# ACCA Pre-Dec 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 Calibri – Ben's answer plan

General notes
1 July X5 - today
Manager - audit
y/e 30/9/X5 - 3m before - planning
Unlisted, family owned
Cars - franchising

**Briefing notes**

To: Gill Sans, audit engagement partner
From: Audit Manager
Subject: Audit planning for Calibri Co
Date: 1 July 20X5

Introduction
These briefing notes will evaluate the significant business risks, evaluate and prioritise the significant risks of material misstatement to be considered in developing the audit strategy and audit plan, justify why the inventories of parts and pre-used cars have been identified as significant risks of material misstatement; design the principal audit procedures to be performed on the valuation of the used car inventory. Finally, ethical and professional issues will be considered regarding sustainability work.

**a) Business risk evaluation (10)**
*5 risks*

Franchise withdrawal
Withdrawn without refund - if conditions not met - customer service and sales KPIs - reliant on single manufacturer - impact ability to trade if withdrawn - profitability impact - writing off $800k franchise fees - significant risk - 1 of the 8 has been withdrawn - could be more

Electric cars
Unavailable until X8 - popular with customers - environmentally conscious - go elsewhere - new sales may fall - reliant on new car sales - 70% of revenue - part exchanges - inventory of used cars - profitability may fall

Listing
Management distraction - preparing for the listing - outside of the normal course of business - preparing documentation and marketing the shares - locations may fail to meet KPIs - further franchises could be withdrawn

Internal audit
Newly qualified - lacks wider experience - background in external rather than internal audit - experience less relevant - required improvements to controls may not materialise - may harm the success of the listing

Obsolete parts
Some parts are 5 years old - 20.8% increase in parts held to $580k - taking up space - reduced operating efficiency - potential write downs - parts obsolete - impact on profitability

***Tutorial notes***
***I planned parts a) and b) together – as the same scenario information is required for both.***

***Each business risk – I tried to explain the impact on the COMPANY going forward.***

***I tried to focus on risks where I was given plenty of information in the scenario, so I would avoid speculation (the examiner hates this!!)***

***As there were 10 marks available, you should go for a maximum of 5 risks (as its 2 marks per business risk)***

**b) Risk of material misstatement (ROMM) evaluation (12)**
*3 ROMMs - NOT INVENTORY*

Materiality
Range of $968k to $1,935k - 5% to 10% of profit before tax (PBT)

Set at lower level $968k - higher risk audit - planned listing - significant change to the business - incentive to overstate performance - increased risk of misstatement

Franchise intangible asset
$6.4m ($800k x 8) capitalised - $5.6m remain after write off - material

Indefinite life - allowable under IFRS - must be reassessed each year - indicators of impairment / indefinite life shortened - withdrawal of agreement - sales targets could be missed elsewhere

Management judgement - overstating useful life - boosts profits (up 14.4% to $19,354k) - potential bias - obtain successful stock market listing

Intangible assets overstated, impairment expense understated.

Prioritized risk - highly material by size - potential for management bias increases risk of misstatement

Impairment
Withdrawal of franchise agreement - clear indicator of impairment - total assets of location are $1.2m (intangible plus tangible) - material in aggregate

Separate CGU - write down to recoverable amount (higher of value in use and fair value less costs to sell)

Management assessment that assets will be used elsewhere could be biased - recoverable amount may be below cost - fixtures and fittings unlikely to move easily - low resale value - parts may be obsolete (some are more than 5 years old)

Intangible and tangible assets overstated, impairment expense understated

Risk prioritised - known error - no adjustments made to the financial statements

<u>Governance structure</u>
Newly established audit committee - doesn't comply with corporate governance best practice - only 2 members (3 required) - lack of financial expertise

Unable to challenge exectuive directors effectively - lack of financial expertise - hard to hold directors to account

Significant improvements in performance - revenue up 4.1%, assets up 10.4% - potential bias due to listing - audit committee unable to robustly challenge management - increased risk of overstatement

***<u>Tutorial notes</u>***
***I planned parts a) and b) together – as the same scenario information is required for both.***

***I found it REALLY hard to come up with ROMMs here. There just wasn't much to go at in the scenario. My third ROMM, on governance, is really weak – but its all I could find.***

