



# ACCA Pre-Sept 24 mock

Ben Wilson's answers

Tutorial notes are provided for each requirement, giving you extra guidance.

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 Thornham – Ben’s answer plan

### General notes

Today - 1 July X5

Audit manager

Listed - public interest, more rules

New client - detection risk, opening balances - CDD performed

Manufacturer - globally famous - global sales

y/e/ 30 Sept X5 - 3 months before y/e - planning phase

Audit committee - use of internal audit

### **Briefing notes**

To: Wendy Runton, audit engagement partner

From: Audit manager

Subject: Thornham Textiles Co audit planning

Date: 1 July 20X5

### **Introduction**

These briefing notes will evaluate and prioritise the significant audit risks to be considered in planning the audit for the financial year ending 30 September 20X5, design the principal audit procedures to be performed in respect of the non-current assets relating to the planned closure of the Holt factory; and the share-based payment scheme. They will also discuss the factors to be considered when determining the nature and extent of reliance which can be placed on the work of the internal audit department of Thornham Textiles Co.

### **a) Evaluate and prioritise the significant audit risks to be considered in planning the audit for the financial year ending 30 September 20X5 (22)**

*ALL EXHIBITS - 6 or 7 risks required*

### Materiality

Range of \$440k to \$880k - 5% to 10% of profit before tax (PBT)

Set at lower level \$440k - higher risk audit - significant changes to the business (closure of Holt factory) - increasing risk of misstatement - new audit - reduce detection risk - unfamiliar with the company's processes and systems

### ***Analytical procedures***

***Revenue / profit / margins calculations – include these to add depth to other risks***

### Holt factory - asset held for sale / discontinued operation

\$4.7m carrying value - highly material

Requires classification as an asset held for sale or discontinued operation

- Buyer actively being sought (actively discussing sale to another company)

- Asset available for sale in its current condition (factory is operational and being sold as an ongoing business)

- Sale is highly probable (discussions ongoing with a buyer, judgement involved here)

- Sale will be completed within 1 year (closure planned for November X5)

Required to reclassify the assets as 'current', to stop depreciation, and record the assets at the lower of book value and fair value less costs to sell.

Unusual transaction - risk that management are not aware of the reporting requirements - increased risk of error

Inadequate disclosure - assets and liabilities not presented separately

Risk prioritised - judgement involved in assessing if a sale highly probable - unusual transaction - highly material by size

#### Redundancy

\$1.2m cost - material - could require a provision

Present obligation - if staff have been notified about the redundancy programme - further information required

Past event - decision has been made to close the factory

Reliably measurable - cost figure of \$1.2m given by management

Probable outflow - judgemental - dependent on whether sale of factory goes ahead

Potential for management bias - overstate the likelihood of sale going through - avoid recognising the \$1.2m cost - boost profits - listed - pressure to deliver profitability to the market

New client - auditor lacks experience - hard to robustly challenge management's judgement over the likelihood of sale - increased detection risk

Current liabilities (provisions) understated - redundancy costs (SPL) understated

Risk prioritised - management judgement involved - likelihood of sale proceeding - lack of third party evidence available - reliant on management representations - increases risk of misstatement

#### Holt factory - impairment

\$0.7m write down required (\$4.7m - \$4m) - material

Asset held for sale - required to write down to lower of book value (\$4.7m) and fair value less cost to sell (\$4m) - value in use assumed to be \$0 as closure is planned.

PBT increased by \$2.3m (35.4%) - suggests write down has not been recorded - would decrease PBT

\$4m does not include sale costs - legal fees, advisor costs - actual write down could be greater than \$0.7m

Factory value overstated (current asset, as an asset held for sale) - impairment expense (SPL) understated

#### Share options

Equity settled share options - spread cost evenly over the vesting period - value at grant date  
 $1,000 \text{ staff} \times 1,000 \text{ shares} \times \$1.70 / 3 \text{ years} = \$567\text{k per year}$  - maximum cost - assuming redundant staff retain options - material

Potential for error - new scheme - management may lack experience of performing the calculation - unrealistic assumption that all staff will remain - unclear if redundant staff will retain their options

Equity could be under or overstated - employee expense (SPL) under or over stated. More likely overstated, given the unrealistic assumption over all staff remaining increasing the cost of the scheme.

#### Litigation

\$2m claim - material

Contingent asset - recognise if virtually certain to be received - breach of patent seems clear from the scenario - use of the name is protected - status of the legal claim unknown - prudent not to recognise an asset

Disclosure required - if probable - further information required about the status of the case - management incentive not to disclose - draws attention to the matter - globally famous brand - could impact sales if customers question legitimacy of the products

Disclosures inadequate - full details of the case required (\$2m claim, status of the case, court dates, likelihood of winning) - user of accounts fully informed

#### Flood damage

Damaged inventory - value of \$625k - material

Valued at the lower of cost and net realisable value - \$625k assumed to be the cost of the inventory (further information required to confirm this) - net realisable value likely to be \$0 - flood damage would damage the cloth making it impossible to sell - write down of \$625 required

Management bias - may be reluctant to recognise the cost - profit margins have fallen (11.1% in X5 [\$8,800/\$79,500]) vs 11.3% in X4 [\$6,500/\$57,400]) - would further reduce margins - negative signal to market - listed

