ACCA Pre-June 24 mock

Ben's answers

These answers were planned and written under exam conditions, to time.

They are NOT perfect, but who you what is achievable in the time allowed.

See the 'examiner's answers' for the 'perfect' answer

Ben Wilson

AAA Expert Tutor

Question 1 Siberian – Ben's answer plan

General notes
1 July X5 – today
Audit manager
y/e 30 Sept X5 – planning
Listed client – retailer (clothing, homeware, food)
Single country
Single currency
Governance weaknesses – CEO / Chair combined – remuneration & and audit committee

a) Evaluate & prioritise audit risks (24 marks)

Materiality

PBT - $523m – 5 to 10% - $26.15m to $52.3m

$26.13m – lower level – high risk audit – decreasing revenue and profits – incentive to overstate performance to mask decline – heightened risk of misstatement

Redundancy provision

$62m – highly material - >2x materiality level

Redundancy discussions – May X5 – redundancy notices not yet served / announced – may not be by 30 Sept X5 – not committed to making the staff redundant – may not be a 'present obligation to pay' at the year end date.

Relocation and retraining costs – ongoing costs – relate to future periods – not appropriate to provide for these.

Management incentive to overstate 'exceptional items' – rather than recognise as ongoing costs – bonus linked to EPS after exceptional items – adjusted EPS has increased by 7% - despite declining EPS (down by 15.2%)

Redundancy provision overstated, exceptional adjustments to profit overstated

Prioritised – highly material – subjectivity over assessment as 'present obligation' – potential for management bias

Loss making stores

200 stores operating at a loss - $1,633m PPE – indicator of impairment – loss making, plans to close

Hugely material balance – a 1.6% reduction in value would be material ($26.15m / $1,633m).

No impairment review performed – should be performed on each store – CGU – plans to close them – value in use $0 – written down to resale value if below book value

Management incentive not to recognise the impairment – would reduce profit – impact bonus

Classified as PPE – if committed to closing stores / sell off assets (to be consistent with the redundancy provision being in place) – classify separately as assets held for sale – cease depreciation PPE overstated, impairment expense understated, assets held for sale understated.

Risk prioritised – hugely material – clear error (impairment indictors are clear)

Leased properties

$2,397m - material

Lease lengths 3-15 years – all depreciated on the same basis – 10 years – inappropriate

Understate some, overstate others – each should be depreciated over its actual term – matching concept

Depreciation under/overstated, leased assets (PPE) under/overstated

Defined benefit pension

Net liability $576m – past service cost (exceptional item) $86m – highly material

Highly subjective – estimates – complex calculations – mitigated by the use of the auditor's expert

Highly technical – auditor may lack the knowledge to robustly challenge the actuary / assess the auditor's experts work – increasing detection risk

Pensions liability under/overstated – employee expenses under/overstated

Inventory

Hugely material at $780m (c30 times materiality)

Perpetual inventory system – each line counted at least once per year – no year-end count

May count attended – same each year – auditor too predictable – risk that other counts not performed properly – misstatements overlooked – fraud risk increased

3 discrepancies identified – immaterial and corrected – could be material if extrapolated over the wider inventory system – could indicate control weaknesses.

Inventory overstated – inventory write downs understated

Inventory - clothing

$405m - material – 15.5x materiality – holding period increased by 40.3% to 73 days

Lower of cost and NRV – NRV may have fallen below cost

Clothing is a fashion item – could become obsolete as fashions / tastes change – demand for Siberian clothing known to be falling (decreasing revenue) – may have to reduce prices to below cost to sell older items

Inventory overstated, inventory write downs understated

<u>Board structure</u>

Breach of corporate governance principles – CEO and chair roles combined – executive director on the audit committee and remuneration committee.

Dominant individual - reduces the ability of those charged with governance to hold the board to account.

Audit committee – may have contributed to the intimidation threat place on the auditors to accept the non audit work

Remuneration committee – executive directors receive a bonus based on adjusted EPS – incentive to overstate exceptional items so the bonus is received

<u>Tutorial notes</u>
This was the LAST question I did in the exam – leaving the balance of my time for this huge and important question. I reached here with 1 hour remaining

24 marks….less 3 marks for materiality…..21 marks for audit risks. With 3 marks per well explained risk, I was aiming for 7 risks

Prioritisation – I prioritised the first 2 risks that I cam e up with – to make sure I earned the PSM even if I ran out of time (and didn't put a conclusion)

Management bias due to the bonus – I used this for my first 2 risks. I tried to make the points different though…..with one being focused on the exceptional items, the other on the scheme itself.

Defined benefit scheme – I avoided too much discussion about subjectivity/ bias here – as the use of an auditor's expert mitigates this somewhat. I showed my 'judgement' by discussing this

Boad structure – I would've preferred to use this to support another audit risk (somewhere that the dominant individual may have exerted influence) – but I didn't find a place to do so!

