
Answers

Section A

QUESTIONS 1–10 – MULTIPLE CHOICE

| Part | Answer | See Note Below |
|------|--------|----------------|
| 1 | D | 1 |
| 2 | B | 2 |
| 3 | B | 3 |
| 4 | B | 4 |
| 5 | A | 5 |
| 6 | C | 6 |
| 7 | B | 7 |
| 8 | D | 8 |
| 9 | B | 9 |
| 10 | A | 10 |

NOTES

- Option D is the correct answer. Self-reliance is not a circumstance that is a potential threat to compliance with the fundamental principles. Self-interest, intimidation and advocacy are all potential threats.
- Where an audit firm is retained as the auditors to such entities the pre-determined period should be no more than five years. Option B is therefore correct.
- Where disclosure is reasonably necessary to protect an ACCA member's interest, disclosure of such confidential information *may* be disclosed to a third party. Where an auditor suspects that a client company is engaged in money laundering activities, the member *must* disclose his/her suspicions to the appropriate public or regulatory authority. Auditors *must never* disclose confidential information acquired about an audit client simply on the basis that they believe it will not be detrimental to the company. Option B is therefore correct.
- Option B is correct. To be effective it is imperative for an auditor to have an understanding of the entire text of an International Standard on Auditing (ISA). Similarly, ISAs require the auditor to obtain only reasonable assurance about whether financial statements as a whole are free from material misstatement. An auditor may adapt the content of an ISA in certain circumstances and ISAs do not address the responsibilities of the auditors that may exist in legislation, regulation or otherwise.
- Considering the audit procedures that are required to be carried out, so that the engagement complies with the ISA, (activity iv) is not an activity carried out when establishing the overall strategy of an audit engagement. The procedures would comprise detailed planning of the work to be carried out by members of the audit engagement team, to help ensure that sufficient, appropriate evidence could be obtained to gain assurance on the absence of material misstatement at the assertion level. Option A is therefore correct, as each of the other stated activities should be carried out when establishing the audit strategy for an audit engagement.
- Option C is the correct answer. Audit planning should be carried out by the audit engagement partner *and key members* of the audit engagement team. Each of the statements at A, B and D are true.
- Segregation of duties, performance reviews, and authorisation controls are all categories of control activities relevant to an audit and the determination of control risk. Control activities pertaining to the objectives of an organisation are not recognised as an area relevant to this. Option B is therefore correct.
- Tests of controls are carried out by the auditor to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls. Each of the procedures identified is a test of control, therefore option D is the correct answer.
- Option B is correct. The primary objective of a trade receivables circularisation is to obtain assurance that trade receivables are not overstated.
- Option A is correct. A disclaimer of opinion should be expressed only where the auditor has been unable to obtain sufficient appropriate audit evidence on a material matter that is considered to be pervasive to the financial statements.

Section B

1 Pears Co

- (a) The objectives of the internal control that should be exercised over tangible non-current assets include:
- (i) To ensure that non-current assets are acquired on a timely basis.
 - (ii) To ensure that all acquisitions of non-current assets are authorised.
 - (iii) To ensure that non-current assets are acquired at the lowest possible price after taking account of quality issues and payment terms.
 - (iv) To ensure that non-current assets are safe from loss and damage.
 - (v) To ensure that transactions pertaining to non-current assets are entered timeously into the company's accounting records.
 - (vi) To ensure that non-current assets are properly accounted for in the company's accounting records.
 - (vii) To ensure that non-current assets are properly presented (disclosed) in the company's accounting records.
 - (viii) To ensure that non-current assets are properly maintained.
 - (ix) To ensure that only non-current assets surplus to requirement are disposed of by the company.
 - (x) To ensure that all disposals of non-current assets are authorised.
 - (xi) To ensure that non-current assets are disposed of at the best possible price after taking account of quality issues and payment terms.

(Full marks will be awarded for answers that identify any FIVE of the above or other relevant objectives.)

- (b) Control activities are the policies and procedures that help ensure that management directives are carried out.