***Had I done this question first in the exam, it would've dented my confidence. I'm so pleased I did it last of all!***

**<u>c) i) Inventory justification as a ROMM (5)</u>**
Material in aggregate - $1,988k

Used cars individually material - $1,408 - parts immaterial - significant increases to both balances - parts +20.8%, used cars +30% - despite relatively stable business - revenue +4.1% - potential for overstatement

Inventory count - 6 months before year end - roll forward of 6 months worth of transactions - high volume - potential for error or fraud - if controls not operating over that 6 month period - increases risk of misstatement

Used cars - judgemental valuation - may accept sub standard cars in part exchange - drive new car sales (70%) - incentive to overvalue on part exchange - meet franchise sales KPIs - retain franchises - struggle to sell used cars - increased inventory level

Inventory valued at lower of cost and net realisable value - cost is part exchange value - reale value may be lower - management incentive not to write down - profits - successful flotation

Count procedures inappropriate - not assessing valuation - parts can become obsolete (5 years) - cars damaged (whilst at the showroom site) - not assessed during the count - increases risk that inventory overstated

***<u>Tutorial notes</u>***
***The 'parts' were individually immaterial…so I avoided focusing on the issues around parts (obsolete after 5 years). I wanted to make sure I was answering the question……which asked you to focus on why there is a 'significant risk of misstatement'***

***I'm proud of my linkage point to Franchise KPIs – this would help me earn professional skills marks***

**c) ii) Audit procedures (valuation of used cars) (5)**

Cost - agree to part exchange agreement / receipt - signed by customer - ensure cost recorded accurately

Net realisable value - cars sold after year end - agree to invoices / bank statements - ensure greater than cost

Costs incurred to sell the cars - repairs or upgrades - ensure included in net realisable value assessment

Cars unsold - compare to similar cars advertised online - assess if net realisable value is greater than cost - or if a write down to cost is required

Obtain roll forward - agree starting position to March inventory count - auditor's records - ensure damaged car write down has been recorded

***Tutorial notes***
***There weren't many facts to verify from the scenario. I focused instead on 'cost' and 'net realisable value'***

***When writing the answer up – I emphasised the tests that focused on 'judgemental' areas – to help me earn professional skills marks***

**<u>d) i) Ethical and professional issues (8)</u>**

Management threat - determining KPIs - judgemental - not prescribed by standards - making decisions - prohibited under ES

Self review threat - KPIs featuring in financial statements - audit team may accept as correct without robust challenge - over rely on colleague's work on the assurance report

Self review threat - advising on systems - testing the output of the systems (assurance report) - may overlook systems issues - reflect poorly on original advice

Professional competence - KPIs may be technical - staff may lack skills / experience to robustly audit - challenge management on any judgements

Staff availability - right skills - perform the assurance work - 3m before year end - ability to implement safeguards self review - separate teams

<u>d) ii) Services to provide</u>

Determining KPIs - cannot perform - no safeguards could mitigate management threat

Systems advice - permitted as unlisted - cannot make decisions - must ensure informed managent in place (management make all decisions)

Assurance report - permitted as unlisted - self review threat if advised on systems - threat too great - only perform if not doing systems work

***<u>Tutorial notes</u>***
***I answered this part first….as it was a standalone requirement, just required me to read Exhibit 5.***

***I find the ethics question easier to answer and score marks on that the 'risk' questions…..starting here builds my confidence.***

***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 Calibri - 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: Gill Sans, audit engagement partner
From: Audit Manager
Subject: Audit planning for Calibri Co
Date: 1 July 20X5

Introduction
These briefing notes will evaluate the significant business risks, evaluate and prioritise the significant risks of material misstatement to be considered in developing the audit strategy and audit plan, justify why the inventories of parts and pre-used cars have been identified as significant risks of material misstatement; design the principal audit procedures to be performed on the valuation of the used car inventory. Finally, ethical and professional issues will be considered regarding sustainability work.

**a) Business risk evaluation (10)**

Franchise withdrawal
Franchise can be withdrawn without refund by Perpetua Cars (PC) if franchise conditions not met. Customer service and sales KPIs are set by PC, Calibri is reliant on single manufacturer who could set hard targets to force an end to the franchise.

