Answers

1 (a) Inventory count arrangements

Deficiencies	Recommendations
The warehouse manager is planning to supervise the inventory count. Whilst he is familiar with the inventory, he has overall responsibility for the inventory and so is not independent. He may want to hide inefficiencies and any issues that arise so that his department is not criticised.	An alternative supervisor who is not normally involved with the inventory, such as an internal audit manager, should supervise the inventory count. The warehouse manager and his team should not be involved in the count at all.
There are ten teams of counters, each team having two members of staff. However, there is no clear division of responsibilities within the team. Therefore, both members of staff could count together rather than checking each other's count; and errors in their count may not be identified.	Each team should be informed that both members are required to count their assigned inventory separately. Therefore, one counts and the second member checks that the inventory has been counted correctly.
The internal audit teams are undertaking inventory counts rather than reviewing the controls and performing sample test counts. Their role should be focused on confirming the accuracy of the inventory counting procedures.	The internal audit counters should sample check the counting undertaken by the ten teams to provide an extra control over the completeness and accuracy of the count.
Once areas are counted, the teams are not flagging the aisles as completed. Therefore there is the risk that some areas of the warehouse could be double counted or missed out.	All aisles should be flagged as completed, once the inventory has been counted. In addition, internal audit or the count supervisor should check at the end of the count that all 20 aisles have been flagged as completed.
Inventory not listed on the sheets is to be entered onto separate sheets, which are not sequentially numbered. Therefore the supervisor will be unable to ensure the completeness of all inventory sheets.	Each team should be given a blank sheet for entering any inventory count which is not on their sheets. This blank sheet should be sequentially numbered, any unused sheets should be returned at the end of the count, and the supervisor should check the sequence of all sheets at the end of the count.
The sheets are completed in ink and are sequentially numbered, however, there is no indication that they are signed by the counting team. Therefore if any issues arise with the counting in an aisle, it will be difficult to follow up as the identity of the counting team will not be known.	All inventory sheets should be signed by the relevant team upon completion of an aisle. When the sheets are returned, the supervisor should check that they have been signed.
Damaged goods are not being stored in a central area, and instead the counter is just noting on the inventory sheets the level of damage. However, it will be difficult for the finance team to decide on an appropriate level of write down if they are not able to see the damaged goods. In addition, if these goods are left in the aisles, they could be inadvertently sold to customers or moved to another aisle.	Damaged goods should be clearly flagged by the counting teams and at the end of the count appropriate machinery should be used to move all damaged windows to a central location. This will avoid the risk of selling these goods. A senior member of the finance team should then inspect these goods to assess the level of any write down or allowance.
Lily Window Glass Co (Lily) undertakes continuous production and so there will be movements of goods during the count. Inventory records could be under/overstated if goods are missed or double counted due to movements in the warehouse.	It is not practical to stop all inventory movements as the production needs to continue. However, any raw materials required for 31 December should be estimated and put to one side. These will not be included as raw materials and instead will be work-in-progress. The goods which are manufactured on 31 December should be stored to one side, and at the end of the count should be counted once and included within finished goods. Any goods received from suppliers should be stored in one location and counted once at the end and included as part of raw materials. Goods to be despatched to customers should be kept to a minimum for the day of the count.

Deficiencies	Recommendations
The warehouse manager is to assess the level of work-in-progress and raw materials. In the past, a specialist has undertaken this role. It is unlikely that the warehouse manager has the experience to assess the level of work-in-progress as this is something that the factory manager would be more familiar with.	A specialist should be utilised to assess both work-in-progress and the quantities of raw materials.
In addition, whilst the warehouse manager is familiar with the raw materials, if he makes a mistake in assessing the quantities then inventory could be materially misstated.	With regards to the warehouse manager, he could estimate the raw materials and the specialist could check it. This would give an indication as to whether he is able to accurately assess the quantities for subsequent inventory counts.