TIME – this was ridiculously time pressured. Had you done this question first…..you would undoubtedly have overrun……and been chasing time for the rest of the exam.

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b) Principle audit procedures to be performed in respect of the defined benefit pension scheme (6 marks)

Increase in pension benefit – obtain scheme documentation – HR records / contract letters - ensure enhanced benefits are fully reflected in the actuarial assessment – all past and present members uplifted

Remeasurement gain on plan assets – agree to market data (e.g. share prices, bond prices) / financial press – incentive to overstate – judgemental area – ensure gains are genuine

Actuarial loss – remeasurement of liability – clear incentive to understate – reduce liability – judgemental areas – e.g. life expectancy – analytical procedures – changes in any assumptions – investigate further – discount rate used – confirm reasonable based on inflation rates, interest rates – consistent with other companies in the sector

Past service costs – obtain auditor's expert's report – confirm work carried out in line with the instructions given – review results of their procedures – fully understand their work – confirm that it supports the figure

Re-calculate the auditor's expert's calculations – highly technical – significant risk of error – ensure that their work is reliable

<u>Tutorial notes</u>
Principal procedures – main ones only. I avoided anything minor (like 'add up/cast'), to reduce the risk of losing a PSM for not adhering to the requirements. I avoided anything to do with the 'current service cost' as it was so small ($0.2m) in relation to the other figures given

I focused my answer on 'judgemental' matters, and used the word 'judgemental' in my answer – to make it super clear to marker, so I would get the PSM for judgement.

I was tempted to suggest procedures for the specific figures given in the scenario – but then realised that these were the figures as at 31 March X5 – when the requirement asked for procedures 'to be performed', i.e. at 30 September X5. Instead, I used the list of figures to give me ideas for procedures

No marks for discussing the auditor's expert's independence, competence etc, as this has already been done (per the scenario)

c) Ethical and professional issues arising from the request by the audit committee (10 marks)

<u>Insurance claim</u>
Non audit work –self review – wastage/losses in the FS – overreliance on the non-audit work

Listed – immaterial – permitted – safeguards – separate teams

Advocacy – report forms basis of insurance claim – third party – insurer – basis of negotiation – promoting the client – receive a higher amount – third party test

<u>Controls work</u>
Designing controls – role of management / TCWG - management threat – making decisions – prohibited from doing so under the ES

Controls relate to inventory – material balance in the FS – prohibited under the ES – no safeguards could mitigate

Self-review threat – future audits – unwilling to highlight issues with the new controls – would reflect badly on the advice given

<u>Intimidation threat</u>
Threat to put audit out to tender – undue pressure on auditor to accept the work – despite ethical standards breaches – retain the presumably lucrative audit (listed client)

Audit committee behaving inappropriately – compromising the objectivity of the audit – putting the auditor in an impossible position - consider resigning

<u>Tutorial notes</u>
As this was 10 marks – I used sub headings (I do this if the number of marks is 8 or more) Instead of 'ethical' and 'professional issues', I made my sub-headings each individual issue.

I could only generate 8 points – that's fine for a 10 mark question – saved me time to use elsewhere

Most of the issues were at the 'end' of the exhibit – this is common – rewarding a student who plans effectively, rather than starting to write immediately.

I was tempted to talk about a 'police investigation' as there has been a fraud – but there is no mention of this in the scenario – so would have been 'speculating' (and wouldn't earn marks

The examiner's answer does into discussing actions for the auditor. This is beyond the scope of the requirement – I would advise you NOT to do this – likely to cost you time and PSMs!!!! Do as the examiner says……not as they do!

Question 1 Siberian - Ben's full written answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

Briefing notes
To: Tabby Birman, audit engagements partner
From: Audit manager
Subject: Audit planning for EEG

These briefing notes will evaluate and prioritise the significant audit risks to be considered in planning Siberian Co's audit, design the principal audit procedures to be performed in respect of the defined benefit pension scheme, and evaluate the ethical and professional issues arising from the request made by the audit committee.

a) Evaluate & prioritise audit risks (24 marks)

<u>Materiality</u>

Profit before tax (PBT) of $523m has been used as the basis for materiality, in line with the partner's instructions. A materiality range of 5% to 10% of PBT, $26.15m to $52.3m, has ben calculated.

$26.15m, the lower level, has been set as materiality, as Siberian is a high risk audit. Decreasing revenue and profits give an incentive to overstate performance to mask decline, heightening the risk of misstatement.

<u>Redundancy provision</u>

$62m provision is highly material as more than double the £26.15m materiality level.

Redundancy discussions took please in May X5, with there being a plan in place to close stores. However, redundancy notices have not yet been served, and there does not seem to have been a market announcement to date.

A public commitment to the programme may not be made by 30 Sept X5, Siberian may not be committed to making the staff redundant. There may not be a 'present obligation to pay' at the year end date.