Current assets (inventory) overstated - inventory write down expense (SPL) understated

#### **Tutorial notes**

***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 c1 hour remaining. This was ridiculously time pressured. Had you done this question first, you would undoubtedly have overrun and been under pressure.***

***22 marks....less 3 marks for materiality.....19 marks for audit risks. With 3 marks per well explained risk, I was happy with 6, as there will be a few marks for the calculations I included in the answer***

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

***Forex – I didn't think this was a 'significant' risk as the company is listed, it's a simple calculation. So I avoided it as I didn't want to lose a PSM for not adhering to the requirements.***

***New client / analytical procedures – I use these to add depth to other risks.....rather than making them risks in their own right***

**b) Principal audit procedures****Non current assets (planned closure of Holt factory) (5)**

Board minutes - approval of closure of factory - additional detail (e.g. planned date of closure - November X5) - evidence that TT are committed to the closure within 12 months - classification as an asset held for sale / discontinued operation

Obtain valuation report - assuming available by the date of the audit - confirm market value of the factory as an individual asset - market value of other properties in the area - valuation reasonable

Obtain qualification certificates - trade references - external valuer - assess their professional competence - reliability of their valuation

Evidence of negotiations with the potential buyer - emails / meeting minutes - assess likelihood of the sale going ahead - likelihood of \$4m being received - assess if fair value is genuinely \$4m

Written management representations - confirm intent to sell within 12 months - evidence to support \$4m valuation - management judgement - confirm in writing

**Share based payment scheme (5)**

Contract letters / HR records - terms and conditions of the share scheme - accuracy of the stated terms - number of shares (1,000), price (\$2.50), requirement to remain until 30 September X7 - drives the cost of the scheme

Board minutes - confirm approval of the scheme - 1 October X4 - board approval required to issue shares - without this, the scheme doesn't actually exist

Fair value calculation - \$1.70 per share - judgement assumptions made - e.g. discount rate - assess if reasonable - in line with discount rates used by other companies made in the sector

HR records - historic staff turnover rates - employees that have already left (October X4 to today) - assess reasonableness of assumption that no staff will leave - unrealistic given the 3 year timeframe

Legal advice - staff made redundant - entitlement to shares - impacts the cost of the scheme

**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. The examiner’s answer includes lots of ‘basic’ tests.....going against their own advice. Do as the examiner SAYS not as they DO!***

***Assumed 5 marks per sub requirement – although we don’t know this for sure, it is the only assumption we can make. Important to have a balanced answer here for PSMs***

***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 started here – picking up the ‘easier’ marks for procedures while I was still fresh.***

***Notice that each of my procedures follows the same structure. 1) The ‘evidence’. 2) Explain ‘how’ the test works. 3) Explain ‘why’ I am doing the test. Do these 3 things to earn a full mark.***

c) Discuss factors to consider (reliance on internal audit) (8)

Objectivity - employed by the company - inherent self interest threat - may not highlight issues that impact going concern - impact their employment - consider who directs their work - if free to decide where to focus - or if controlled by an executive director

Report to audit committee - enhances objectivity - non executive directors - more able to report issues without fear of recrimination from an executive director - more able to place reliance on their work

New client - lack of prior year file - documentation of systems - internal audit report useful starting point - external auditor must assess how well the work was planned / performed / reviewed - cannot rely on it fully - must perform testing to confirm the quality of the report

Qualifications and experience of internal auditors - not required to be qualified accountants - if unqualified / inexperienced, less reliance can be placed

Resourcing / staffing - sufficient people and technology resources - perform work effectively - if under-resourced - less likely to be professionally competent - place less reliance on their work

Level of substantive testing - driven by risk of material misstatement - judgement for the external auditor - where high, must perform appropriate level of testing - despite audit committee suggestion - listed client - public interest - risk of being sued if negligent

Internal audit performing testing - only where routine / mechanical - no judgement involved - work reviewed by external auditor - any high risk areas must be tested by the external auditor directly

Conclusion

Objectivity and quality of work - key factors - if satisfactory can place some reliance on internal audit - only in low risk / non judgemental areas

**Tutorial notes**

***As this was 8 marks – I used sub headings (I do this if the number of marks is 8 or more).***

***Sub headings make your answer easier to mark, and help to earn a communication PSM in Q1.***

***Lots of 'knowledge' was required here about internal audit – there wasn't much to use in the scenario. This is unusual in AAA.***

***If you struggled to generate points here – its totally fine to just make a few short points and move on. Save the time to use elsewhere in the exam! Clearly you can't do this on every requirement and pass the exam....but in one or two places, its fine.***

## Question 1 Thornham - 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: Wendy Runton, audit engagement partner

From: Audit manager

Subject: Thornham Textiles Co audit planning

Date: 1 July 20X5

### Introduction

These briefing notes will evaluate and prioritise the significant audit risks to be considered in planning the audit for the financial year ending 30 September 20X5, design the principal audit procedures to be performed in respect of the non-current assets relating to the planned closure of the Holt factory; and the share-based payment scheme. They will also discuss the factors to be considered when determining the nature and extent of reliance which can be placed on the work of the internal audit department of Thornham Textiles Co.

### **a) Evaluate and prioritise the significant audit risks to be considered in planning the audit for the financial year ending 30 September 20X5 (22)**

#### Materiality

Range of \$440k to \$880k, 5% to 10% of profit before tax (PBT).