(b) Procedures during the inventory count

- Observe the counting teams of Lily to confirm whether the inventory count instructions are being followed correctly.
- Select a sample and perform test counts from inventory sheets to warehouse aisle and from warehouse aisle to inventory sheets.
- Confirm the procedures for identifying and segregating damaged goods are operating correctly.
- Select a sample of damaged items as noted on the inventory sheets and inspect these windows to confirm whether the level of damage is correctly noted.
- Observe the procedures for movements of inventory during the count, to confirm that no raw materials or finished goods have been omitted or counted twice.
- Obtain a photocopy of the completed sequentially numbered inventory sheets for follow up testing on the final audit.
- Identify and make a note of the last goods received notes (GRNs) and goods despatched notes (GDNs) for 31 December in order to perform cut-off procedures.
- Observe the procedures carried out by the warehouse manager in assessing the level of work-in-progress and consider the reasonableness of any assumptions used.
- Discuss with the warehouse manager how he has estimated the raw materials quantities. To the extent that it is possible, re-perform the procedures adopted by the warehouse manager.
- Identify and record any inventory held for third parties (if any) and confirm that it is excluded from the count.

(c) Computer-assisted audit techniques (CAATS)

(i) Audit procedures using CAATS

The audit team can use audit software to calculate inventory days for the year-to-date to compare against the prior year to identify whether inventory is turning over slower, as this may be an indication that it is overvalued.

Audit software can be utilised to produce an aged inventory analysis to identify any slow moving goods, which may require write down or an allowance.

Cast the inventory listing to confirm the completeness and accuracy of inventory.

Audit software can be used to select a representative sample of items for testing to confirm net realisable value and/or cost.

Audit software can be utilised to recalculate cost and net realisable value for a sample of inventory.

CAATs can be used to verify cut-off by testing whether the dates of the last GRNs and GDNs recorded relate to pre year end; and that any with a date of 1 January 2013 onwards have been excluded from the inventory records.

CAATs can be used to confirm whether any inventory adjustments noted during the count have been correctly updated into final inventory records.

(ii) Advantages of using CAATS

- CAATs enable the audit team to test a large volume of inventory data accurately and quickly.
- If CAATs are utilised on the audit of Lily, then as long as they do not change their inventory systems, they can be cost effective after setup.
- CAATs can test program controls within the inventory system as well as general IT controls, such as passwords.
- Allows the team to test the actual inventory system and records rather than printouts from the system which could be incorrect.
- CAATs reduce the level of human error in testing and hence provide a better quality of audit evidence.
- CAATs results can be compared with traditional audit testing; if these two sources agree, then overall audit confidence will increase.
- The use of CAATs frees up audit team members to focus on judgemental and high risk areas, rather than number crunching.

(iii) Disadvantages of using CAATS

- The cost of using CAATs in this first year will be high as there will be significant set up costs, it will also be a time-consuming process which increases costs.

- As this is the first time that CAATs will be used on Lily's audit, then the team may require training on the specific CAATs to be utilised.
- If Lily's inventory system is likely to change in the foreseeable future, then costly revisions may be required to the designed CAATs.
- The inventory system may not be compatible with the audit firm's CAATs, in which case bespoke CAATs may be required, which will increase the audit costs.
- If testing is performed over the live inventory system, then there is a risk that the data could be corrupted or lost.
- If testing is performed using copy files rather than live data, then there is the risk that these files are not genuine copies of the actual files.
- In order to perform CAATs, there must be adequate systems documentation available. If this is not the case for Lily, then it will be more difficult to devise appropriate CAATs due to a lack of understanding of the inventory system.

2 (a) Auditors' rights

- Right of access at all times to the company's books, accounts and vouchers.
- Right to require from an officer of the company such information or explanations as they think necessary for the performance of their duties as auditors.
- Right to receive all communications relating to written resolutions.
- Right to receive all notices of, and other communications relating to, any general meeting which a member of the company is entitled to receive.
- Right to attend any general meeting of the company.
- Right to be heard at any general meeting which an auditor attends on any part of the business of the meeting which concerns them as auditor.

(b) Control activities

Segregation of duties – assignment of roles/responsibilities to different people, thereby reducing the risk of fraud and error occurring.

Information processing – computer controls including general IT controls, which cover a range of applications and support the overall IT environment and application controls which are manual or automated controls which operate on a cycle/business process level.

Authorisation – approval of transactions by a suitably responsible official to ensure transactions are genuine.

Physical controls – restricting access to physical assets such as cash, inventory and plant and equipment, thereby reducing the risk of theft.