Relocation and retraining costs are ongoing business costs and relate to the period in which the costs are incurred. It is not appropriate to provide for these.

Management have an incentive to overstate 'exceptional items' by including these costs in the provision, rather than treat them as ongoing costs. Executive directors get a bonus linked to Earnings Per Share (EPS) after exceptional items. Adjusted EPS has increased by 7%, despite declining EPS (down by 15.2%), which could be due in part to this overstatement.

Redundancy provision overstated, exceptional adjustments to profit overstated

Risk prioritised as it is highly material at more than double materiality, the subjectivity over assessing the redundancies as a 'present obligation', and the potential for management bias over classifying costs as exceptional.

Loss making stores

200 stores are operating at a loss, with $1,633m of Property Plant and Equipment (PPE). A clear indicator of impairment exists as the stores are loss making, with plans to close them.

$1,663m is a hugely material balance. A 1.6% reduction in the value of PPE would be material ($26.15m / $1,633m).

No impairment review seems to have been performed. Management should perform a review on each store (as each is a separate Cash Generating Unit) that is planned to be closed. The stores have a $0 value in use (as they will be closed), they should be written down to resale value if this is below book value.

Management incentive not to recognise the impairment as it would reduce profit and impact their bonus.

Stores to be closed are classified as PPE. If management truly are committed to closing the stores and selling off assets (to be consistent with the redundancy provision being in place), the stores should be classified separately as assets held for sale (with depreciation ceased).

PPE is overstated, impairment expense understated, assets held for sale understated.

Risk prioritised as it is hugely material, and appears to be a clear error (impairment indictors are clear).

Leased properties

$2,397m value of leased properties is clearly material.

Lease lengths vary from 3 to 15 years, but all are depreciated on the same basis of 10 years. This is inappropriate. The depreciation term will be too long for short lease properties (e.g. 3 years), understating depreciation. It will be too short for long term leases (e.g. 15 years) overstating depreciation.

Each lease should be depreciated over its actual term, increasing accuracy. The under and overstatements may not balance each other out, particularly if higher value leases are either short or long term.

Depreciation may be under or overstated, leased assets (PPE) under or overstated.

Defined benefit pension

Net liability of $576m and the past service cost (exceptional item) of $86m are highly material.

Highly subjective estimates factor into the calculation, which is technical and complex. The risk of error or bias is partially mitigated by the use of an auditor’s expert.

However, the audit team may lack the technical knowledge to robustly challenge the actuarial assumptions and to robustly assess the auditor’s experts work, increasing detection risk.

Pensions liability may be under or overstated, employee expenses under or overstated.

Inventory

Hugely material at $780m (around 30 times the $26.15m materiality level).

Perpetual inventory system means that each line is counted at least once per year, but there is no year-end count.

The May count was attended by the audit team, who 'always' attend just the May count, the same each year. The auditor is too predictable here, there is a risk that other monthly counts are not performed properly as the client team know they will be unsupervised. Misstatements may be overlooked and fraud risk increased (as theft deterrent is reduced).

3 discrepancies were identified in May. Although immaterial and corrected, they could be material if extrapolated over the wider inventory system, and could indicate control weaknesses.

Inventory may be overstated, inventory write downs understated.

Inventory - clothing

Clothing inventory $405m balance is material at 15.5 times the materiality level. Holding period increased significantly (by 40.3%) to 73 days.

Inventory should be valued at the lower of cost and Net Realisable Value (NRV). The longer holding period indicates that NRV may have fallen below cost.

Clothing is a fashion item, and could become obsolete as fashions / tastes change. Holding inventory for longer increases this risk. Furthermore, demand for Siberian clothing known to be falling (decreasing revenue overall). Siberian may have to reduce prices to below cost to sell older items

Inventory may be overstated, inventory write downs understated

Board structure

CEO and chair roles are combined, a clear breach of corporate governance principles. Further breaches exist, with the same executive director being present on the audit committee and remuneration committee.

Devon Rex (CEO and Chair) is clearly a dominant individual. This reduces the ability of those charged with governance to hold the executive board to account.

Audit committee's function may have been compromised by Devon's presence. This may have contributed to the intimidation threat place on the auditors to accept the non audit work

Remuneration committee also shows signs of being ineffective. Executive directors receive a bonus based on adjusted EPS, giving an incentive to overstate exceptional items so the bonus is received. Devon may have pushed for this scheme to be in place.

Tutorial notes

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Boad structure – I would've preferred to use this to support another audit risk (somewhere that the dominant individual may have exerted influence) – but I didn't find a place to do so!

TIME – this was ridiculously time pressured. Had you done this question first…..you would undoubtedly have overrun……and been chasing time for the rest of the exam.

b) Principle audit procedures to be performed in respect of the defined benefit pension scheme (6 marks)

Increase in pension benefits. Obtain scheme documentation (or HR records / contract letters) and ensure that enhanced benefits are fully reflected in the actuarial assessment. Ensure that he uplift was applied to all past and present members.