If withdrawn, profitability would be impacted by writing off the $800k franchise fees. This is a significant risk as 1 of the 8 agreements has been withdrawn, more could follow.

Electric cars
Unavailable until X8. Likely to be popular with environmentally conscious customers. They may go elsewhere, causing new car sales to fall.

Calibri is hugely reliant on new car sales. 70% of revenue directly from new cars, with used car sales driven by part exchanges against new cars. Revenue may fall as Calibri does not have electric cars to sell.

Listing
Management distraction in preparing for the listing. A huge transaction that is outside of the normal course of business (preparing documentation, dealing with lawyers, marketing the shares).

Distraction may mean that further locations may fail to meet KPIs, leading to further franchises being withdrawn.

Internal audit
Newly qualified auditor lacks wider experience. Their background in external rather than internal audit makes their experience less relevant. The required improvements to controls may not materialise. This may harm the success of the listing.

Obsolete parts
Some parts are 5 years old (as have been counted 5 times). The 20.8% increase in parts held (to $580k) means that more space is being taken up by parts, reducing operating efficiency.

Potential write downs of parts that are obsolete would impact profitability

***Tutorial notes***
***I planned parts a) and b) together – as the same scenario information is required for both.***

***Each business risk – I tried to explain the impact on the COMPANY going forward.***

***I tried to focus on risks where I was given plenty of information in the scenario, so I would avoid speculation (the examiner hates this!!)***

***As there were 10 marks available, you should go for a maximum of 5 risks (as its 2 marks per business risk)***

**b) Risk of material misstatement (ROMM) evaluation (12)**

Materiality
Range of $968k to $1,935k has been calculated, being 5% to 10% of profit before tax (PBT)

$968k has been set at the materiality level.

The lower level has been used as this is a higher risk audit. The planned listing is a significant change to the business. Management have an incentive to overstate performance, increasing the risk of misstatement. Setting a lower materiality level will bring more balances in scope for testing, reducing detection risk.

Franchise intangible asset
$6.4m ($800k x 8) capitalised in total, with $5.6m remaining after the loss of a franchise. A material balance.

Indefinite life is allowable under IFRS, if supported by evidence (as was the case here). The useful life must be reassessed each year, particularly as there are indicators of impairment / indefinite life shortening (withdrawal of an agreement and potential for sales targets to be missed elsewhere). The useful life of remaining locations should be assessed. This does not appear to have taken place.

Management judgement in overstating useful life helps to boost profits (up 14.4% to $19,354k). Potential bias here to obtain a successful stock market listing

Intangible assets overstated, impairment expense understated.

Prioritized risk as it is highly material by size and the potential for management bias increases risk of misstatement.

Impairment
Withdrawal of franchise agreement is a clear indicator of impairment. Total assets of location are $1.2m (intangible plus tangible assets). This is material in aggregate.

Separate CGU should be written down to recoverable amount (higher of value in use and fair value less costs to sell) where there are indicators of impairment.

Management assessment that assets will be used elsewhere could be biased. The recoverable amount may be below cost. Fixtures and fittings unlikely to move easily and would have low resale value. Parts may be obsolete (some are more than 5 years old).

Intangible and tangible assets overstated, impairment expense understated

Risk prioritised as this is a known error. No adjustments have been made to the financial statements.

Governance structure
Newly established audit committee (AC) doesn't comply with corporate governance best practice. It only has 2 members (3 required), and all lack financial expertise.

The AC are unable to challenge executive directors effectively due to the lack of financial expertise. It is not possible for them to hold executive directors to account on financial matters.

Significant improvements in performance are projected (revenue up 4.1%, assets up 10.4%). These figures may be overstated due to potential bias (planned listing). As the AC are unable to robustly challenge management here, there is an increased risk of overstatement.

***Tutorial notes***
***I planned parts a) and b) together – as the same scenario information is required for both.***

***I found it REALLY hard to come up with ROMMs here. There just wasn't much to go at in the scenario. My third ROMM, on governance, is really weak – but its all I could find.***

***Had I done this question first in the exam, it would've dented my confidence. I'm so pleased I did it last of all!***

**c) i) Inventory justification as a ROMM (5)**

Inventory is a material balance in aggregate ($1,988k).