Performance reviews – comparison or review of the performance of the business by looking at areas such as budget v actual results.

Arithmetical controls – controls which check the arithmetical accuracy of accounting records.

Account reconciliations – comparison of an account balance with another source; often this source is from a third party, such as the bank, with differences being investigated.

(c) Limitations of external audits

An external audit has a number of limitations which reduce its usefulness:

Sampling – it is not practical for an auditor to test 100% of transactions and so they have to apply sampling methodologies in selecting balances/transactions to test. Therefore, there could be an error in an item not selected for testing by the auditor.

Subjectivity – financial statements include judgemental and subjective areas and therefore the auditor is required to use their judgement in assessing whether the financial statements are true and fair.

Inherent limitations of internal control systems – an internal control system is operated by people and hence is liable to human error. In addition, there is the possibility of controls override by management and of collusion and fraud. It is impossible to remove all of these inherent limitations and as the auditor relies on the internal control systems, this can reduce the usefulness of the audit.

Evidence is persuasive not conclusive – the opinion is based on audit evidence gathered; however, while this evidence can indicate possible issues affecting the audit opinion, evidence involves estimates and judgements and hence does not give a definite conclusion.

Audit report format – the format of the opinion is determined by International Standards on Auditing. However, the terminology used is not usually understood by non-accountants. This means that users may not actually understand the audit opinion given.

Historic information – the audit report is often issued some time after the year end, and so the financial information can be quite different to the current position. In the current marketplace where companies' financial positions can change quite quickly, the audit opinion may no longer be relevant as it is out of date.

3 (a) Understanding an entity

Source of information	Information expect to obtain
Prior year audit file	Identification of issues that arose in the prior year audit and how these were resolved. Also whether any points brought forward were noted for consideration for this year's audit.
Prior year financial statements	Provides information in relation to the size of the entity as well as the key accounting policies and disclosure notes.
Accounting systems notes	Provides information on how each of the key accounting systems operates.
Discussions with management	Provides information in relation to any important issues which have arisen or changes to the company during the year.
Current year budgets and management accounts of Sunflower Stores Co (Sunflower)	Provides relevant financial information for the year to date. Will help the auditor to identify whether Sunflower has changed materially since last year. In addition, this will be useful for preliminary analytical review and risk identification.
Permanent audit file	Provides information in relation to matters of continuing importance for the company and the audit team, such as statutory books information or important agreements.
Sunflower's website	Recent press releases from the company may provide background on changes to the business during the year as this could lead to additional audit risks.
Prior year report to management	Provides information on the internal control deficiencies noted in the prior year; if these have not been rectified by management then they could arise in the current year audit as well.
Financial statements of competitors	This will provide information about Sunflower's competitors, in relation to their financial results and their accounting policies. This will be important in assessing Sunflower's performance in the year and also when undertaking the going concern review.

(b) Audit risks and auditor responses

Audit risk	Auditor response
Sunflower has spent \$1·6m on refurbishing its 25 food supermarkets. This expenditure needs to be reviewed to assess whether it is of a capital nature and should be included within non-current assets or expensed as repairs.	Review a breakdown of the costs and agree to invoices to assess the nature of the expenditure and, if capital, agree to inclusion within the asset register and, if repairs, agree to the income statement.
During the year a small warehouse has been disposed of at a profit. The asset needs to have been correctly removed from property plant and equipment to ensure the non-current asset register is not overstated, and the profit on disposal should be included within the income statement.	Review the non-current asset register to ensure that the asset has been removed. Also confirm the disposal proceeds as well as recalculating the profit on disposal. Consideration should be given as to whether the profit on disposal is significant enough to warrant separate disclosure within the income statement.
Sunflower has borrowed \$1·5m from the bank via a five year loan. This loan needs to be correctly split between current and non-current liabilities.	During the audit the team would need to confirm that the \$1·5m loan finance was received. In addition, the split between current and non-current liabilities and the disclosures for this loan should be reviewed in detail to ensure compliance with relevant accounting standards.
In addition, Sunflower may have given the bank a charge over its assets as security for the loan. There is a risk that the disclosure of any security given is not complete.	The loan agreement should be reviewed to ascertain whether any security has been given, and this bank should be circularised as part of the bank confirmation process.
Sunflower will be undertaking a number of simultaneous inventory counts on 31 December including the warehouse and all 25 supermarkets. It is not practical for the auditor to attend all of these counts; hence it may not be possible to gain sufficient appropriate audit evidence over inventory counts.	The team should select a sample of sites to visit. It is likely that the warehouse contains most goods and therefore should be selected. In relation to the 25 supermarkets, the team should visit those with material inventory balances and/or those with a history of inventory count issues.

