

6 A and B

A and B are advantages of flowcharts.

C and D are advantages of internal control questionnaires.

E and F are advantages of narrative notes.

7 D

Cost of implementation is not a limitation of internal control.

ISA 315 (Revised) Appendix 3 notes that controls can be circumvented by the collusion of two or more people, or inappropriate management override of controls. Human judgement in decision making can be faulty and breakdowns in the entity's system of internal control can occur because of human error.

8 A

Haphazard sampling is when the auditor selects a sample without any predictable pattern however there is a risk of auditor bias in the selection.

Statement 2 describes block selection.

9 B and C

As the sales team are paid a sales-related bonus, there is a risk that fictitious sales are recorded. The assertion of occurrence must be the primary focus of audit procedures i.e. ensuring that a sale took place and is genuine.

Procedure B would help to identify overstatement of revenue which could be caused by fictitious sales which could be investigated further.

Procedure C would identify if sales recorded before the year end have since been reversed which may indicate that they were fictitious sales.

Procedure A tests completeness of revenue but not occurrence. As the sample is selected from the customer orders, rather than the detailed sales listing, this procedure will not identify if any recorded sales are fictitious as there would not be an audit trail of customer order and sales invoice.

Procedure D tests accuracy but not occurrence.

10 Matter 1 – Before the expert is appointed

Matter 2 – When evaluating the work of the expert

Matter 3 – When evaluating the work of the expert

Matter 4 – Before the expert is appointed

Competence and objectivity should be considered before appointing an auditor's expert, therefore, qualifications of the expert and whether there are any conflicts of interest between the expert and the client should be considered before appointment.

Reliability of the source data and the reasonableness of the expert's assumptions should be considered when evaluating the work of the auditor's expert.

11 A and C

More evidence will be required in respect of material items and where controls are weak and cannot be relied on.

The firm's quality management processes should ensure that the audit team is competent to perform the audit and that sufficient time is available to obtain the audit evidence required.

12 B

Reviewing the working papers of the previous auditor provides evidence over opening balances. Inspecting payments from customers in the first month of the year gives evidence over the recoverability of the prior year receivables balance.

Purchases is not a balance which is carried over to the following year and a walkthrough of the purchases system will only enable the auditor to obtain an understanding of the control system.

13 A

A is required between the date of the financial statements and the date of the auditor's report. ISA 560, para 7.

B, C and D are required after the date of the auditor's report but before the date the financial statements are issued as per ISA 560, paras 10 and 11.

14 Item 1 – Not included**Item 2 – Not included****Item 3 – Included**

Item 1: signature of audit engagement partner is not included. The written representation should be signed by management of the client, not the audit engagement partner.

Item 2: a caveat that the letter is not a comprehensive list of management representations is not included. If the written representation did not cover what it needs to cover for audit purposes, it will not constitute sufficient and appropriate evidence.

Item 3: a statement of management responsibilities is included.

15 D

All must be included in the auditor's report of a listed company such as Koirra Co. As per ISA 700 and ISA 570 (Revised 2024).

Section B

16 B and C

The direct controls in the purchases system are authorisation of purchase orders and batch controls over invoices. Authorisation of orders ensures that orders are only made for a valid business use. Batch controls over the input of invoices ensures invoices are input completely.

For option A to be correct, the goods received would need to be agreed to the purchase order rather than the supplier's delivery note.

For D to be correct the list would need to be updated more frequently. The approved supplier list was last updated two years ago therefore the suppliers may no longer represent the best quality or cost effectiveness.

17 A

1 and 2 are deficiencies in the purchases system. Purchase requisitions should include details of the current inventory level so a check can be performed to ensure the goods are required. Goods received should be agreed to the purchase order to ensure only goods that have been ordered have been delivered.

3 is a direct control as limiting access prevents the risk of error and fraud.

18 Audit procedure 1 – Test data

Audit procedure 2 – Audit software

Audit procedure 3 – Audit software

Test data involves accessing the client's system to test the controls within it.