Used cars are individually material at $1,408k. Although parts are immaterial, there were significant increases to both balances (parts +20.8%, used cars +30%). This was despite the relatively stable business (revenue +4.1%). There is potential for material overstatement.

Inventory count was performed 6 months before year end, with a roll forward of 6 months worth of transactions. As there would be a high volume of transactions over this period, there is potential for error or fraud (if controls were not operating over that 6 month period). Increased risk of misstatement as the inventory count is out of date.

Used car value is highly judgemental. Sales staff may accept sub-standard cars in part exchange, to drive new car sales (70%). There is a management incentive to overvalue cars on part exchange, to help meet franchise new sales KPIs and retain franchises. Calibri may struggle to sell the used cars, leading to increased inventory levels.

Inventory should be valued at lower of cost and net realisable value. Cost is the part exchange value. Resale value may be lower (as noted above). Planned listing creates a management incentive not to write down cars, to maintain profits, and boost the chances of a successful flotation.

Count procedures inappropriate (not assessing valuation during the count). Parts can become obsolete (some are 5 years old) and cars can be damaged (whilst at the showroom site). Not assessing valuation during the count increases the risk that inventory overstated.

***Tutorial notes***

***The 'parts' were individually immaterial…so I avoided focusing on the issues around parts (obsolete after 5 years). I wanted to make sure I was answering the question……which asked you to focus on why there is a 'significant risk of misstatement'***

***I'm proud of my linkage point to Franchise KPIs – this would help me earn professional skills marks***

**c) ii) Audit procedures (valuation of used cars) (5)**

Cost of cars. Agree to part exchange agreements / receipts (ideally signed by the customer). Ensure that cost has been recorded accurately.

Net realisable value (NRV) for cars sold after year end. Agree to invoices and bank statements. Assess if the NRV is greater than cost. If not, the inventory would be overvalued at year end.

Costs incurred to sell the cars (e.g. repairs or upgrades). Ensure these are included in NRV assessment. This would reduce the NRV, potentially bringing it below cost, requiring a write down.

NRV of cars remaining unsold. Compare to similar cars advertised online. Assess if NRV is greater than cost, or if a write down to cost is required. NRV is highly judgemental, and at risk of management bias, making this a particularly important test.

Obtain roll forward. Agree starting position to March inventory count (auditor's records). Ensure that the damaged car write down has been recorded

***Tutorial notes***

***There weren't many facts to verify from the scenario. I focused instead on 'cost' and 'net realisable value'***

***When writing the answer up – I emphasised the tests that focused on 'judgemental' areas – to help me earn professional skills marks***

**d) i) Ethical and professional issues (8)**

Management threat. Determining KPIs to report is judgemental, the metrics are not prescribed by standards. Making judgement and decisions is the role of management. It is prohibited under the Ethical Standards (ES) for the auditor to make decisions.

Self-review threat. Certain KPIs may also feature in financial statements, there could be overlap. The audit team may accept such KPIs as correct without robust challenge. They may over rely on colleague's work on the assurance report.

Self-review threat. Advising on the choice of system, and then testing the output of the system (assurance report) may lead to systems issues being overlooked. The assurance team may not wish to highlight problems that reflect poorly on the original advice.

Professional competence. Sustainability KPIs may be technical (e.g. carbon or water emissions). Audit staff may lack the engineering skills / experience to robustly challenge management on any judgements made in preparing the KPIs.

Staff availability with the right skills to perform the assurance work. As there are 3 months until year end, there is time to assign staff. Consider also the ability to implement safeguards to mitigate the ethical threat noted above.

d) ii) Services to provide

Determining KPIs. Cannot perform this work, no safeguards could mitigate the management threat.

Systems advice. Permitted as Calibri is unlisted. The auditor cannot make decisions, must ensure that informed management is in place (management make all decisions).

Assurance report. Permitted as Calibri is unlisted. However, if the systems advice work is also performed, self-review threat would be too great. Only provide assurance if the systems work is rejected (do not perform both engagements).