Set at lower level \$440k as this is a higher risk audit. Significant changes to the business have occurred (closure of Holt factory), increasing the risk of misstatement. As a new audit client, lowering materiality helps to reduce detection risk as the auditor is unfamiliar with the company's processes and systems.

#### Holt factory - asset held for sale / discontinued operation

\$4.7m carrying value is highly material.

Requires classification as an asset held for sale or discontinued operation as the IFRS criteria have been met:

- Buyer actively being sought (actively discussing sale to another company)
- Asset available for sale in its current condition (factory is operational and being sold as an ongoing business)
- Sale is highly probable (discussions are ongoing with a buyer, judgement is involved here. It is not clear that this criteria has been met)
- Sale will be completed within 1 year (closure planned for November X5)

If the criteria are met, Thornham Textiles (TT) are required to reclassify the assets as 'current', to stop depreciation, and record the assets at the lower of book value and fair value less costs to sell.

Unusual transaction, not in the normal course of business. Increased risk that management are not aware of the reporting requirements, increasing the risk of error.

Inadequate disclosure in the financial statements. Assets and liabilities may not presented separately and disclosed as held for sale / discontinued.

Risk prioritised. Judgement is involved in assessing if a sale highly probable, with scope for management bias. This is an unusual transaction that is highly material by size, disclosure errors could be significant.

#### Redundancy

\$1.2m cost is material, it could require a provision if the criteria below are met:

- Present obligation would exist if staff have been notified about the redundancy programme. Further information required here to assess if staff have been notified.
- Past event exists, as the decision has been made to close the factory.
- Reliably measurable as the cost figure of \$1.2m has been given by management.
- Probable outflow required is judgemental, dependent on whether sale of factory goes ahead. If the factory is sold, less redundancies will be needed.

Potential for management bias to overstate the likelihood of sale going through. This would avoid recognising the full \$1.2m cost and boost profits. As TT is listed, there may be pressure to deliver profitability to the market.

New client, where the auditor lacks experience. May be hard to robustly challenge management's judgement over the likelihood of sale, increasing detection risk.

Current liabilities (provisions) may be understated, redundancy costs (SPL) understated.

Risk prioritised as management judgement is involved over the likelihood of sale proceeding. A lack of third party evidence may be available, the auditor will be reliant on management representations. This increases the risk of misstatement.

#### Holt factory - impairment

\$0.7m write down required (\$4.7m - \$4m) is material

Asset held for sale (if the criteria above are met), TT are required to write down the factory to the lower of book value (\$4.7m) and fair value less cost to sell (\$4m). Value in use is assumed to be \$0 as closure is planned.

PBT increased by \$2.3m (35.4%), suggesting that the write down has not been recorded, as this would decrease PBT.

\$4m does not include sale costs (such as legal fees and advisor costs). Actual write down could be greater than \$0.7m, as these costs would need to be recognised in the fair value less costs to sell calculation.

Factory value may be overstated (current asset, as an asset held for sale), impairment expense (SPL) understated

#### Share options

Equity settled share options, as employees have the right to buy shares (no cash received). TT must spread the cost evenly over the vesting period, based on the fair value of the options at the grant date.



1,000 staff x 1,000 shares x \$1.70 / 3 years = \$567k per year. This is the maximum cost, assuming redundant staff retain options, making the cost material.

Potential for error. As a new scheme, management may lack experience of performing the calculation. An unrealistic assumption that all staff will remain has been made, and it is unclear if redundant staff will retain their options, both of which would impact the cost of the scheme.

Equity could be under or overstated, employee expense (SPL) under or over stated. More likely overstated, as the unrealistic assumption over all staff remaining would increase the cost of the scheme.

#### Litigation

\$2m claim is material.

Contingent asset should be recognised if virtually certain to be received. The breach of patent seems clear from the scenario (use of the 'Norfolk Cloth' name is protected). However, the status of the legal claim is unknown, it is prudent not to recognise an asset.

Disclosure required if winning the case is probable. Further information required about the status of the case to assess this fully. Management could be biased here, not disclosing the matter to avoid drawing attention to it. Norfolk cloth is a globally famous brand, it could impact sales if customers question the legitimacy of the products.

Disclosures may be inadequate. Full details of the case must be disclosed (\$2m claim, status of the case, court dates, likelihood of winning) so that a user of the accounts is fully informed.

#### Flood damage

Damaged inventory with a value of \$625k, which is material.

Inventory must be valued at the lower of cost and net realisable value. \$625k assumed to be the cost of the inventory (further information required to confirm this). Net realisable value likely to be \$0 as severe flood damage would damage the cloth, making it impossible to sell. A write down of \$625 is required.

Management bias could be present here. They may be reluctant to recognise the cost as profit margins have fallen (11.1% in X5 [\$8,800/\$79,500]) vs 11.3% in X4 [\$6,500/\$57,400]). This extra cost would further reduce margins, a negative signal to the market.

Current assets (inventory) may be overstated, inventory write down expense (SPL) understated.