Audit software is used to help with substantive testing such as performing calculations and selecting samples.

Therefore, 1 is a procedure using test data and 2 and 3 are examples of the use of audit software.

19 Procedure 1 – Appropriate**Procedure 2 – Appropriate****Procedure 3 – Not appropriate**

The first two procedures are appropriate to test the controls relating to classification of assets/expenses.

The third procedure is a substantive test of detail over the classification of assets and would not be appropriate.

20 C

Incorrect classification would result in the non-current asset register being inaccurate as assets which should have been recorded may have been expensed or vice versa. This would lead to depreciation being incorrectly calculated.

Incorrect classification would not cause delays to purchases or to production.

21 B and D

B and D would provide evidence in relation to accuracy assertion.

A tests classification and C tests occurrence.

22 Bank statements showing the total payroll paid each month**Internal audit reports documenting tests of controls over payroll****Monthly payroll reports detailing payroll costs per employee**

Bank statements are generated by a third party therefore the most reliable.

Internal audit reports are the next most reliable as, whilst they are employees of the company, the internal auditors are separate from the operations of the company and more independent and objective.

Monthly payroll reports are client generated. If management wanted to show a lower or higher profit, they could amend the monthly payroll expense to achieve this.

23 32,807

$350 \times 1.06 = 371$ employees from 1 April 20X4

Adjust core salaries before pay rise and bonus = $30 \times 1.06 = \$31.8\text{m}$

Pay rise impact = $\$31.8 \times 3\% \times 8/12 = \0.636m

Bonus = $\$1,000 \times 371 = \0.371m

Total: \$32,807,000

24 D

D is a substantive procedure, whereas A, B, and C are tests of details using payroll records.

25 A and C

A and C are substantive procedures.

B confirms the valuation of inventory at the year-end but not existence and D is a test of presentation and disclosure.

26 A and D

The legal claim and late payments to suppliers would cast doubt over going concern.

The loss of Ocean Co has been mitigated by finding an alternative supplier.

The loss caused by the fire at the distribution centre is insured and the insurance claim is expected to be paid out. Temporary premises have been found which means operations will not be severely disrupted, therefore it is unlikely to cast doubt over going concern.

27 B and D

Assessing the reasonableness of the assumptions and enquiring of management are procedures which Sunny & Co should perform in respect of going concern for Golden Co.

The auditor would review correspondence sent from the bank to the client but would not contact the bank directly about such issues.

Calculation of ratios identifies indicators of going concern problems but does not provide evidence as to whether the company is a going concern. Where indicators are identified, procedures must then be performed to obtain evidence.

28 C

As there is a material uncertainty which has not been disclosed, the financial statements are materially misstated. This will require an adverse opinion in accordance with ISA 570 (Revised 2024), Illustration 6.

A is incorrect as the financial statements are materially misstated and so the opinion will be modified.

B is incorrect as an unmodified opinion with a material uncertainty related to going concern can only be issued if the material uncertainty has been disclosed.

D is incorrect as the evidence required to form a conclusion has been obtained.

29 Action 1 – Appropriate

Action 2 – Not appropriate

Action 3 – Not appropriate

Action 1: appropriate as ISA 570 (Revised 2024) para 21, requires management’s going concern assessment to cover a minimum of twelve months from the date of approval of the financial statements.

Action 2: not appropriate as it is the client’s responsibility to prepare forecasts. The forecast should also cover a period of twelve months from the date of approval of the financial statements rather than the date of the financial statements.

Action 3: not appropriate as the reason for the qualified opinion would be due to an inability to obtain sufficient appropriate evidence.

30 The audit opinion will be UNMODIFIED

The auditor’s report will need to include AN EMPHASIS OF MATTER PARAGRAPH

The company is ceasing trading therefore there is no uncertainty relating to going concern.

An emphasis of matter paragraph will be needed to draw the user’s attention to the disclosure made by the client which explains the use of the break-up basis of accounting.

Section C

31

(a)

Business risks

Foreign currency transactions

Purchases from international suppliers are denoted in foreign currency. This exposes the company to fluctuations in exchange rates which can impact budgeting, cash flow and profitability.