Remeasurement gain on plan assets. Agree asset values to market data or financial press (e.g. share prices, bond prices for the scheme assets). There is a clear incentive for management to overstate the gain (to reduce the pension liability), and this is a highly judgemental / subjective area. Ensure gains are genuine.

Actuarial loss on remeasurement of liability. There is again a clear incentive to understate the loss, to reduce the pension liability. There are many judgemental areas here, e.g. life expectancy, mortality rates. Perform analytical procedures over any changes in any assumptions, particularly those that reduce the liability, and investigate further.

Discount rate used in the actuarial calculations. Confirm reasonable based on inflation rates, interest rates, and ensure consistent with other companies in the sector.

Past service costs. Obtain auditor's expert's report and confirm work carried out was in line with the instructions given. Review the results of their procedures, and fully understand their work, to confirm that it supports the figure.

Re-calculate the auditor's expert's calculations. As they are highly technical, there is a significant risk of error. Ensure that their work has been properly performed.

Tutorial notes
Principal procedures – main ones only. I avoided anything minor (like 'add up/cast'), to reduce the risk of losing a PSM for not adhering to the requirements. I avoided anything to do with the 'current service cost' as it was so small ($0.2m) in relation to the other figures given

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No marks for discussing the auditor's expert's independence, competence etc, as this has already been done (per the scenario)

c) Ethical and professional issues arising from the request by the audit committee (10 marks)

Insurance claim
Non audit work create a self-review for the audit (wastage and losses will be reflected in the financial statements being audited). The audit team may overly rely on the work performed by their colleagues, accepting it as correct without robust challenge.

Siberian is listed, meaning that most non-audit work is prohibited under the ethical standards (ES). However, as the balance tested is immaterial, it would be permitted with safeguards (e.g. separate teams).

Advocacy threat arises as the report forms basis of insurance claim to a third party (the insurer). The auditor's work will form the basis of a negotiation with the insurer over the amount to be paid. The auditor may be perceived as promoting the client, helping them to receive a higher amount from the insurer, failing the reasonable third party test.

Controls work
Designing controls is the role of management, overseen by those charged with governance. By giving advice on the controls, a management threat exists, with the auditor making decisions on behalf of management. This is prohibited under the ES

Controls relate to inventory, a material balance that will be audited (i.e. the controls relate to financial reporting). Advising here is prohibited under the ES, no safeguards could mitigate the self review threat.

Self-review threat exists for future audits. The audit team may be unwilling to highlight issues with the new controls, as this would reflect badly on the advice given by the advisory team at their own firm.

<u>Intimidation threat</u>
Threat to 'put audit out to tender' places undue pressure on the auditor to accept the work. The auditor may say yes, despite the ED breaches noted above, to retain the presumably lucrative audit (listed client).

Audit committee is behaving inappropriately, compromising the objectivity of the audit. They are putting the auditor in an impossible position, the auditor should consider resigning.

<u>Tutorial notes</u>
As this was 10 marks – I used sub headings (I do this if the number of marks is 8 or more) Instead of 'ethical' and 'professional issues', I made my sub-headings each individual issue.

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The examiner's answer does into discussing actions for the auditor. This is beyond the scope of the requirement – I would advise you NOT to do this – likely to cost you time and PSMs!!!! Do as the examiner says……not as they do!

Question 2 Carrot – Ben's answer plan

1 July X5
Manager – quality control
Audit quality and SQM – Pumpkin Group
Listed – large manufacturer – multiple subsidiaries

a) Objectives of an audit firm's system of quality management (8)

Leadership – appropriate tone at the top – partners commit to audit quality – filters down through the audit team

Audit methodology – adapt to the circumstances of each audit client – respond to specific risks – rather than a generic approach – ensure audit quality is maintained - reduce audit risk

Use of experts – decisions to be made based on need – risk – rather than expense – prioritise quality over profitability

Supervision – senior staff to be appropriately available – support junior staff – answer questions – reduce risk that misstatements are overlooked

Technology – ensure audit evidence is securely stored – backed up - accessible – evidence to support the audit opinion

How ISQM1 will help to achieve those objectives

Standardised guidelines for firms to follow – ensure consistency between audits at different audit firms – ensure legal and regulatory requirements are followed

Principles based approach – not prescriptive – able to be flexed to the needs of each individual audit – regardless of size or nature of client

Reinforces good practice – ensure audit firms are aware of need to prioritise audit quality

<u>Tutorial notes</u>
I've deliberately written an answer here that DOES NOT require detailed knowledge of ISQM1.

Although the questions says 'you do not NEED to use an exhibit to answer this requirement' – you can of course use the exhibit to help you to come up with ideas!!