#### Tutorial notes

***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 c1 hour remaining. This was ridiculously time pressured. Had you done this question first, you would undoubtedly have overrun and been under pressure.***

***22 marks....less 3 marks for materiality.....19 marks for audit risks. With 3 marks per well explained risk, I was happy with 6, as there will be a few marks for the calculations I included in the answer***

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

***Forex – I didn't think this was a 'significant' risk as the company is listed, it's a simple calculation. So I avoided it as I didn't want to lose a PSM for not adhering to the requirements.***

***New client / analytical procedures – I use these to add depth to other risks.....rather than making them risks in their own right***

### **b) Principal audit procedures**

#### Non current assets (planned closure of Holt factory) (5)

Obtain board minutes. Confirm board approval factory closure and the planned date of closure (November X5). Evidence that TT are committed to the closure within 12 months, driving classification as an asset held for sale / discontinued operation.

Obtain valuation report (assuming available by the date of audit fieldwork). Confirm market value of the factory as an individual asset. Assess if valuation is in line with market value of other properties in the area (valuation reasonable)

Obtain qualification certificates and trade references for the external valuer. Assess their professional competence, as this drives the reliability of their valuation.

Evidence of negotiations with the potential buyer (e.g. emails / meeting minutes). Assess the likelihood of the sale going ahead and that \$4m will be received. Evidence to support the fair value being genuinely \$4m.

Written management representations should be obtained. Confirm the board's intent to sell within 12 months, and the assessment that \$4m will be received. These are key management judgements so must be confirmed formally in writing.

#### Share based payment scheme (5)

Contract letters and HR records should be obtained, particularly the terms and conditions of the share scheme. Confirm the accuracy of the stated terms:

- number of shares (1,000)
- price (\$2.50)
- requirement to remain until 30 September X7

These inputs drives the cost of the scheme, recognised in the financial statements, so must be verified.

Board minutes should be reviewed. Confirm board approval of the scheme and the grant date of 1 October X4. Board approval is required to issue shares, without this, the scheme doesn't actually exist.

Fair value calculation performed by management should be obtained (\$1.70 per share). Assess the judgemental assumptions made (e.g. discount rate) and assess if reasonable. Confirm if the discount rate used is in line with that used by other companies made in the sector.

HR records showing historic staff turnover rates and employees that have already left (October X4 to today) should be obtained. Assess reasonableness of assumption that no staff will leave, this appears unrealistic given the 3 year timeframe and 1,000 staff included in the scheme.

Legal advice obtained by management should be reviewed, regarding the staff being made redundant. Assess their entitlement to shares, if redundancy is exempted by the scheme as a leaving condition. The impacts the cost of the scheme.

### **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. The examiner’s answer includes lots of ‘basic’ tests.....going against their own advice. Do as the examiner SAYS not as they DO!***

***Assumed 5 marks per sub requirement – although we don’t know this for sure, it is the only assumption we can make. Important to have a balanced answer here for PSMs***

***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 started here – picking up the ‘easier’ marks for procedures while I was still fresh.***

***Notice that each of my procedures follows the same structure. 1) The ‘evidence’. 2) Explain ‘how’ the test works. 3) Explain ‘why’ I am doing the test. Do these 3 things to earn a full mark.***

### **c) Discuss factors to consider (reliance on internal audit) (8)**

#### **Objectivity**

Internal audit (IA) are employed by the company. An inherent self interest threat exists, IA may not highlight issues that impact going concern (as it could impact their employment).

Consider who directs their work. If IA are free to decide where to focus, it makes them more objective (and we can place more reliance on their work). If they are controlled by an executive director, they would be less objective.

#### **Reporting**

IA report directly to the audit committee. This enhances objectivity as reporting is to non executive directors. IA would be more able to report issues without fear of recrimination from an executive director. Would allow reliance to be placed on their work.

#### **New client**

As this is the first year auditing TT, there is no prior year file. TT's controls and systems must be documented fully as part of the audit. Internal audit report would be a useful starting point for this. The external auditor (EA) must assess how well the work was planned / performed / reviewed . EA cannot rely on the report fully, they must perform testing to confirm the quality of the report.

#### **Qualifications and experience**

Internal auditors are not required to be qualified accountants. If IA staff are unqualified / inexperienced, less reliance can be placed on their work

Resourcing / staffing

Consider if IA have sufficient people and technology resources to perform their work effectively (planning, performing and reviewing). If under-resourced, IA are less likely to be professionally competent, meaning less reliance can be placed on their work

Level of substantive testing

Must be driven by the risk of material misstatement, a judgement for the external auditor. Where risk is high, EA must perform detailed substantive testing, despite the audit committee's suggestion. As a listed client. public interest is high and there is a risk of being sued if negligent (e.g. be over-relying on IA's work).

Internal audit performing testing

Must only allow IA to assist where controls are routine / mechanical, with no judgement involved in the testing. IA's work must be reviewed in detail by the EA. Any high risk areas of the audit must be tested by the external auditor directly

Conclusion

Objectivity of IA and the quality of IA's work are key factors to consider when placing reliance on their work. If satisfactory, EA can place some reliance on IA's work, but only in low risk / non-judgemental areas.