Disruption to supply

Severe flooding has affected the supply of timber causing a temporary delay to production and an increase in prices which were not passed on to customers. This will have reduced the company's profit.

Even though supplies of timber have now recovered and prices have stabilised, the impact of climate change may mean the area is likely to experience this type of event on a more regular basis. If so, Basil Co will need to change its suppliers and consider factoring volatility of supplies into its pricing. This could make Basil Co uncompetitive.

Investment in new factory

There are several business risks associated with the construction of the new factory:

Potential for cost overruns resulting in Basil Co having to borrow additional money to complete the construction incurring additional interest and increasing the company's gearing.

Delays in the project resulting in the new factory not being brought into use when expected. This will impact the ability to fulfil orders and affect profitability.

If the new range of kitchens does not generate the level of demand expected, the desired return on investment may not be achieved.

New accounting system

Data was transferred from the old to the new system with no further checks being performed which could result in the information produced by the system being incorrect. Inaccurate management information could lead to poor decision making affecting future profitability.

Legal claim

The legal claim from a customer will incur legal costs as the company has had to seek legal advice and may require the company to pay compensation if the claim succeeds. This could be substantial and will affect profitability. In addition, any negative publicity about the case could affect Basil Co's reputation and reduce future revenues.

(b)

| Audit risk | Analysis | Audit work |
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| Foreign exchange transactions | <p>In accordance with IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i>, purchases should be translated at the spot rate or average rate.</p> <p>Trade payables denominated in a foreign currency must be retranslated using the closing rate, with exchange gains or losses recognised in profit or loss for the year.</p> <p>As Basil Co intends to use an average rate rather than the closing rate at the year end, this will result in the trade payables balance being misstated.</p> | <p>Agree the year end exchange rate used for retranslation of monetary balances to a reliable source.</p> <p>Recalculate the year-end payables balance using the closing rate and compare to the trade payables figure calculated by management.</p> <p>If management has not used an appropriate rate, ask them to adjust and review the adjusting journal.</p> |
| Assets under construction | <p>The factory will be under construction at the year end and therefore the costs capitalised should be classified as assets under construction.</p> <p>No depreciation should be charged until the factory is available for use.</p> <p>There is a risk that the costs have been incorrectly classified as property, plant and equipment.</p> <p>There is also a risk that depreciation has been charged</p> | <p>Review the disclosure of the construction costs to ensure they are classified as assets under construction and not within PPE.</p> <p>If the classification is incorrect, ask management to reclassify as assets under construction.</p> <p>Review the breakdown of the depreciation expense to ensure that no depreciation is included for the factory under construction.</p> |

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| | <p>on assets under construction during the construction period resulting in overstatement of the depreciation expense and understatement of assets under construction.</p> | |
| <p>Borrowing costs in relation to the five-year bank loan taken out to finance the new factory</p> | <p>The factory meets the definition of a qualifying asset under IAS 23 <i>Borrowing Costs</i>.</p> <p>The borrowing costs relating to the construction of qualifying assets should be capitalised during the construction period.</p> <p>Several risks arise:</p> <ol style="list-style-type: none"> 1. Basil Co may incorrectly recognise the loan interest as an expense in the statement of profit or loss, overstating interest expenses on borrowings and understating property, plant and equipment (PPE). 2. Basil Co could incorrectly capitalise interest which does not qualify as a borrowing cost resulting in overstatement of PPE and understatement of interest expenses on borrowings. | <p>Agree the loan proceeds to the loan documentation.</p> <p>Review the plans for the factory to confirm that all of the loan will be used for the construction of the factory and therefore all interest should be capitalised.</p> <p>Review the supporting documentation to confirm the date construction commenced and agree that interest has only been capitalised from this date.</p> <p>Recalculate the interest which should be capitalised as borrowing costs and compare to management's calculations.</p> |
| <p>New accounting software system</p> | <p>A new integrated accounting software system was introduced in May 20X5. The data was transferred from the old to the new system with no further checks being performed.</p> <p>There is a risk of opening balances in May being misstated and a loss of data if the balances have not been transferred from the old</p> | <p>Detailed testing should be performed to confirm that all of the accounting balances at the transfer date have been correctly recorded in the new system.</p> <p>Controls over the transfer of data should be reviewed to ensure they have operated effectively.</p> |