All of my 'objectives' come from the scenario
- ***Leadership – comes from the audit partner Kinga Edwards being unavailable***
- ***Audit methodology – comes from the standardised audit tests on Turnip Co***
- ***Use of experts – not using an expert for Turnip co jewellery***
- ***Supervision – Kinga Edwards being unavailable***
- ***Technology – information stored on laptops, not backed up***

My 'how will ISQM 1 achieve these' are all general points about having 'rules' in place, you don't need to know ISQM1 to make these points!

b) Evaluation of quality management issues (12 marks)

Turnip Co

Standardised tests - not customised to needs of the audit – may not be appropriate – high value precious metals and gemstones – risk of theft – valuation subjective (fluctuating market rate) – bespoke items - tests may not have been appropriate – insufficient evidence to support inventory

Valuation of inventory – low risk – in line with previous years – despite significant change in the business – acquisition of Turnip Co - high value of individual items of jewellery – risk should be assessed each year – prior year irrelevant – insufficient audit procedures performed

Use of an independent valuer – partner refused – based on cost – valuer could be required particularly as this is a new audit, auditor lacks experience - prioritising profitability over quality – breach of quality management principles

Partner unavailable to answer audit queries – too busy – weak tone at the top – weak leadership – partner not taking the audit seriously – filter down to junior auditors – may cut corners – lack of professional competence and due care – misstatements overlooked

Yam

Documentation stored on individual laptops – no central file – harder to review effectively – linkages between evidence over different parts of the audit – partner may overlook material issues – harder to perform analytical procedures on completion – required per the ISAs

Evidence on Senior's laptop – unavailable now they have left – documentation must be retained for at least 5 years – money laundering requirement – clear breach of regulations

No backups during the audit – audit evidence could become corrupted – processes should be in place to have an alternative backup process if there is no internet connection

Engagement Quality Review

New partner – charity audits only – lack of industry experience – less able to challenge the audit partner on judgements made during the audit – e.g. valuation of inventory assessed as low risk

Risk heightened – audit partner (Kinga) assessed them as the 'ideal candidate' – may feel they owe Kinga a favour – less likely to challenge Kinga

Ethical issues

Long service

Partner in place for 10 years – listed client – breach of ethical standards (INT 7 years / UK 5 years) – familiarity threat – close personal relationships developed – may have led to Kinga's hands off approach (not responding to audit queries) – not expecting to find issues – overly trusting of the client

Self-review threat – unwilling to change audit approach – challenge methodology followed – reflect badly on prior year audit decisions – evidence by unwillingness to update inventory risk assessment (low risk in line with previous years)

Engagement quality reviewer

Attended audit committee meetings – developed a relationship with the directors – familiarity threat – knowledge of the client's plans and objectives – overly sympathetic

Conclusion

Significant breaches – particularly assessment of inventory as high risk – poor documentation – listed client – high public interest – could be sued for negligence – likely to lose – lack of documentation to defend in court

Tutorial notes
There was SO MUCH to go at here in the scenario…….biggest risk was overrunning on time. It was a 12 mark question, no need for more than 12 points (there was more I could've written)

If you overrun on time here, it will really hurt you elsewhere in the exam.

I tried to avoid repetition, but it was hard to avoid! There were 2 familiarity threats (Kinga's long service and the EQR being on the audit committee) – I tried my best to make my explanations different for each.

With each issue, I tried to use multiple facts from the scenario, and explain WHY this issue had arisen/why it was a problem.

Question 2 Carrot - Ben's full written answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

a) Objectives of an audit firm's system of quality management (8)

Leadership. Setting an appropriate tone at the top, where partners commit to audit quality that filters down through the audit team. A culture of commitment to quality.

Audit methodology. Adapt the audit approach to the circumstances of each audit client, responding to specific risks rather than following a generic approach. Ensure that audit quality is maintained regardless of the client's circumstances, reducing audit risk overall.

Use of experts. Decisions to be made based on need and risk, rather than cost. Prioritise quality over profitability, if an expert is required, they should be engaged regardless of the cost.

Supervision. Senior staff to be appropriately available to support junior staff (answering questions during the audit). This will reduce the risk that misstatements are overlooked by junior auditors.

Technology. Ensure audit evidence is securely stored, is backed up and accessible. Evidence must be retained to support the audit opinion.

How ISQM1 will help to achieve those objectives

Standardised guidelines for firms to follow. Ensure consistency between audits at different audit firms, ensuring that legal and regulatory requirements are followed. This is increase public confidence in audit.

Principles based approach, rather than being prescriptive or rules based. Quality standards can be flexed to the needs of each individual audit, regardless of the size or nature of the client.

Reinforces good practice. Ensure audit firms are aware of need to prioritise audit quality by giving clear guidance.

Tutorial notes
I've deliberately written an answer here that DOES NOT require detailed knowledge of ISQM1.

Although the questions says 'you do not NEED to use an exhibit to answer this requirement' – you can of course use the exhibit to help you to come up with ideas!!