**Tutorial notes**

***As this was 8 marks – I used sub headings (I do this if the number of marks is 8 or more).***

***Sub headings make your answer easier to mark, and help to earn a communication PSM in Q1.***

***Lots of 'knowledge' was required here about internal audit – there wasn't much to use in the scenario. This is unusual in AAA.***

***If you struggled to generate points here – its totally fine to just make a few short points and move on. Save the time to use elsewhere in the exam! Clearly you can't do this on every requirement and pass the exam....but in one or two places, its fine.***

## Question 2 Soba – Ben’s answer plan

### General notes

1 July X5 - today

Manager - forensics department (specialist)

Udon - CF client - NOT audit client

Ramen - fraud - NOT an existing client

### **a) Discuss how ISQM 1 can improve audit quality / public trust in audit (6)**

#### Acceptance & continuance

New clients - know your client procedures - reputation and ethical behaviour - only accept if desirable to associate with the client

Existing clients - identify if there have been changes to business - professional competence - or new evidence over desirability of client - e.g. behaviour during previous engagements, access to information / explanations - only continue audit quality can be maintained

#### Firm wide culture & system of quality management

Firm wide commitment to quality - senior leadership of audit firm prioritising quality over profitability - sets an example for junior staff - filters down through the organisation - improving the robustness of audit work

System of quality management - process applied to all engagements - ensure quality is maintained - conclusions/opinions supported by robust evidence- audits reviewed against the SoQM - identify areas for improvement - boost public trust as gives confidence that quality is monitored

#### Conclusion

Improves quality - setting expectations for all firms to follow - regardless of size or specialism - public confident that firms are given guidance on how to maintain quality throughout an audit

#### **Tutorial notes**

***The examiner has stated that you can expect ‘up to 6 marks’ for a ‘pure knowledge’ question in the AAA exam.***

***Its not efficient to memorise all of the technical articles and AAA text book.....and not worth it for just 6 marks.***

***I tried to keep this answer brief and non technical.....showing you how to pick up a few marks and then move on***

***Each point.....I tried to bring it back to answering the question, referring to the requirement (how it boosts audit quality or public confidence in auditing)***

**b) Evaluate professional and ethical matters BEFORE accepting (Udon) (8)**

Professional competence - specialist department - experienced in insurance claims

Industry experience - fashion - seasonal sales - fast moving - judgement - income that would have been generated

Insurance claim - reporting required - scope of work - deadline - availability of resources

Insurance company - third party - relying on report - increased risk - negligence claim - sued - fee

Finance director (FD) calculation - unusual calculation - may lack experience - self interest threat - overstate the claim - more experienced staff required - robustly challenge FDs assumptions - inventory valuation

Contingent fee - paid 50% extra if completed within 2 weeks - self interest threat - incentive to cut corners to meet the deadline - impair professional competence

2 week deadline - tight timeframe to plan and perform the work - availability of staff at short notice

Safeguards

Reject contingent fee - negotiate fee based on skills required / time

Appoint team with experience of fashion - robustly challenge FD's assumptions

Clearly establish scope of work - use of report - distribution to third parties beyond insurance company

Tutorial notes

*I did this part first (before part a) to see if there were 'ideas' here I could use in part a).*

*Danger here.....there was lots more I could write in the answer! This is a recipe for overrunning on time. I had to control myself, writing an appropriate amount for the 8 marks on offer.*

*Each point, I tried to bring it back to why it was important to consider BEFORE accepting (i.e. making sure that I answered the specific question asked).*

**c) Investigation procedures (6)****Land**

Obtain sale agreement - land registry documents - accuracy of amount sold for (\$2.8m) - date of sale (April X5) - verify sale actually took place

Bank statements - confirm \$2.6m and \$200k receipts - verify accuracy of Seth's account - he could be involved in the fraud

Unidentified bank account - obtain details of account (trace transaction) - data analytics - identify other payments to this account - fraud could be more widespread

**Warehouse**

Obtain contract - \$1,500 management fee - what it relates to - who the fee is to be paid to (Ramen, or Bess Bell directly) - management fee could be an incentive payment to Bess

Contact bank - confirm details of all accounts held by Ramen - identify if the 'other account' is genuine - board approval required (confidentiality)

Board minutes - historic records - approval of the opening of the 'other account' - could be with a different bank - if no records - suggests the account doesn't exist - implicates Bess Bell

**Tutorial notes**

***The examiner was MEAN here.....setting me a trap. There were LOADS more procedures I could've written.....but with only 6 marks available, I went for 6 only (to avoid overrunning on time).***

***I tried to write 'different' procedures for the land and the warehouse, as I know that repetition often doesn't score in AAA.***

***I tried to focus on the 'riskier' areas, particularly with the Warehouse, as I know that there is often a PSM for 'judgement' for focusing on things that are most likely to be incorrect.***

## Question 2 Soba - 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) Discuss how ISQM 1 can improve audit quality / public trust in audit (6)

#### Acceptance & continuance

New clients. ISQM1 requires firms to perform 'know your client procedures' for new clients, assessing their reputation and commitment to ethical behaviour. New clients should only be accepted if deemed desirable to associate with the client.

Existing clients. ISQM1 requires firms to identify if there have been changes to clients' business that could impact professional competence (e.g. moving to a new industry). Auditors are required to assess this each year, giving the public confidence that they will only continue as auditor if they are competent.

ISQM1 also requires auditors to assess if new evidence has emerged over the desirability of a client. E.g. client behaviour during previous engagements, giving access to information / explanations required. Auditors should only continue if audit quality can be maintained, helping to improve audit quality.

#### Firm wide culture & system of quality management

Firm wide commitment to quality is a requirement of ISQM1. Senior leadership of the audit firm must prioritise quality over profitability, setting an example for junior staff to follow. Quality should filter down through the organisation, improving the robustness of audit work.