***Tutorial notes***
***I answered this part first….as it was a standalone requirement, just required me to read Exhibit 5.***

***I find the ethics question easier to answer and score marks on that the 'risk' questions…..starting here builds my confidence.***

***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 Adana – Ben's answer plan

**General notes**
1 July X5 - today
Audit manager - cold reviews - learning lessons for future audits
Airline haulage client - parcels only (no passengers)
3 routes - segmental?
Parent & 100% owned sub - all audited by Adana
Materiality $210k

**a) Discuss how ISQM1 can improve audit quality and public trust (6)**

i) Acceptance and continuance

New clients - ISQM1 requires processes in place - assess if firm has required experience and resources

Existing clients - continuance process - ISQM1 requires assessment of changes to client business - updates to audit plan

ii) Communication and use of IT

Within firm - regular technical updates and training - latest audit regulations being complied with

Within engagment team - establish communication channels - open culture - juniors raise issues arising during audit

IT - storing sensitive client data securely - access controls

Conclusion

ISQM1 promotes quality and trust - principles based guidance - applicable to all audits - ensure consistency of quality

***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) i) Evaluation of audit quality and other professional issues (14)**

Materiality
$210k - 5.7% of PBT - ($210k / $3.7m) - low end of 5-10% range - prudent - brings more balances in scope for testing

Farland work
Agreeing figures - routine and non-judgemental - acceptable

Goodwill - $6m - material - judgemental - could require impairment - further work required - assess if underlying asset's value in use supports the goodwill valuation - evidence on file does not support goodwill valuation

Lack of adequate reviews - manager and partner did not identify - unaudited goodwill

Completion processes lacking - analytical procedures required - would have identified the unsupported balance

Intragroup differences - $1.2m - material - receivables (asset) overstated - presents a stronger financial position

Miri

Material acquisition - assets increased by $3.8m - material increase - $4.1m is 17.1% of group assets ($4.1m/$24m) - significant component - more audit evidence required - audit plan requires amending.

Industry change - private charter flights - change from haulage only - different risk profile - audit procedures need to change to address new risks faced

No change to audit plan - procedures performed inadequate - analytical procedures only

Audit assistant - too inexperienced to perform the work - incorrectly assessing materiality on profit only - ignoring material change to assets

Work should have been assigned to a more experienced auditor - increased risk of misstatement given changes to the business - more experienced auditor less likely to overlook issues (reduce detection risk)

Conclusion

Significant quality issues - lack of evidence on file for material balances, particularly $6m goodwill

b) ii) Quality management processes to prevent these issues arising

Regular training - managers and partners - reminded of the need to review junior's work in detail

Process in place - audit plan updated if changes to the business - require senior auditor to assess changes prior to agreeing the audit plan

Communicate effectively with juniors - flag if asked to do work that is beyind their capability or experience

Engagement quality control review - independent partner - identify lack of evidence prior to the audit report being signed - obtain further evidence

***Tutorial notes***

***I answered part b) first – to give me ideas I could use in part a)***

***The examiner was MEAN here…..setting me a trap. There were LOADS of issues in the scenario, I could've done much more here – there was too much given for 14 marks.***

***I fell for the trap a little…….but realised I had planned too many points……and adjusted in my writing up so that I stuck to time. An important AAA exam skill is to adjust as you go, so that you keep to time.***

***Did you like my conclusion? I'm proud of it! Not only is it a 'justified' conclusion (explaining why the conclusion was given)…….it was also developed into a commercial point. Great job Ben.***

## Question 2 Adana - 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)**

i) Acceptance and continuance

New client acceptance. ISQM1 requires processes in place to assess if the audit firm has required experience and resources. Boosts public trust as auditors only take on work where professionally competent.

Existing clients (continuance process). ISQM1 requires assessment of changes to client business, and updates to the audit plan to reflect those changes. Audit quality will result, as the evidence obtained will be targeted at the risks faced.

ii) Communication and use of IT

Within firm. ISQM1 requires regular technical updates and training. Ensures the latest audit regulations are complied with, boosting audit quality.

Within engagement team. ISQM1 requires the manager/partner to establish communication channels and an open culture. This allows juniors to raise issues arising during audit, helping the audit approach to flex to those issues.

IT. ISQM1 requires auditors to store sensitive client data securely, with access controls. Public trust will result, as auditors are less likely to be involved in data breaches (less negative press).