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| | <p>system completely and accurately.</p> | <p>The controls over the new system should be documented and tested.</p> <p>The auditor should review any management reports which aim to identify any issues with the processing of accounting information.</p> |
| <p>Legal claim from customer</p> | <p>No provision will be recognised or disclosures included in the financial statements in respect of the legal claim.</p> <p>If it is probable that Basil Co will lose the claim, a provision is required to comply with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>. If the payment is possible rather than probable, a contingent liability disclosure will be necessary.</p> <p>If the company has not recognised a provision or disclosed a contingent liability, there is a risk over the completeness of any provisions or adequacy of disclosure over contingent liabilities.</p> | <p>Obtain confirmation from the company's lawyers on the likely outcome of the claim.</p> <p>If at the year end the claim is still only possible to succeed, ask management to include a contingent liability disclosure in the financial statements providing details of the claim.</p> <p>Review board minutes for progress on the status of the claim which may affect the accounting treatment required.</p> |

32

(a)

| Matters | FD joining the firm and may undertake the role of audit partner | 30% discount given to the audit team |
|----------------------|--|--|
| Type of threat | A self-review threat would be created. | Self-interest, familiarity or intimidation threats may be created. |
| Assessment of threat | <p>The FD/partner would be responsible for the audit of the financial statements for the year ending 31 December 20X5 which cover the period from January to September 20X5 when the FD worked at Iceberg Co.</p> <p>The FD would be unlikely to raise concerns about accounting treatments and management judgements they had made and may feel they could not be critical of the finance team for which they had previously been responsible.</p> <p>A familiarity threat would also be created as the FD would know people at the client from having recently worked with them and may exercise less professional scepticism than would be required for a new audit client.</p> | <p>Audit staff may feel indebted to the client and feel that they cannot raise issues identified during the audit.</p> <p>The offer may be in breach of bribery and corruption laws.</p> <p>The discount may be seen by a reasonable and informed third party to be an inducement to improperly influence the auditor or the outcome of the audit.</p> <p>A 30% discount may not be considered trivial and inconsequential given the nature of the products.</p> |
| Safeguard | The FD should not take on the role as audit engagement partner for the audit of Iceberg Co. | Only gifts which are clearly trivial and inconsequential can be accepted, therefore the audit team should be informed that they cannot accept the offer. |

(b)

Money laundering checks/customer due diligence should be performed as this is a new client, not just a new engagement. This is a legal requirement in many jurisdictions.

Contact with Glacier & Co should be made to determine if there are any professional matters which Penguin & Co should be aware of which would cause it to decline the engagement. This is required as a matter of professional courtesy as the two firms may have to liaise with each other to obtain information relevant to the work they perform for Iceberg Co.

The reputation of the company and the integrity of management must be considered. If management lack integrity, the control environment will be weaker and there may be an increased risk of fraud. As the company has met the global certification for environmental performance, transparency and accountability for the past six years, this is less likely to be a risk.

Penguin & Co must establish whether the preconditions for an audit are present, in accordance with ISA 210 *Agreeing the Terms of Audit Engagements*. These are that an acceptable financial reporting framework is used to prepare the financial statements, management acknowledges and understands its responsibilities in relation to preparation of the financial statements, internal control and for providing the auditor with access to information and personnel to enable them to obtain audit evidence and perform the audit.

(c)

The auditor is responsible for planning and performing the audit to obtain reasonable assurance that the financial statements are free from material fraud (ISA 24 (Revised), para 2a); however, management has the primary responsibility to prevent and detect fraud.

There is an unavoidable risk that some material misstatements will not be identified due to the inherent limitations of an audit. (ISA 240 (Revised) para 10).