- (c) The following control activities are examples of those that should be established over the non-current assets of Pears Co:

- (i) there should be adequate segregation of duties over the acquisition and disposal, recording and custody functions of tangible non-current assets.
- (ii) management should prepare an authorised annual budget for the acquisition and disposal of tangible non-current assets.
- (iii) requests to acquire or dispose of tangible non-current assets as budgeted should, in the first instance, be the subject of special purchase requisition and disposal requisition notes, appropriately authorised by a responsible official or officials of the company.
- (iv) all tangible non-current assets purchases should be subject to an official purchase order of the company, duly authorised by an appropriate responsible official or officials of Pears Co.
- (v) all tangible non-current assets disposals should be subject to laid down procedures such that the company can ensure that disposals are made at the best price on the best available terms.
- (vi) procedures should ensure that depreciation methods and rates adopted by the company are appropriate and authorised at an appropriate level by a responsible official of the company.
- (vii) tangible non-current assets should be stored securely and safely.
- (viii) procedures should ensure that all tangible non-current assets are used in accordance with the manufacturer's instructions.
- (ix) Pears Co should ensure that all tangible non-current assets are adequately insured.
- (x) procedures should ensure that all transactions pertaining to the company's tangible non-current assets are promptly and accurately recorded in the company's accounting records.
- (xi) there should be an appropriate level of monitoring at senior management level, to ensure compliance with authorised procedures within the company's non-current assets system.

(Full marks will be awarded to answers describing any SIX of the above or other appropriate control activities.)

- (d) A self-review threat occurs when the auditor carries out audit procedures on an area of client's financial statements, on which the auditor has carried out work on behalf of the client. For my firm, the self-review threat is that staff engaged on the audit will not report objectively if they subsequently find deficiencies in Pears Co's tangible non-current assets system.

- (e) (i) The following information should typically be contained in a tangible non-current assets (plant) register:

- A description of each asset.
- The date of acquisition of each asset.
- The initial cost of each asset.
- The cost of additions or alterations of each asset.

- The accumulated depreciation of each asset.
- The net book value of each asset.
- The estimated useful life of each asset.
- The estimated end-of-life residual value of each asset.
- The supplier and manufacturer of each asset.
- The serial number of each asset.
- The location of each asset.
- The insurance cover details of each asset.
- The maintenance timetable for each asset.

(Full marks will be awarded to answers which list SIX of the above or other relevant pieces of information.)

- (ii)** My firm should plan to use the tangible non-current assets (plant) register of Pears Co when carrying out substantive procedures – primarily to gain assurance as to the existence and completeness of recorded assets. To check existence, a representative sample of non-current assets should be selected from the register and checked to actual physical assets. To obtain assurance as to the completeness of recording in the accounting records, a representative sample of assets physically in existence should be checked to assets entered in the register.

2 Peaches Co

- (a)** My firm would have considered the following matters when it carried out its client screening procedures in respect of Peaches Co, before approving the company as a potential audit client:
- (i) The integrity of Peaches Co's directors and senior management – this is a particularly important aspect of the screening process. Risk of material misstatement in the financial statements is increased significantly in companies with directors and senior management of low integrity. My firm would not want to expose itself to unnecessary audit risk by accepting an audit appointment where the directors and/or senior management are perceived to be of low integrity.
 - (ii) The general level of inherent risk factors associated with the financial statements of the company. These would include such matters as the long-term prospects of the company, the availability of finance, the prudence and integrity of accounting policies and the existence of related party transactions.
 - (iii) The perceived level of experience and competence of the directors and senior management of Peaches Co. My firm would need to ascertain the extent to which it could rely on the directors and senior management of Peaches Co. Any doubts about their level of experience and competence would inevitably impinge on the extent to which my firm would want to rely on representations made by them and could adversely affect the auditor/client working relationship.
 - (iv) The level of audit fees which my firm would need to charge Peaches Co should reflect the level of risk associated with the audit. If the company was reluctant to pay such a level then my firm may wish to withdraw from the appointment process.
 - (v) The ability of my firm to carry out an effective audit of Peaches Co's financial statements. In determining this, such matters as having sufficient audit resources (availability of staff in numbers and levels of expertise) and the impact on existing engagements and commitments would need to be considered.
 - (vi) Possible ethical issues arising as consequence of accepting the audit engagement, for example, threats to objectivity due to the potential level of audit fee attached to the engagement or other potential threats to independence, caused (for example) by employees of my audit firm having previously been employed as accounts staff of Peaches Co.

(Full marks will be given to answers which explain FOUR of the above or other relevant matters.)