Conclusion

ISQM1 promotes quality and trust by providing principles based guidance. ISQM1 is applicable to all audits, ensuring consistency of quality.

***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) i) Evaluation of audit quality and other professional issues (14)**

Materiality
$210k is 5.7% of PBT ($210k / $3.7m). At the low end of 5-10% range, prudent. This brings more balances in scope for testing.

Farland work
Agreeing figures is routine and non-judgemental. Acceptable for this to be done at low cost.

Goodwill of $6m is highly material. A judgemental balance as it could require impairment. Further work required to assess if the underlying asset's value in use supports the goodwill valuation. This wok was not performed. Evidence on file does not support goodwill valuation.

Intragroup differences of $1.2m are material. Receivables (asset) are overstated, incorrectly presenting a stronger financial position.

Lack of adequate reviews. Manager and partner did not identify the unaudited goodwill and the intragroup issue.

Completion processes lacking. Analytical procedures are required at completion. This would have identified the unsupported goodwill balance and the intragroup mismatch.

Miri
Material acquisition. Assets increased by $3.8m, a material increase. $4.1m is 17.1% of group assets ($4.1m/$24m), Miri could be a significant component to the Group, requiring more audit evidence. The audit plan required amending.

Industry change. Private charter flights are offered, a change from haulage only. The Group will face a different risk profile, with different risks of misstatement. Planned audit procedures need to change to address new risks faced

No changes were made to the audit plan. Procedures performed were inadequate (analytical procedures only), the evidence on file will not support the conclusions drawn.

Audit assistant is too inexperienced to perform the work on Miri. They incorrectly assessed materiality on profit only, ignoring the material change to assets.

Work should have been assigned to a more experienced auditor. There is an increased risk of misstatement given changes to the business. A more experienced auditor would be less likely to overlook issues (reduce detection risk).

Conclusion

Significant quality issues, particularly the lack of evidence on file for material balances ($6m goodwill). Unmodified audit opinion is unsupported by evidence, Adana could be sued by users of the accounts for negligent auditing.

b) ii) Quality management processes to prevent these issues arising

Regular training of managers and partners. Reminded them of the need to review junior's work in detail and to follow company processes.

Process in place requiring the audit plan to be updated if changes to the business. Require senior auditor to assess such changes prior to agreeing the audit plan.

Communicate effectively with juniors. Require them to report if asked to do work that is beyond their capability or experience.

Engagement quality control review by an independent partner on high risk audits (such as here, where the business has changed materially). This would identify any lack of evidence prior to the audit report being signed.

***Tutorial notes***

***I answered part b) first – to give me ideas I could use in part a)***

***The examiner was MEAN here…..setting me a trap. There were LOADS of issues in the scenario, I could've done much more here – there was too much given for 14 marks.***

***I fell for the trap a little…….but realised I had planned too many points……and adjusted in my writing up so that I stuck to time. An important AAA exam skill is to adjust as you go, so that you keep to time.***

***Did you like my conclusion? I'm proud of it! Not only is it a 'justified' conclusion (explaining why the conclusion was given)…….it was also developed into a commercial point. Great job Ben.***

# Question 3 Sunnie – Ben's answer plan

General notes
1 July X5 - today
Audit manager - 2 clients
y/e 31/3/X5 - 3 months after y/e - completion

Olive (a)
Listed
Audit report - signed next week
$250k materiality

a) Matters to consider (completion) (7)

Control weakness - inventory count - no segregation of goods in and out during count - cannot count accurately - controls ineffective

Discrepancies each month - $642k ($53.5k x 12 months) - material - could be linked to poor count controls - reported to client - no action taken - could be fraud or incompetence

Full year end count not performed - lack of evidence over inventory figure - controls ineffective - substantive procedures required - evidence needed before audit report signed - potential for delay

Finance director (FD's) attitude - accepting of material error - covered by provision - not taking it seriously - may be other areas of misstatement - additional review of audit file - please less reliance on evidence from the FD

Reporting to Those Charged with Governance (TCWG)

Control weakness - inventory count - significant - make them aware - responsible for overseeing system of internal control