System of quality management is the quality process applied to all engagements, as required by ISQM1. The SoQM ensures quality is maintained, that conclusions/opinions are supported by robust evidence. Audits are reviewed against the SoQM to identify areas for improvement, boosting public trust as gives confidence that quality is monitored.

#### Conclusion

ISQM1 should improve audit quality by setting expectations for all firms to follow, regardless of size or specialism. Giving overall guidance should make the public confident that firms know how to maintain quality throughout an audit.

#### Tutorial notes

***The examiner has stated that you can expect 'up to 6 marks' for a 'pure knowledge' question in the AAA exam. Its not efficient to memorise all of the technical articles and AAA text book.....and not worth it for just 6 marks.***

***I tried to keep this answer brief and non technical.....showing you how to pick up a few marks and then move on***

***Each point.....I tried to bring it back to answering the question, referring to the requirement (how it boosts audit quality or public confidence in auditing)***



**b) Evaluate professional and ethical matters BEFORE accepting (Udon) (8)**

Professional competence. Soba's specialist forensics department is experienced in insurance claims, this is typical work for the firm.

Industry experience. Fashion retail, with seasonal sales and fast moving inventory. Judgement will be involved in determining the income that would have been generated from selling the destroyed inventory (a financial forecast). The items may have been sold at a discount if not popular. Consider the availability of staff with experience of fashion retail.

Insurance claim. Consider the exact reporting required as this will drive the scope of the work required (the testing needed). Consider also the deadline for the work (potentially 2 weeks), and the availability of suitably experienced staff / resources to meet this deadline.

Insurance company. A known third party will be relying on report. Consider if the report will be more widely distributed. This would increase engagement risk, as other parties could sue Soba for negligence if the work turns out to be flawed. Engagement risk should be considered when negotiating a suitable fee.

Finance director (FD) preparing the calculation. Outside of their normal role, they may lack experience and make errors. Consider their competence. A self interest threat exists for the FD to overstate the claim, as this would boost the performance of Udon. More experienced staff required, who can robustly challenge the FDs assumptions in judgement areas (e.g. inventory valuation and margins).

Contingent fee (paid 50% extra if work completed within 2 weeks). Self interest threat created, an incentive to cut corners to meet the deadline. Insufficient evidence may be obtained just to meet the deadline, impairing professional competence. Risk heightened as a known third party (insurance company) will be relying on the work, and may sue Soba if they are negligent.

2 week deadline. Tight timeframe to plan and perform the work appropriately. Consider the availability of suitably experienced staff at short notice, they may be booked to other work.

Safeguards

Reject contingent fee. No safeguards could mitigate the self interest threat created. Negotiate a fixed fee based on skills required, time required and engagement risk.

Appoint a team with experience of fashion, who can robustly challenge the FD's assumptions in judgemental areas.

Clearly establish scope of the work. Use of report and distribution to third parties beyond insurance company should be set out in the engagement letter, to reduce the risk that Soba is sued for negligence related to wider use of the report.

Tutorial notes

*I did this part first (before part a) to see if there were 'ideas' here I could use in part a).*

*Danger here.....there was lots more I could write in the answer! This is a recipe for overrunning on time. I had to control myself, writing an appropriate amount for the 8 marks on offer.*

*Each point, I tried to bring it back to why it was important to consider BEFORE accepting (i.e. making sure that I answered the specific question asked).*

**c) Investigation procedures (6)****Land**

Obtain sale agreement and land registry documents confirming the sale. Verify the accuracy of amount sold for (\$2.8m) and the date of sale (April X5) to verify that the sale actually took place.

Obtain bank statements to confirm separate \$2.6m and \$200k receipts. Verify the accuracy of Seth's account as he could be involved in the fraud.

Unidentified bank account. Obtain details of account (trace the transaction, what was the account number and sort code of the account). Use data analytics to identify other payments to this account, as the fraud could be more widespread.

**Warehouse**

Obtain lease contract. Identify the \$1,500 management fee in the contract, what it relates to and who the fee is to be paid to. It could be paid to Ramen, or Bess Bell directly. The management fee could be an incentive payment to Bess.

Contact Ramen's bank to confirm details of all accounts held by Ramen. This will identify if the 'other account' is genuine. Board approval will be required (as the bank has a duty of confidentiality to Ramen).

Review historic board minutes. Identify approval of the opening of the 'other account' (it could be with a different bank, so the bank confirmation test above may not identify it). If no board minute records exist regarding the account, it suggests the account doesn't exist, implicating Bess Bell. Avoid questioning Bess Bell about the account as she may be involved with the fraud, and could destroy evidence.