- (b) (i)** Staffing requirements – As for all audit engagements, my firm has an obligation to ensure that collectively, the audit engagement team has the appropriate level of competences and capabilities to:
- Perform the audit work in accordance with professional standards and applicable legal and regulatory requirements; and
 - Enable the issuance of an auditor's report that is appropriate in the circumstances.

In meeting the above obligations my firm would have to demonstrate that it exercised reasonable care and skill when carrying out all audit work. Staffing requirements would therefore need to be planned to ensure that sufficient levels of properly trained and experienced staff were assigned to meet the technical demands of the audit engagement, that work was effectively supervised and that it was subject to adequate and timely review procedures. Specific considerations should include the geographical spread of the company's operations and the logistics of audit personnel visiting remote branches and sites. My firm would also need to consider staff development issues, for example, the assignment of individual employees to this particular engagement to address their needs for specific audit experience. Additional pertinent matters to consider would include annual leave and study leave commitments and the non-availability of specified staff as a consequence of their having to work on other audit engagements. Additionally, when planning the staffing requirements for the audit of the financial statements of Peaches Co, my firm would need to plan appropriately for the use of experts from outside the firm.

- (ii)** The company's computer-based accounting system – My firm would need to consider the computer-based accounting system of Peaches Co, as part of its risk assessment procedures. The auditor(s) responsible for the development of the

strategy and detailed planning of the audit should focus on the risk of material misstatement in the financial statements associated with the existence of the system and adopt an appropriate strategy and detailed plan of audit work, to reduce audit risk to an acceptable level. As such, careful consideration would need to be given to the assignment of appropriately skilled and experienced staff, such that they could be confident that all audit objectives could be achieved without undue hindrance caused by the existence of the computer-based system. Similarly, in the planning process, account would need to be taken of the availability of computer time and the available time of Peaches Co's data processing staff, systems personnel and relevant managers. It is highly probable that my firm would rely on the use of computer-assisted audit techniques (CAATs) to perform audit work. The timing of the use of these by specified members of the audit engagement team would require careful planning, as would the extent to which CAATs may need to be used, in order to meet reporting deadlines set by the directors of Peaches Co.

(Full marks will be awarded to answers that are similar in content of (i) and (ii) above.)

- (c) An internal control questionnaire (ICQ) is a document that auditors may use to record a company's information system and internal control and to obtain an understanding of the control activities that exist in the same. In its simplest form an ICQ asks a series of questions to ascertain whether specified control activities (to meet control objectives) exist. Such questions are usually phrased in such a way that a 'yes' answer confirms the existence of a specified activity whilst a 'no' answer confirms the absence of it. However, if an appropriate alternative activity exists, which meets the same control objective as that of the specified activity, the use of an ICQ alone will not reveal the existence of it. This is the major weakness of the ICQ as an evaluation tool. An internal control evaluation questionnaire (ICEQ) is a document specifically designed to confirm whether a company's information system and internal control do meet control objectives. This is done by asking 'key' control questions to which a 'yes' or 'no' answer would indicate that a specified control objective will not be met, leading to an increased possibility of material misstatement in the company's financial statements. Consequently, as compared to an ICQ, an ICEQ is considered to be a superior audit tool in terms of the evaluation of a company's information system and internal control.

(Full marks will be awarded to answers that are similar in content to the above.)

- (d) The geographical spread of Peaches Co's stores presents a significant inherent risk to the financial statements of Peaches Co, particularly with regard to the completeness of transactions and account balances reflected in those financial statements. The remoteness of locations from the central accounting and administration function raises various issues, all of which add to the risk of material misstatement. It is incumbent on the directors of the company to reduce the risk of material misstatement in the financial statements to an acceptable level, by ensuring the existence of adequate information systems and internal controls. However, given the nature of the company's activities and the spread of its operations, this would not be easily achieved.

(Full marks will be awarded for answers containing points similar to those above.)

3 Audit evidence

- (a) (i) 'Sufficiency' is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.
- (ii) 'Appropriateness' is the measure of quality of audit evidence, that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
- (b) Other generalisations about the reliability of audit evidence comprise:
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
 - Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
 - Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than audit evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of matters discussed).
 - Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

(Full marks will be awarded to answers which state THREE of the above, or similarly worded, additional generalisations about the reliability of audit evidence.)