Audit risk	Auditor response
Sunflower's inventory valuation policy is selling price less average profit margin. Inventory should be valued at the lower of cost and net realisable value (NRV) and if this is not the case, then inventory could be under or overvalued.	Testing should be undertaken to confirm cost and NRV of inventory and that on a line-by-line basis the goods are valued correctly.
IAS 2 *Inventories* allows this as an inventory valuation method as long as it is a close approximation to cost. If this is not the case, then inventory could be under or overvalued.	In addition, valuation testing should focus on comparing the cost of inventory to the selling price less margin to confirm whether this method is actually a close approximation to cost.
The opening balances for each supermarket have been transferred into the head office's accounting records at the beginning of the year. There is a risk that if this transfer has not been performed completely and accurately, the opening balances may not be correct.	Discuss with management the process undertaken to transfer the data and the testing performed to confirm the transfer was complete and accurate. Computer-assisted audit techniques could be utilised by the team to sample test the transfer of data from each supermarket to head office to identify any errors.
There has been an increased workload for the finance department, the financial controller has left and his replacement will only start in late December.	The team should remain alert throughout the audit for additional errors within the finance department.
This increases the inherent risk within Sunflower as errors may have been made within the accounting records by the overworked finance team members. The new financial controller may not be sufficiently experienced to produce the financial statements and resolve any audit issues.	In addition, discuss with the finance director whether he will be able to provide the team with assistance for any audit issues the new financial controller is unable to resolve.

(c) Internal audit department

Prior to establishing an internal audit (IA) department, the finance director of Sunflower should consider the following:

(i) The costs of establishing an IA department will be significant, therefore prior to committing to these costs and management time, a cost benefit analysis should be performed.

(ii) The size and complexity of Sunflower should be considered. The larger, more complex and diverse a company is, then the greater the need for an IA department. At Sunflower there are 25 supermarkets and a head office and therefore it would seem that the company is diverse enough to gain benefit from an IA department.

(iii) The role of any IA department should be considered. The finance director should consider what tasks he would envisage IA performing. He should consider whether he wishes them to undertake inventory counts at the stores, or whether he would want them to undertake such roles as internal controls reviews.

(iv) Having identified the role of any IA department, the finance director should consider whether there are existing managers or employees who could perform these tasks, therefore reducing the need to establish a separate IA department.

(v) The finance director should assess the current control environment and determine whether there are departments or stores with a history of control deficiencies. If this is the case, then it increases the need for an IA department.

(vi) If the possibility of fraud is high, then the greater the need for an IA department to act as both a deterrent and also to possibly undertake fraud investigations. As Sunflower operates 25 food supermarkets, it will have a significant risk of fraud of both inventory and cash.

4 (a) Fundamental principles

Integrity – to be straightforward and honest in all professional and business relationships.

Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client receives competent professional services, and to act diligently and in accordance with applicable technical and professional standards.

Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not to disclose any such information to third parties without proper authority, nor use the information for personal advantage.

Professional Behaviour – to comply with relevant laws and regulations and avoid any action that discredits the profession.

(b) Substantive procedures

(i) Trade payables and accruals

- Calculate the trade payable days for Rose Leisure Clubs Co (Rose) and compare to prior years, investigate any significant difference, in particular any decrease for this year.
- Compare the total trade payables and list of accruals against prior year and investigate any significant differences.
- Discuss with management the process they have undertaken to quantify the understatement of trade payables due to the cut-off error and consider the materiality of the error.
- Discuss with management whether any correcting journal entry has been included for the understatement.
- Select a sample of purchase invoices received between the period of 25 October and the year end and follow them through to inclusion within accruals or as part of the trade payables journal adjustment.
- Review after date payments; if they relate to the current year, then follow through to the purchase ledger or accrual listing to ensure they are recorded in the correct period.
- Obtain supplier statements and reconcile these to the purchase ledger balances, and investigate any reconciling items.
- Select a sample of payable balances and perform a trade payables' circularisation, follow up any non-replies and any reconciling items between the balance confirmed and the trade payables' balance.
- Select a sample of goods received notes before the year end and after the year end and follow through to inclusion in the correct period's payables balance, to ensure correct cut-off.