**Tutorial notes**

***The examiner was MEAN here.....setting me a trap. There were LOADS more procedures I could've written.....but with only 6 marks available, I went for 6 only (to avoid overrunning on time).***

***I tried to write 'different' procedures for the land and the warehouse, as I know that repetition often doesn't score in AAA.***

***I tried to focus on the 'riskier' areas, particularly with the Warehouse, as I know that there is often a PSM for 'judgement' for focusing on things that are most likely to be incorrect.***

## Question 3 Rashid – Ben’s answer plan

### General notes

1 July X5 - today

Audit manager

Rashid - y/e 31 March X5 - 3 months after year end - completion

Listed - (public interest, rules)

Financials stable - could use for analytical procedures

Materiality \$2.2m - 5.2% of PBT

### **a) i) Explain matters to discuss with management (9)**

#### Franchise agreement

Indicators of impairment exist - sugar tax - reduced demand for products - value of exclusive franchise agreement has fallen - management must perform an impairment review to comply with IFRS

Impairment review - write down value of asset - book value is \$40m (\$50m less 6 years of amortisation at \$1.6666m per year) - vs higher of value in use (\$35m) - fair value less cost to sell (\$0 as the franchise rights are non transferable) - \$5m write down required (\$40m - \$35m)

Management assertion that sales will return to normal levels - seems unlikely given the new tax - management's justification for this - potential bias to avoid a write down (protect profits) - without robust evidence to support - material misstatement - over \$2.2m materiality level

#### Forward contract

Financial instrument - speculating - not used for hedging - hedge accounting cannot be applied - IFRS requires the financial instrument to be revalued at year end - gains or losses recognised in the SPL (fair value through profit or loss)

Instrument has increased in value by \$0.35m (\$1.35m - \$1m) - gain must be recognised in the SPL - would boost profits (offsetting the \$5m reduction due to the franchise impairment).

Misstatement is immaterial - below \$2.2m - encourage management to correct it anyway - increase accuracy of financial statements - best practice to correct it

#### Legal action

Possible loss of the case (per legal advisers) - past event at year end (legal action ongoing) - no reliable estimate of the potential outflow of economic benefits - meets criteria of IFRS to be recognised as a contingent liability - disclosure is required.

Prejudice outcome of the case - trying to avoid negative publicity - listed company - public health impact - user of the accounts must be informed - could impact decision making - material by nature - non compliance with accounting standards - public health

Disclosure must be sufficient to fully inform a user - details of the case - legal opinion on likelihood of losing - date of court case - no reliable estimate available - otherwise material misstatement - inadequate disclosure

**Tutorial notes**

**9 marks here for financial reporting knowledge – shows the need to revise accounting standards!**

***I've assumed an even split of the marks, 3 per scenario – this is standard in AAA***

***The 'easiest' scenario was the 3<sup>rd</sup> one.....the examiner is being mean here! Hoping that you waste so much time discussing financial instruments (scenario 2) and run out of time.***

**a) ii) Assuming misstatements NOT corrected (5)**Actions for the auditor

Report to those charged with governance - listed client - audit committee - make them aware - encourage them to pressure management to make changes - avoid modified audit opinion/report

Justified audit opinion

Consider misstatements individually and in aggregate

Franchise impairment - material misstatement due to disagreement - not pervasive - isolated to single balances, not widespread

Forward contract - immaterial - can remain unadjusted

Legal action - material by nature - disagreement over required disclosure - could be pervasive - nature of claim - public health - fundamental importance to a user - conclude material only - isolated and unlikely to lose case

Qualified "except for" opinion required - accounts are true and fair - except for franchise impairment & legal action disclosure misstatements - described in the basis of qualified opinion paragraph

Impact on the audit report

Basis paragraph title 'basis of qualified opinion - immediately after the opinion - describing the franchise impairment and legal action disclosure misstatements - setting out the financial impact of correcting the misstatements

**Tutorial notes**

***A straightforward requirement – important not to overdo it through, this is an opportunity to make up some time!***

***There is often a PSM for 'arguing both sides' regarding pervasiveness, so I always try to do this, before concluding clearly***

**b) Professional and ethical issues (6)**

Self review threat - assets acquired form part of audited financial statements - audit team could over-rely on work performed by colleagues - not robustly challenge - mitigated as assets not material - separate teams - audit team not aware of the work performed by colleagues

Management threat - valuation subjective / judgemental - key part of decision to buy the company - mitigated as listed client - management team likely to be capable of making own decisions (informed management)

Listed client - greater public interest - ethical standards prohibit any involvement in management decision making - reasonable third party could conclude auditor objectivity impaired

**Actions for Bob & Co (audit firm)**

Report to those charged with governance (audit committee) - breach of ethical standards - make them aware - including any safeguards to mitigate the impact of the breach

Independent partner review of due diligence work - reasonableness of assumptions made in valuation work - assess if informed management was in place - level of influence of Bob & Co over the decision to buy Carlos Co

Inform Engagement Quality Control reviewer (independent reviewer of audit work, listed client) - pay particular attention to the audit work performed in this area - any evidence of self review threat

**Tutorial notes**

***I had to control myself here! There were only 6 marks available, so no value in generating more points.***

***With ethical issues, it is important that you explain the issue in the context of the scenario. There are no marks for just stating 'self review threat' – even if it is 'correct' – its your explanation that scores marks.***

***I explained how the threats had been 'mitigated' to help earn PSM for judgement***

### Question 3 Rashid - 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) i) Explain matters to discuss with management (9)**

##### Franchise agreement

Indicators of impairment exist. New sugar tax will reduce demand for products (evidenced by market research). The value of the exclusive franchise agreement has fallen, as sales of products will fall in the future. Management must perform an impairment review to comply with IFRS.