- (c) (i) Examples of documents prepared outside the company include:
- purchase invoices
 - bank statements
 - customer orders
 - legal correspondence
 - supplier statements
 - experts' reports.
- (ii) Examples of documents prepared inside the company include:
- wages payrolls
 - purchase orders
 - goods received notes
 - goods returned notes
 - sales invoices
 - minutes of meetings.
- (iii) Examples of recalculations prepared by the auditor include:
- recalculation of the depreciation charge on non-current assets
 - recalculation of the sales tax on sales invoices
 - recalculation of gross wages sums due
 - recalculation of net wages sums due
 - recalculation of total trade receivables balances owed to the company
 - recalculation of total trade payables balances owed by the company.

(Full marks will be awarded to answers which identify any TWO examples for each of the categories as above, or other relevant examples for each of the categories.)

4 Auditor's expert and audit documentation (working papers)

- (a) (i) ISA 620 *Using The Work of an Auditor's Expert*, provides examples of various fields in which an auditor's expert may have expertise. These, together with other examples, include:
- Valuation of plant and machinery
 - Valuation of land and buildings
 - Valuation of works of art
 - Valuation of antiques
 - Valuation of intangible assets
 - Valuation of assets that may have been impaired
 - Valuation of financial instruments
 - The estimation of mining reserves
 - The estimation of gas reserves
 - The interpretation of contracts and complex agreements
 - The interpretation of laws and regulations
 - The performance or interpretation of actuarial calculations.

(Full marks will be awarded to answers which identify FOUR of the above or similar examples.)

(ii) Competence, capabilities and objectivity of an auditor's expert

The sources of information include:

- Personal experience with previous work of that expert
- Discussions with that expert
- Discussions with other auditors or others who are familiar with that expert's work
- Knowledge of that expert's qualifications, membership of a professional body or industry association, licence to practise, or other forms of external recognition
- Published papers or books written by the expert
- Media coverage and media exposure of the expert
- The auditor's firm's quality control policies and procedures.

(Full marks will be awarded to answers which identify FOUR of the above or other appropriate sources.)

(b) (i) Form, content and extent of audit documentation (working papers)

Other factors, on which the form, content and extent of audit documentation depend, include:

- The nature of the audit procedures to be performed
- The identified risks of material misstatement
- The extent of judgement required in performing the work and evaluating the results
- The significance of the audit evidence obtained
- The nature and extent of exceptions identified
- The audit methodology and tools used (for example, CAATs)
- The need to document a conclusion or the basis for a conclusion not readily determinable from other audit documentation, or audit evidence obtained.

(Full marks will be awarded to answers which identify FOUR of the above or similar examples.)

(ii) 'Hot review' and 'cold review' of audit documentation (working papers)

A hot review is a review, carried out prior to the signing of the audit report, of the audit work as evidenced in the audit files. By this type of review, work is normally reviewed by an audit supervisor or manager, as and when the work is performed. In contrast, a cold review is carried out after the signing of the audit report by knowledgeable auditors who had no involvement in the audit. A cold review of audit work as evidenced in the audit files may be conducted by individuals working for the firm or by external individuals. In both instances the purpose of the reviews are to ensure that a firm's audit procedures are maintained to a high standard. With a hot review, feedback should be provided to facilitate the achievement of all audit objectives. Following a cold review, feedback should be provided on any deficiencies identified in the audit work carried out, so that measures can be taken to eliminate these on future audit engagements.

(Full marks will be awarded to answers which include points similar to those included above.)

In Section A questions 1 to 10, each multiple choice question carries 2 marks. Full marks are awarded for choosing the correct option. No marks will be awarded where an incorrect option is selected or where more than one option is selected.

In Section B for all questions the marking scheme generally indicates that up to 2 marks may be awarded for each relevant point. Consideration should be given to the depth and relevance given by each candidate when answering the question; for example if only a brief explanation is given then it may only be worth ½ a mark whilst a more detailed answer could be worth up to a maximum of 1½ marks.

Marks are not allocated to specific points as the candidate may include a valid point within their answer that is not included in the model answer; the candidate should be given full credit for such points.

The majority of the questions require several points to be included within the answer, so if a candidate concentrates on a few points then they should not be given as much recognition, and their overall mark should be lower than a candidate who provides a range of points.