All of my 'objectives' come from the scenario
- ***Leadership – comes from the audit partner Kinga Edwards being unavailable***
- ***Audit methodology – comes from the standardised audit tests on Turnip Co***
- ***Use of experts – not using an expert for Turnip co jewellery***
- ***Supervision – Kinga Edwards being unavailable***
- ***Technology – information stored on laptops, not backed up***

My 'how will ISQM 1 achieve these' are all general points about having 'rules' in place, you don't need to know ISQM1 to make these points!

b) Evaluation of quality management issues (12 marks)

Turnip Co

Standardised tests were performed, not customised to the needs of the audit. Turnip's inventory is high value precious metals and gemstones (high risk of theft), and its valuation may be subjective (fluctuating market rate). Standard tests would not gather the required evidence to support the inventory balance.

Valuation of inventory was deemed to be low risk, in line with previous years. However, significant changes in the business (acquisition of Turnip Co with high value of individual items of jewellery). Risk should be assessed each year, the prior year assessment is irrelevant. Again, this would lead to insufficient evidence being gathered over inventory.

Use of an independent valuer. Partner refused this, based on cost. Independent valuation could be required particularly as this is a new audit, where auditor may lack the experience to value the inventory. The partner is prioritising profitability over quality, a breach of quality management principles

Partner unavailable to answer audit queries due to being 'too busy'. A weak tone at the top, with the partner not taking the audit seriously. Weak leadership can filter down to junior auditors, who may follow this example and cut corners during the audit (lack of professional competence and due care). Misstatements could be overlooked.

Yam

Documentation stored on individual laptops, with no central file. Harder to review effectively, as linkages between evidence over different parts of the audit may not be apparent. The review partner may overlook material issues. Also, would be harder to perform analytical procedures on completion without all documentation being in one place, which is required per the ISAs.

Evidence on Senior's laptop was unavailable now they have left the business. Documentation must be retained for at least 5 years, a money laundering requirement. Poor documentation retention here is a clear breach of regulations.

No backups were performed during the audit. Audit evidence could become corrupted on individual laptops (e.g. viruses), making it unavailable if needed in the future (e.g. if there is a court case for negligence). Processes should be in place to have an alternative backup process if there is no internet connection

Engagement Quality Review (EQR)

EQR partner is a new partner, with experience of charity audits only. Their lack of industry experience (and listed company audits) may leave them less able to challenge the audit partner on judgements made during the audit (e.g. valuation of inventory assessed as low risk).

Risk heightened as the audit partner (Kinga) assessed the EQR reviewer as the 'ideal candidate'. The EQR partner may feel they owe Kinga a favour, making them less likely to challenge Kinga.

Ethical issues

Long service

Audit partner in place for 10 years for a listed client, a clear breach of the ethical standards (INT 7 years / UK 5 years). A familiarity threat may have arisen, where close personal relationships developed over time between Kinga and senior client management. This may have led to Kinga's hands off approach (not responding to audit queries). Kinga was not expecting to find issues, showing they are overly trusting of the client.

Self-review threat may have arisen due to the long service. The partner is unwilling to change audit approach as to do so could reflect badly on prior year audit decisions. Evidenced by the partner's unwillingness to update inventory risk assessment (low risk in line with previous years)

Engagement quality reviewer

EQR partner attended client audit committee meetings. A relationship may have developed with the directors, leading to a familiarity threat. The partner would have knowledge of the client's plans and objectives, and could be overly sympathetic to the client (compromising objectivity).

Conclusion

Significant breaches of quality management principles, particularly the poor documentation standards. As Pumpkin is a listed client, there is high public interest in the financial statements and audit report. Carrot could be sued for negligence by a user of the accounts. They would be likely to lose due to the lack of documentation to defend in court.

Tutorial notes
There was SO MUCH to go at here in the scenario…….biggest risk was overrunning on time. It was a 12 mark question, no need for more than 12 points (there was more I could've written)

If you overrun on time here, it will really hurt you elsewhere in the exam.

I tried to avoid repetition, but it was hard to avoid! There were 2 familiarity threats (Kinga's long service and the EQR being on the audit committee) – I tried my best to make my explanations different for each.

With each issue, I tried to use multiple facts from the scenario, and explain WHY this issue had arisen/why it was a problem.

Question 3 Cydonia & Co – Ben's answer plan

General notes
1 July X5 – today
Audit manager

Showbiz – unlisted
y/e 31 Mar X5
Materiality - $50k

Resistance Group
y/e 31 Dec X4 – completion
Unlisted
Subs audited by other companies
Intercompany trading
Group Materiality $34m

Tutorial notes
2 completely separate scenarios, different companies – take care not to get mixed up.
Plan and answer each separately!