Impairment review must write down the value of the intangible asset. Book value is \$40m (\$50m less 6 years of amortisation at \$1.6666m per year), which is above the higher of value in use (\$35m) and fair value less cost to sell (\$0 as the franchise rights are non-transferable). Explain that a \$5m write down is required (\$40m - \$35m).

Management assertion that sales will return to normal levels must be discussed. It seems unlikely given the new tax. Obtain management's justification for this, being mindful of potential management bias to avoid a write down (and protect profits). Without robust evidence to support this assertion, the accounts are materially misstated (as the \$5m issue is over the \$2.2m materiality level).

##### Forward contract

Financial instrument used for speculating (not hedging). Hedge accounting cannot be applied, IFRS requires the financial instrument to be revalued at year end. Any gains or losses must be recognised in the SPL (fair value through profit or loss).

Instrument has increased in value by \$0.35m (\$1.35m - \$1m). The gain must be recognised in the SPL. This would boost profits (offsetting the \$5m reduction due to the franchise impairment), it would be in management's interest to make this adjustment.

Misstatement is immaterial (clearly below the \$2.2m materiality level). Encourage management to correct it anyway to increase accuracy of financial statements. It is best practice to correct known misstatements.

##### Legal action

Possible loss of the case (per legal advisers), with a past event at year end (legal action ongoing), and no reliable estimate of the potential outflow of economic benefits. Criteria met (per IFRS) to recognise a contingent liability. Disclosure is required.

Non-disclosure due to 'prejudicing the outcome of the case' could be management trying to avoid negative publicity. As a listed company (greater public interest), and the nature of the case (public health impact), a user of the accounts must be informed. The case could impact their decision making. It is material by nature due to non compliance with accounting standards and the public health impact.

Disclosure must be sufficient to fully inform a user. Full details of the claim, the legal opinion on likelihood of losing, and the date of any court case must be disclosed, together with a justification of why no reliable estimate is available. Without this, a material misstatement exists due to inadequate disclosure.

***Tutorial notes***

***9 marks here for financial reporting knowledge – shows the need to revise accounting standards!***

***I've assumed an even split of the marks, 3 per scenario – this is standard in AAA***

***The 'easiest' scenario was the 3<sup>rd</sup> one.....the examiner is being mean here! Hoping that you waste so much time discussing financial instruments (scenario 2) and run out of time.***

**a) ii) Assuming misstatements NOT corrected (5)**

Actions for the auditor

Report misstatements to those charged with governance. As a listed client, this would be the audit committee. Make them aware of the issues and encourage them to pressure management to make changes to avoid a modified audit opinion/report.

Justified audit opinion

Consider misstatements individually and in aggregate.

Franchise impairment. A material misstatement exists due to disagreement. It is not pervasive as is isolated to single balances, no widespread impact on the financial statements.

Forward contract misstatement is immaterial. It can remain unadjusted.

Legal action inadequate disclosure is material by nature. There is a disagreement over required disclosure. It could be pervasive due to the nature of claim (public health impact being of fundamental importance to a user). Conclude that it is material only, as it is isolated and Rashid unlikely to lose case.

Qualified "except for" opinion required. The accounts are true and fair, except for franchise impairment & legal action disclosure misstatements, as described in the basis of qualified opinion paragraph.

Impact on the audit report

Basis paragraph titled 'basis of qualified opinion', placed immediately after the opinion. Describe the franchise impairment and legal action disclosure misstatements, setting out the financial impact of correcting the misstatements.

***Tutorial notes***

***A straightforward requirement – important not to overdo it through, this is an opportunity to make up some time!***

***There is often a PSM for 'arguing both sides' regarding pervasiveness, so I always try to do this, before concluding clearly***

**b) Professional and ethical issues (6)**

Self review threat. Assets acquired form part of audited financial statements. Audit team could over-rely on work performed by colleagues, and not robustly challenge the assumptions made in valuing the assets. Risk mitigated as the assets were not material, and separate teams were used (the audit team not aware of the work performed by colleagues).

Management threat. Valuation is subjective / judgemental, and would be a key part of the decision to buy the company. Bob & Co's valuation level could have driven the decision, effectively they could be making the decision by giving a high valuation. Risk mitigated as Rashid is listed, the management team likely to be capable of making own decisions (informed management).

Listed client. There is greater public interest in the financial statements. The ethical standards prohibit any auditor involvement in management decision making, as a reasonable third party could conclude auditor objectivity impaired. By performing the work, Bob & Co may have breached the ethical standards.

**Actions for Bob & Co (audit firm)**

Report to those charged with governance (audit committee) that there has been a breach of ethical standards. Make them aware of the matter, including any safeguards to mitigate the impact of the breach.

Independent partner review of due diligence work. Focus on the reasonableness of assumptions made in valuation work. Assess if informed management was in place, and the level of influence of Bob & Co over the decision to buy Carlos Co.

Inform Engagement Quality Control reviewer (independent reviewer of audit work, as Rashid is a listed client). Encourage them to pay particular attention to the audit work performed over the acquisition / value of assets acquired, to assess if there is any evidence of the self review threat materialising.

**Tutorial notes**

***I had to control myself here! There were only 6 marks available, so no value in generating more points.***

***With ethical issues, it is important that you explain the issue in the context of the scenario. There are no marks for just stating 'self review threat' – even if it is 'correct' – its your explanation that scores marks.***

***I explained how the threats had been 'mitigated' to help earn PSM for judgement***