In conclusion, it is important that the overall standard of the candidate's answers is considered in terms of whether it is above or below a pass grade. After marking each question, the total mark awarded should be evaluated to assess whether it is fair. If it is decided that the total mark is not a proper reflection of the standard of the candidate's answer then the answer should be reviewed again, and the marks adjusted to ensure that the total awarded is fair. If the answer is of a pass standard then it should be awarded a minimum of 50%; if it is below a pass standard then it should be awarded less than 50%.

Section A

Questions 1–10 – Multiple Choice

2 marks for each correct answer with an overall maximum of (2 x 10) **(20 marks)**

Section B

1 Pears Co

- (a)** Stating FIVE objectives of the internal control that should be exercised over tangible non-current assets.
Up to 1 mark per objective up to a maximum of **(5 marks)**
 - (b)** Definition of the term control activities. **(2 marks)**
 - (c)** Describing SIX control activities that should be established in connection with tangible non-current assets by Pears Co.
Generally up to 1½ marks per activity up to a maximum of **(9 marks)**
 - (d)** Explaining why your audit firm's involvement in the design of an improved system will represent a self-review threat to its audit of Pears Co's financial statements.
Generally up to 1 mark per point, up to a maximum of **(3 marks)**
 - (e) (i)** Listing SIX pieces of information that should typically be included in the tangible non-current assets (plant) register for each asset.
Up to ½ mark per point, up to a maximum of **(3 marks)**

(ii) Explaining how your audit firm should plan to use the tangible non-current asset (plant) register when auditing the financial statements of Pears Co for the year ending 30 June 2012.
Generally up to 1 mark per point, up to a maximum of **(3 marks)**
- (25 marks)**

2 Peaches Co

- (a) Identifying and explaining FOUR factors that would have been considered by your firm when it carried out its client screening procedures in respect of Peaches Co.
Generally up to 1 mark per point for each factor up to a maximum of 2 marks per factor to a maximum of (1 x 2 x 4)
(8 marks)
- (b) Explaining why your firm should have considered each of the following aspects when planning the audit of the financial statements of Peaches Co for the year ending 31 December 2011.
- (i) Staffing requirements
Generally up to 1 mark per point for each factor up to a maximum of (5 marks)
- (ii) The company's computer-based accounting system
Generally up to 1 mark per point for each factor up to a maximum of (5 marks)
- (c) Explaining and distinguishing between ICQs and ICEQs.
Generally up to 1 mark per point up to a maximum of (5 marks)
- (d) Explaining why the wide geographical spread of Peaches Co's stores would present a significant inherent risk to the company's financial statements.
Generally up to 1 mark per point up to a maximum of (2 marks)
- (25 marks)**

3 Audit evidence

- (a) Defining the following terms:
- (i) sufficiency (of audit evidence). (1½ marks)
- (ii) appropriateness (of audit evidence). (1½ marks)
- (b) Stating THREE other generalisations about the reliability of audit evidence.
Up to 1 mark per point per generalisation up to a maximum of 2 marks per generalisation up to a maximum of (1 x 2 x 3)
(6 marks)
- (c) Identifying TWO practical examples typically arising during the audit of the financial statements of a limited liability company, for each of the following types of audit evidence:
- (i) documents prepared outside the company.
Up to 1 mark per example (2 marks)
- (ii) documents prepared inside the company.
Up to 1 mark per example (2 marks)
- (iii) recalculations performed by the auditor.
Up to 1 mark per example (2 marks)
- (15 marks)**

4 Auditor's expert and audit documentation (working papers)

- (a) (i)** Fields of expertise of an auditor's expert
Identifying FOUR examples of individual fields of expertise of an auditor's expert.
Up to 1 mark per point up to a maximum of (4 marks)
- (ii)** Competence, capabilities and objectivity of an auditor's expert
Identifying FOUR examples of sources of information with regard to the above.
Up to 1 mark per point up to a maximum of (4 marks)
- (b) (i)** Form, content and extent of audit documentation (working papers)
Stating FOUR other factors on which the form, content and extent of audit documentation (working papers) depends:
Up to 1 mark per factor, up to a maximum of (4 marks)
- (ii)** 'Hot review' and 'cold review' of audit documentation (working papers).
Distinguishing between a 'hot review' and a 'cold review' of audit documentation (working papers).
Up to 1 mark per point up to a maximum of (3 marks)
- (15 marks)**