Material misstatement ($642k) - potential for fraud - significant findings from the audit to report

No year end count - FD refused to perform count - lack of evidence over inventory - management not fully supporting the audit

***Tutorial notes***
***Here, there were 2 entirely separate scenarios – each with its own 'background information'. This is happening regularly in Section B of the exam.***

***I separated out the 'matters to consider' and 'reporting to TCWG' to encourage me to answer both parts of the question fully.***

***With each point – my final sentence explains how that point is answering the question (why is it a matter to consider? Why should it be reported to TCWG?). This is a highly effective technique.***

<u>3b) General notes</u>
Listed
Food manufacturer
Exclusive overseas suppliers - Farland
Materiality $334k
y/e 31/3/X5

**<u>b) Matters to consider (8)</u>**

Farland export restrictions - reliant exclusively on Farland suppliers - alternatives unavailable - loss of existing clients - failing to deliver on commitments - consider going concern impact - ability to deliver on remaining contracts if export restrictions not lifted

Potential for further airlines terminating - 3 already - impact on profitability and cash flow - pay debts as they fall due (fixed costs, e.g. staff) - gong concern impact

Bank may not renew borrowing facility - consider size of facility - ability to pay debts if the renewal is refused - at least 12 months - going concern

Return of 2 airline customers - likelihood of renewal - ability to continue to trade without them - management representations unreliable - presenting on optimistic view - encourage bank to renew overdraft

**<u>Evidence expected on file</u>**

Review of management budgets/forecasts - ability to deliver on contracts if export restrictions not lifted - reasonableness of assumptions made (e.g. alternative supplies unavailable)

Analysis of remaining airline contracts - evidence that deliverables have been met - correspondence from clients - assess likelihood of cancelling

Cashflow forecasts - reasonableness of assumptions made - headroom / ability to pay debts if borrowing facility not renewed

Latest bank correspondence - emails - assess likelihood of borrowing being renewed

***<u>Tutorial notes</u>***
***I found this very tough going. The scenario information was very repetitive – a series of going concern uncertainties.***

***I tried to make each of my explanations 'different' as to why the factor should be considered. No point repeatedly typing 'the company might not be a going concern' . Repeating myself doesn't' earn credit doesn't earn credit (do you like what I did there?!)***

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Ben Wilson
AAA Expert Tutor

<u>3c) General notes</u>
1 Aug X5 (4m after y/e)
Disclosure note

**<u>c) Evaluate appropriateness of audit report (5)</u>**

Disclosure note inadequate - no reference to bank loan renewal - expire in August X5 - disagreement / misstatement over the required disclosure.

Likely material - user of the accounts would require this information for decision making

Likely pervasive - if the loan is refused, Sunnie may not be a going concern - fundamentally impacts the financial statements - decision making

Adverse opinion required - material and pervasive misstatement - financial statements do not present a true and fair view

Basis paragraph modified - basis of adverse opinion - explain reasons for adverse opinion - set out the missing disclosures

KAM section - correct to include (listed company) - remove reference to disclosure note - covered in basis of adverse opinion paragraph

***<u>Tutorial notes</u>***
***I had to control myself here! There were only 5 marks available, so no value in generating more points.***

***I try to avoid 'if' points (if material, if material and pervasive, if not material) as they rarely score. I got off the fence, made a decision that it was material and pervasive, and moved on.***

# Question 3 Sunnie - 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) Matters to consider (completion) (7)**

Control weakness (inventory count). No segregation of goods in and out during count, unable to count inventory accurately. Controls are ineffective. Consider need to update the audit plan to obtain more substantive evidence.

Discrepancies each month are $642k in total ($53.5k x 12 months), a material error. This could be linked to poor count controls. The matter was reported to the client, with no action taken. Could be fraud or incompetence from management, consider need to investigate the matter further prior to signing the audit report.

Full year end count not performed. Lack of audit evidence over inventory figure as controls were ineffective. Substantive procedures required before audit report signed. Consider how to obtain that evidence and the potential for delaying release of the audit report.

Finance director (FD's) attitude, they are accepting of the material error (as it is 'covered by a provision'). This suggests the FD is not taking the audit seriously. The may be other areas of misstatement. Consider performing an additional review of audit file, scrutinising evidence from the FD closely.