I did b) first – as it was shorter, I could bag the marks quickly and leave the balance of time for part a)

Think there is an error in the scenario for part b) – the post balance sheet event should be for the X4 accounts. If this happens in the exam (it can and does), don't let it throw you – just state your assumption and move on

a) Matters to report to Those Charged with Governance (TCWG) & explanation (Showbiz) – 13 marks

Grant
$1.2m recognised in full – before the conditions of the grant met – not compliant with IAS – recognise grant income when the conditions are met – match the grant income to the expenditure - report to TCWG – non-compliance with accounting standards – may not be aware

Grant maximum exceeded – 20% of $5m – maximum grant allowed $1m - $1.2m received - $0.2m may have to be repaid – report to TCWG – significant finding from the audit

24 month project – 3 months since start - $1.2m x 3/24 - $150k – grant income overstated by $1.05m – deferred income understated – highly material vs $50k – report material misstatements to TCWG – significant finding from the audit

50% of filming in Waterside – unable to verify – management restricted viewing of the production schedule – required to assess if the terms forecast to be met – management not providing information and explanations required for the audit – not complying with legal requirements — report to TCWG - could impact audit opinion

Controls deficient – allowed grant income to be recognised before conditions met – report to TCWG - control deficiencies – awareness – overall responsibility for system of internal control – can take action

Expenses

Breach of documented procedures – authorisation control not operating effectively – report to TCWG – suggest control improvement - implement computer controls – only allow payments that have been independently authorised

33 claims from a single finance manager – suspiciously high – all $240-$249 – could be fraudulent – manager aware that the control not operating below $250 – potentially fraudulent – not material - $8k vs $50k – still report to TCWG – management fraud – could be more widespread – allow them to take action (disciplinary, further investigation)

Claims made, processed and received by the same person – lack of segregation of duties – design of controls deficient – report to TCWG – suggest segregation of duties – different individual to make claims and receive cash – reduce fraud risk

General overheads – may relate to individual projects – seems unlikely that all are 'general' – project costs understated – misstatement may not be material - still report to TCWG – aware of the wider implication of the issue

Tutorial notes

Each point finished by explaining WHY it should be reported to TCWG – to make sure every points scored full, making sure I was answering the requirement.

I tried to use EVERY specific detail in the scenario to generate a wide range of scenario specific points. But I could only come up with 9……..that's enough to pass the question.

Did you do calculations here? Any time you can……so some simple numbers – and comment on them – and you'll score easy marks. The numbers were given for a reason!!!

Each explanation – why report to TCWG – I tried to make different. I know the examiner HATES repetition, so I came up with as many different reasons as possible.

Notice that EVERY point had the same structure – finishing with 'why report to TCWG' – being consistent makes life easier for the marker

b) Critical appraisal – 7 marks

Unmodified opinion

Net unreconciled difference $13m – below $23m – not material by size (net position)

Could be larger (material) misstatements that net off – immaterial in aggregate – misstatements should be considered individually – as well as aggregate – further detail needed to confirm – 'not performed any further work' – worrying lack of competence from the group audit team - must be completed before audit report is issued

Could be material by nature – important to a user regardless of size – area where management are moving profits around the group companies – e.g. minimise tax – potential area of management bias, lack of integrity

Modification likely to be required – likely to be material by nature – qualified 'except for' opinion – not pervasive – isolated to single intercompany balance

Proposed Emphasis of Matter paragraph (EOM)

EOM – draw attention to a huge issue – fundamental importance to a user – correctly accounted for and disclosed

Unreconciled difference – not correctly accounted for – not appropriate for EOM – remove

Disposal – could be of fundamental importance – large – more detail needed – date of disposal – consideration received – description of the activities of the company

Reference to correct disclosure note missing – post balance sheet event – allow a user to easily find the full disclosure

Tutorial notes

I had to control myself here! There was more I could say – particularly about the EOM – but there were only 7 marks available, so I kept it to the points I was super confident over

I tried to refer to 'missing information' to earn a PSM mark for judgement

I also referred to the 'no further work performed' over the misstatement – this was in the EOM paragraph – and commented about this being inappropriate – agin to earn PSM credit (A&E, judgement).

Question 3 Cydonia & Co - Ben's full written answer

Note – this is a 'strong' answer, planned / written under exam timed conditions. It isn't perfect, but shows you what is achievable!

<u>Tutorial notes</u>
2 completely separate scenarios, different companies – take care not to get mixed up. Plan and answer each separately!

I did b) first – as it was shorter, I could bag the marks quickly and leave the balance of time for part a)

Think there is an error in the scenario for part b) – the post balance sheet event should be for the X4 accounts. If this happens in the exam (it can and does), don't let it throw you – just state your assumption and move on

<u>a) Matters to report to Those Charged with Governance (TCWG) & explanation (Showbiz) – 13 marks</u>

<u>Grant</u>
$1.2m recognised in full, before the conditions of the grant have been met. Non-compliance with IFRS, which requires grant income to be met when the conditions are met, and to match grant income to the related expenditure.
Report to TCWG as accounting standards have not been complied with (required to report this). TCWG may not be aware of the issue.