(ii) Receivables

- For non-responses, with the client's permission, the team should arrange to send a follow up circularisation.
- If the receivable does not respond to the follow up, then with the client's permission, the senior should telephone the customer and ask whether they are able to respond in writing to the circularisation request.
- If there are still non-responses, then the senior should undertake alternative procedures to confirm receivables.
- For responses with differences, the senior should identify any disputed amounts, and identify whether these relate to timing differences or whether there are possible errors in the records of Rose.
- Any differences due to timing, such as cash in transit, should be agreed to post year-end cash receipts in the cash book.
- The receivables ledger should be reviewed to identify any possible mispostings as this could be a reason for a response with a difference.
- If any balances have been flagged as disputed by the receivable, then these should be discussed with management to identify whether a write down is necessary.

(iii) Reorganisation

- Review the board minutes where the decision to reorganise the business was taken, ascertain if this decision was made pre year end.
- Review the announcement to shareholders in late October, to confirm that this was announced before the year end.
- Obtain a breakdown of the reorganisation provision and confirm that only direct expenditure from restructuring is included.
- Review the expenditure to confirm that there are no retraining costs included.
- Cast the breakdown of the reorganisation provision to ensure correctly calculated.
- For the costs included within the provision, agree to supporting documentation to confirm validity of items included.
- Obtain a written representation confirming management discussions in relation to the announcement of the reorganisation.
- Review the adequacy of the disclosures of the reorganisation in the financial statements to ensure they are in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

5 (a) Written representations

Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

The auditor needs to obtain written representations from management and, where appropriate, those charged with governance that they believe they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor.

Written representations are needed to support other audit evidence relevant to the financial statements or specific assertions in the financial statements, if determined necessary by the auditor or required by other International Standards on Auditing. This may be necessary for judgemental areas where the auditor has to rely on management explanations.

Written representations can be used to confirm that management have communicated to the auditor all deficiencies in internal controls of which management are aware.

Written representations are normally in the form of a letter, written by the company's management and addressed to the auditor. The letter is usually requested from management but can also be requested from the chief operating officer or chief financial officer. Throughout the fieldwork, the audit team will note any areas where representations may be required.

During the final review stage, the auditors will produce a draft representation letter. The directors will review this and then produce it on their letterhead.

It will be signed by the directors and dated as at the date the audit report is signed, but not after.

(b) Oral representation

A representation from management confirming that overdrafts are complete would be relevant evidence. Overdrafts are liabilities and therefore the main focus for the auditor is completeness.

With regards to reliability, the evidence is oral rather than written and so this reduces its reliability. The directors could in the future deny having given this representation, and the auditors would have no documentary evidence to prove what the directors had said.

This evidence is obtained from management rather than being auditor generated, and is therefore less reliable. Management may wish to provide biased evidence in order to reduce the amount of liabilities in the financial statements. The auditors are unbiased and so evidence generated directly by them will be better.

External evidence obtained from the company's banks could be used to confirm the bank overdraft balances and this would be more independent than relying on management's internal confirmations.

(c) Daisy Designs Co (Daisy)

(i) Daisy's sales ledger has been corrupted by a computer virus; hence no detailed testing has been performed on revenue and receivables. The audit team will need to see if they can confirm revenue and receivables in an alternative manner. If they are unable to do this, then two significant balances in the financial statements will not have been confirmed. Revenue and receivables are both higher than the total profit before tax (PBT) of $2m; receivables are 170% of PBT and revenue is nearly eight times the PBT; hence this is a very material issue.

(ii) Procedures to be adopted include:

– Discuss with management whether they have any alternative records which detail revenue and receivables for the year.
– Attempt to perform analytical procedures, such as proof in total or monthly comparison to last year, to gain comfort in total for revenue and for receivables.