For example, if there was collusion between the sales representative and someone in a more senior position, fictitious sales may be able to be created and appear genuine.

Materiality based on revenue using accepted benchmarks of $\frac{1}{2}$ -1% \times \$3m = \$15,000 - \$30,000.

The fraud was $10\% \times \$50,000 = \$5,000$ which is not material to the financial statements and likely to be below performance materiality, making it less likely to be identified by the audit team.

The fraud would consist of much smaller amounts included on many invoices rather than \$5,000 on one invoice. This would make it much more difficult to detect as these invoices may not have been selected for sampling even if tests of detail had been performed.

The auditor is required to use professional scepticism and be alert to the risk of fraud. (ISA 200 para 15) The audit approach taken for this year's audit indicates a lack of professional scepticism and this may have contributed to the failure to identify fraudulent activity.

The auditor must assess the risk of material misstatement due to fraud (ISA 24 (Revised), para 2a). A remuneration scheme dependent on the level of sales should have been identified as a significant inherent risk of fraud and the audit approach for revenue should have reflected this with the inclusion of procedures specifically designed to identify fictitious sales.

Analytical review of sales by sales representative may have identified that sales for this person were significantly higher than the others but as only limited analytical procedures were performed, it is possible this level of analysis was not done, and the focus may have been on more general analytical procedures such as comparison of total sales year on year or month on month.

Mark scheme

Section A

Questions 1 – 15 (all questions worth two marks)

Maximum 30 marks

Section B

Questions 16 – 30 (all questions worth two marks)

Maximum 30 marks

Section C

Question 31

| | | |
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| a | Assessment of business risks: | |
| | - Foreign exchange | 2 |
| | - Disruption to supply | 2 |
| | - Investment in new factory | 2 |
| | - New accounting system | 2 |
| | - Legal claim | 2 |
| Maximum 8 marks | | |
| b | Audit risk and analysis work | |
| | - Foreign exchange transactions | 3 |
| | - Assets under construction | 3 |
| | - Borrowing costs | 3 |
| | - New accounting software | 3 |
| | - Legal claim | 3 |
| Maximum 12 marks | | |
| Total 20 marks | | |

Question 32

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| a | Finance director joining the firm | |
| | - Self-review threat | 1 |
| | - Unlikely to raise concerns | 1 |
| | - Familiarity threat | 1 |
| | - May exercise less professional scepticism | 1 |
| | - Cannot take on role of audit engagement partner for Iceberg Co | 1 |
| | 30% discount | |
| | - Self-interest/familiarity/intimidation threats | 1 |
| | - Team may feel indebted to the client | 1 |
| | - May be in breach of bribery and corruption laws | 1 |

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| | - May be seen as an inducement to influence the auditor or outcome of the audit | 1 |
| | - Cannot accept the offer as may not be trivial and inconsequential | 1 |
| Maximum 7 marks | | |
| b | Acceptance considerations – up to 2 marks for points applied to the scenario | |
| | - Money laundering | 2 |
| | - Contact with Glacier & Co | 2 |
| | - Reputation of the company/integrity of management | 2 |
| | - Preconditions for an audit | 2 |
| | - Other relevant acceptance considerations not specific to scenario e.g. level of fees, risk, controls, resources, competence etc | 1 |
| Maximum 6 marks | | |
| c | Weddell Co fraud | |
| | - Auditor responsibilities | 1 |
| | - Unavoidable risk fraud is undetected due to inherent limitations of an audit | 1 |
| | - Example of limitations of an audit | 1 |
| | - Calculation of materiality | 1 |
| | - May not be identified as likely to be below performance materiality | 1 |
| | - Likely to be many smaller amounts rather than one large amount | 1 |
| | - Audit approach indicates professional scepticism not exercised | 1 |
| | - Planning should have identified sales-related bonus as a significant risk | 1 |
| | - Analytical review of sales may have identified fraud, but only limited procedures performed | 1 |
| Maximum 7 marks | | |
| Total 20 marks | | |