Grant maximum claim has been exceeded. A maximum of 20% of the $5m budget can be claimed ($1m). $1.2m has been received, an excess of $0.2m (this may have to be repaid).
Report to TCWG, this is a significant (and material) finding from the audit.

24 month project. 3 months have elapsed since the start of the project. Only $150k should have been recognised to date ($1.2m x 3/24), assuming that the grant should be recognised evenly over the 24 months. Grant income is overstated by $1.05m ($1.2m - $0.15m), deferred income understated, highly material vs the $50k materiality level.
Report to those TCWG, material misstatements should be collated and reported (whether corrected or not), as a significant finding from the audit.

50% of filming is required to be in Waterside. The auditor was unable to verify if planned production schedules meet this term of the grant. Management restricted viewing of the production schedule, they are not providing information and explanations required for the audit. Management are not complying with legal requirements.
Report to TCWG as the material lack of sufficient and appropriate evidence provided could impact the audit opinion (UK only – reporting by exception – info and explanations for the audit not received)

Controls are deficient. The system of internal control allowed grant income to be recognised before conditions were met. Report to TCWG, required to inform them of control deficiencies so they are aware. TCWG have oversight responsibility for the system of internal control, this will allow them to take action.

Expenses

Breach of documented procedures, the authorisation control was not operating effectively for claims below $250.
Report to TCWG and suggest control improvements (e.g. implement computer controls that only allow payments that have been independently authorised)

33 claims were from a single finance manager. This is suspiciously high, particularly as all were $240-$249. Could be fraudulent, with the manager aware that the control was not operating below $250.
Report to TCWG (despite being immaterial) as required to report on any management fraud. The fraud could be more widespread, this would allow TCWG to oversee action being taken (disciplinary, further investigation).

Claims were made, processed and received by the same individual. Lack of segregation of duties here, the design of controls is deficient.
Report the control deficiency to TCWG and suggest segregation of duties (different individual to make claims and receive cash) to reduce fraud risk.

General overhead classification is incorrect, the expenses may relate to individual projects. Seems unlikely that all are 'general' costs, when all costs over $250 are project specific. Project costs are understated.
Report to TCWG despite the misstatement being immaterial, so they are aware of the wider implications of the issue.

Tutorial notes

Each point finished by explaining WHY it should be reported to TCWG – to make sure every points scored full, making sure I was answering the requirement.

I tried to use EVERY specific detail in the scenario to generate a wide range of scenario specific points. But I could only come up with 9……..that's enough to pass the question.

Did you do calculations here? Any time you can……so some simple numbers – and comment on them – and you'll score easy marks. The numbers were given for a reason!!!

Each explanation – why report to TCWG – I tried to make different. I know the examiner HATES repetition, so I came up with as many different reasons as possible.

Notice that EVERY point had the same structure – finishing with 'why report to TCWG' – being consistent makes life easier for the marker

b) Critical appraisal – 7 marks

Unmodified opinion

Net unreconciled difference is $13m, below the materiality level of $23m. The net position appears to be immaterial by size.

Larger (material) misstatements could be present that that net off to become immaterial in aggregate. Misstatements should be considered individually as well as in aggregate, per the ISAs. The Group team has 'not performed any further work', showing a worrying lack of competence from the group audit team. This must be completed before audit report is issued.

The misstatement could be material by nature, of importance to a user regardless of the size. Intercompany balances are an area where management could be moving profits around the group companies (e.g. to minimise tax). Potential area of management bias or lack of integrity, which would be of interest to a user.

Modification to the opinion would be required, as the matter is likely to be material by nature. A qualified 'except for' opinion would be required. The matter is not pervasive as it is isolated to single intercompany balance.

Proposed Emphasis of Matter paragraph (EOM)

EOM is used to draw attention to a huge issue (of fundamental importance to a user) that has been correctly accounted for and disclosed by management.

Unreconciled difference has not been correctly accounted for. Not appropriate to include this in an EOM paragraph, it should be removed entirely. Likely that this issue would be described in the 'basis of modified opinion' paragraph (assuming the matter is material by nature).

Disposal could be of fundamental importance to a user, given it is 'large'. However, more detail would be needed in the EOM so that a user is fully informed. The date of disposal, consideration received and a description of the activities of the disposed company should be included.

Reference to correct disclosure note is missing. The disposal has been disclosed as a post balance sheet event. A reference to the note in the financial statements should be included (e.g. see note 7) to allow a user to easily find the full disclosure.

Tutorial notes

I had to control myself here! There was more I could say – particularly about the EOM – but there were only 7 marks available, so I kept it to the points I was super confident over

I tried to refer to 'missing information' to earn a PSM mark for judgement

I also referred to the 'no further work performed' over the misstatement – this was in the EOM paragraph – and commented about this being inappropriate – agin to earn PSM credit (A&E, judgement).

I wasn't sure if commenting on the required opinion would score……felt I was going beyond the requirement a little…….so I kept this brief