(iii) The auditors will need to modify the audit report as they are unable to obtain sufficient appropriate evidence in relation to two material and pervasive areas, being receivables and revenue. Therefore a disclaimer of opinion will be required.

A basis for disclaimer of opinion paragraph will be required to explain the limitation in relation to the lack of evidence over revenue and receivables. The opinion paragraph will be a disclaimer of opinion and will state that we are unable to form an opinion on the financial statements.

Fuchsia Enterprises Co (Fuchsia)

(i) Fuchsia is facing going concern problems as it has experienced difficult trading conditions and it has a negative cash outflow. However, the financial statements have been prepared on a going concern basis, even though it is possible that the company is not a going concern. The prior year financial statements showed a profit of $1·2m and the current financial statements show a loss before tax of $4·4m, the net cash outflow of $3·2m represents 73% of this loss (3·2/4·4m) and hence is a material issue.

(ii) Management are confident that further funding can be obtained; however, the team is sceptical and so the following procedures should be adopted:

– Discuss with management whether any finance has now been secured.
– Review the correspondence with the finance provider to confirm the level of funding that is to be provided and this should be compared to the net cash outflow of $3·2m.
– Review the most recent board minutes to understand whether management's view on Fuchsia's going concern has altered.
– Review the cash flow forecasts for the year and assess the reasonableness of the assumptions adopted.

(iii) If management refuse to amend the going concern basis of the financial statements or at the very least make adequate going concern disclosures, then the audit report will need to be modified. As the going concern basis is probably incorrect and the error is material and pervasive, then an adverse opinion would be necessary.

A basis for adverse opinion paragraph will be required to explain the inappropriate use of the going concern assumption. The opinion paragraph will be an adverse opinion and will state that the financial statements do not give a true and fair view.

			Marks
1	**(a)**	Up to 1 mark per well explained deficiency and up to 1 mark per recommendation. If not well explained then just give ½ mark for each. Warehouse manager supervising the count No division of responsibilities within each counting team Internal audit teams should be checking controls and performing sample counts No flagging of aisles once counting complete Additional inventory listed on sheets which are not sequentially numbered Inventory sheets not signed by counters Damaged goods not moved to central location Movements of inventory during the count Warehouse manager not qualified to assess the level of work-in-progress Warehouse manager not experienced enough to assess the quantities of raw materials	12
	(b)	Up to 1 mark per well described procedure Observe the counters to confirm if inventory count instructions are being followed Perform test counts inventory to sheets and sheets to inventory Confirm procedures for damaged goods are operating correctly Inspect damaged goods to confirm whether the level of damage is correctly noted Observe procedures for movements of inventory during the count Obtain a photocopy of the completed inventory sheets Identify and make a note of the last goods received notes and goods despatched notes Observe the procedures carried out by warehouse manager in assessing the level of work-in-progress Discuss with the warehouse manager how he has estimated the raw materials quantities Identify inventory held for third parties and ensure excluded from count	6
	(c)	**(i)** Up to 1 mark per well described procedure, max of 4 procedures Calculate inventory days Produce an aged inventory analysis to identify any slow moving goods Cast the inventory listing Select a sample of items for testing to confirm net realisable value (NRV) and/or cost Recalculate cost and NRV for sample of inventory Computer-assisted audit techniques (CAATs) can be used to confirm cut-off CAATs can be used to confirm whether inventory adjustments noted during the count have been updated to inventory records.	4
		(ii) Up to 1 mark per well explained advantage Test a large volume of inventory data accurately and quickly Cost effective after setup CAATs can test program controls as well as general IT controls Test the actual inventory system and records rather than printouts from the system CAATs reduce the level of human error in testing CAATs results can be compared with traditional audit testing Free up audit team members to focus on judgemental and high risk areas	4
		(iii) Up to 1 mark per well explained disadvantage Costs of using CAATs in this first year will be high Team may require training on the specific CAATs to be utilised Changes in the inventory system may require costly revisions to the CAATs The inventory system may not be compatible with the audit firm's CAATs If testing the live system, there is a risk the data could be corrupted or lost If using copy files rather than live data, there is the risk that these files are not genuine copies Adequate systems documentation must be available	4
			30