**Reporting to Those Charged with Governance (TCWG)**

Control weakness at the inventory count should be reported as a significant control weakness. Make TCWG aware as they are responsible for overseeing the system of internal control, they can encourage management to make improvements.

Material misstatement ($642k) and potential for fraud should be reported. They are significant findings from the audit.

No year end count performed, with the FD refusing to perform count. This led to a lack of audit evidence over inventory. Report as this shows management are not fully supporting the audit, allows TCWG to take action.

***Tutorial notes***

***Here, there were 2 entirely separate scenarios – each with its own 'background information'. This is happening regularly in Section B of the exam.***

***I separated out the 'matters to consider' and 'reporting to TCWG' to encourage me to answer both parts of the question fully.***

***With each point – my final sentence explains how that point is answering the question (why is it a matter to consider? Why should it be reported to TCWG?). This is a highly effective technique.***

**b) Matters to consider (8)**

Farland export restrictions. Sunnie is reliant exclusively on Farland suppliers, alternatives are unavailable. Loss of 3 major clients during X5 due to failing to deliver on commitments. Consider going concern impact, ability to deliver on remaining contract commitments if export restrictions not lifted.

Potential for further airlines terminating (in addition to the 3 already cancelled). Consider impact on profitability and cash flow, and ability to pay debts as they fall due (fixed costs, e.g. staff) if there are further cancellations. Going concern impact must be considered, management may need to make full disclosure of the going concern uncertainties.

Bank may not renew borrowing facility. Consider the size of the facility and Sunnie's ability to pay debts if the renewal is refused over the next 12 months. Without financing in place, Sunnie may not be a going concern. The X5 financials may need to be prepared on a break-up basis if the funding is refused.

Return of 2 airline customers. Consider the likelihood of renewal and Sunnie's ability to continue to trade without them. Management representations are particularly unreliable here, management may be presenting on optimistic view to encourage the bank to renew financing. Consider the availability of third party evidence.

**Evidence expected on file**

Review of management budgets/forecasts. Assess ability to deliver on remaining contracts if export restrictions not lifted, as this could drive further cancellations. Consider the reasonableness of assumptions made (e.g. alternative supplies unavailable).

Analysis of remaining airline contracts. Obtain evidence that deliverables have been met (e.g. deliveries on time). Review correspondence from clients to assess likelihood of cancelling.

Cashflow forecasts, assessing the reasonableness of assumptions made. In particular, the level of headroom / ability to pay debts if borrowing facility not renewed.

Latest bank correspondence (e.g. emails) to assess the likelihood of borrowing being renewed. Without this, Sunnie is unlikely to continue trading.

***Tutorial notes***

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***I tried to make each of my explanations 'different' as to why the factor should be considered. No point repeatedly typing 'the company might not be a going concern' . Repeating myself doesn't' earn credit doesn't earn credit (do you like what I did there?!)***

***In a tough requirement – important that you have a go……and then move on. Don't overrun on time in the 'hope' that you land on mark scoring points. Get in, get out, move on, pass!***

**<u>c) Evaluate appropriateness of audit report (5)</u>**

Disclosure note inadequate. No reference to bank loan renewal, due to expire in August X5. This is a key element of the going concern uncertainty. Disagreement and misstatement over the required disclosure.

Likely material as a user of the accounts would require this information for decision making. The bank's decision will significantly impact the business.

Likely pervasive. If the loan is refused, Sunnie may not be a going concern. This fundamentally impacts the financial statements and a users decision making.

Adverse opinion required, rather than unmodified. The material and pervasive misstatement means that the financial statements do not present a true and fair view

Basis paragraph modified to become the 'basis of adverse opinion' paragraph, explaining reasons for adverse opinion. Set out the missing disclosures here.

KAM section. Correct to include a KAM section as Sunnie is listed. Remove reference to the disclosure note as this is covered in the basis of adverse opinion paragraph.

***<u>Tutorial notes</u>***

***I had to control myself here! There were only 5 marks available, so no value in generating more points.***

***I try to avoid 'if' points (if material, if material and pervasive, if not material) as they rarely score. I got off the fence, made a decision that it was material and pervasive, and moved on.***

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