			Marks
2	**(a)**	Up to 1 mark per well stated right, max of 3 rights – Right of access to books and records – Right to require information or explanations – Right to receive all written resolutions – Right to receive all notices of any general meeting – Right to attend any general meeting of the company – Right to be heard at the annual general meeting	3
	(b)	Up to 1 mark per well explained control activity Segregation of duties Information processing Authorisation Physical controls Performance reviews Arithmetical controls Account reconciliations	4
	(c)	Up to 1 mark per well explained limitation Sampling Subjectivity Inherent limitations of internal control systems Evidence is persuasive not conclusive Audit report format Historic information	3
			10
3	**(a)**	½ mark for source of documentation and ½ mark for information expect to obtain, max of 2½ marks for sources and 2½ marks for information expect – Prior year audit file – Prior year financial statements – Accounting systems notes – Discussions with management – Permanent audit file – Current year budgets and management accounts – Sunflower's website – Prior year report to management – Financial statements of competitors	5
	(b)	Up to 1 mark per well described risk and up to 1 mark for each well explained response. Overall max of 5 marks for risks and 5 marks for responses. Treatment of $1·6m refurbishment expenditure Disposal of warehouse Bank loan of $1·5m Attendance at year-end inventory counts Inventory valuation Transfer of opening balances from supermarkets to head office Increased inherent risk of errors in finance department and new financial controller	10
	(c)	Up to 1 mark per well described point Costs versus benefits of establishing an internal audit (IA) department Size and complexity of Sunflower should be considered The role of any IA department should be considered Whether existing managers/employees can undertake the roles required Whether the control environment has a history of control deficiencies Whether the possibility of fraud is high	5
			20

Marks

4 **(a)** Up to 1 mark per well explained point, being ½ mark for the principle and ½ mark for the explanation.

Integrity
Objectivity
Professional competence and due care
Confidentiality
Professional behaviour — 5

(b) Up to 1 mark per well described procedure

(i) Trade payables and accruals

- Calculate trade payable days
- Compare total trade payables and list of accruals against prior year
- Discuss with management process to quantify understatement of payables
- Discuss with management whether any correcting journal adjustment posted
- Sample invoices received between 25 October and year end and follow to inclusion in year-end accruals or trade payables correcting journal
- Review after date payments
- Review supplier statements reconciliations
- Perform a trade payables' circularisation
- Cut-off testing pre and post year-end GRN — 6

(ii) Receivables

- For non-responses arrange to send a follow up circularisation
- With the client's permission, telephone the customer and ask for a response
- For remaining non-responses, undertake alternative procedures to confirm receivables
- For responses with differences, identify any disputed amounts, identify whether these relate to timing differences or whether there are possible errors in the records
- Cash in transit should be vouched to post year-end cash receipts in the cash book
- Review receivables ledger to identify any possible mispostings
- Disputed balances, discuss with management whether a write down is necessary — 5

(iii) Reorganisation

- Review the board minutes where decision taken
- Review the announcement to shareholders in late October
- Obtain a breakdown and confirm that only direct expenditure from restructuring is included
- Review expenditure to ensure retraining costs excluded
- Cast the breakdown of the reorganisation provision
- Agree costs included to supporting documentation
- Obtain a written representation
- Review the adequacy of the disclosures — 4

20

			Marks
5	**(a)**	Up to 1 mark per well explained point	
		– Written representations are necessary information the auditor needs in connection with the audit of the entity's financial statements	
		– Required to confirm directors' responsibilities	
		– Required to support other evidence or required by other ISAs	
		– Required to confirm management have communicated all deficiencies in internal controls	
		– Normally in the form of a letter, written by the company's directors and addressed to the auditor	
		– Throughout the fieldwork, note any areas where representations may be required	
		– Auditors produce a draft representation letter, directors review and then produce it on their letterhead	
		– Signed by the directors and dated just before the date the audit report is signed	5
	(b)	Up to 1 mark per well described point	
		Relevance	
		Reliability – oral v written	
		Reliability – client v auditor generated	
		Reliability – better external evidence could be obtained	3
	(c)	Up to 1 mark per valid point, overall maximum of 6 marks PER ISSUE	
		Discussion of issue	
		Calculation of materiality	
		Procedures at completion stage	
		Type of audit report modification required	
		Impact on audit report	12
			20