Answers

1 (a) Trombone Co's payroll system deficiencies, controls and test of controls

Deficiencies	Controls	Test of controls
The wages calculations are generated by the payroll system and there are no checks performed. Therefore, if system errors occur during the payroll processing, this would not be identified. This could result in wages being over or under calculated, leading to an additional payroll cost or loss of employee goodwill.	A senior member of the payroll team should recalculate the gross to net pay workings for a sample of employees and compare their results to the output from the payroll system. These calculations should be signed as approved before payments are made.	Review a sample of the gross to net pay calculations for evidence that they are undertaken and signed as approved.
Annual wages increases are updated in the payroll system standing data by clerks. Payroll clerks are not senior enough to be making changes to standing data as they could make mistakes leading to incorrect payment of wages. In addition, if they can access standing data, they could make unauthorised changes.	Payroll clerks should not have access to standing data changes within the system. The annual wages increase should be performed by a senior member of the payroll department and this should be checked by another responsible official for errors.	Ask a clerk to attempt to make a change to payroll standing data; the system should reject this attempt. Review the log of standing data amendments to identify whether the wage rate increases were changed by a senior member of payroll.
Overtime worked by employees is not all authorised by the relevant department head, as only overtime in excess of 30% of standard hours requires authorisation. This increases the risk that employees will claim for overtime even though they did not work these additional hours resulting in additional payroll costs for Trombone.	All overtime hours worked should be authorised by the relevant department head. This should be evidenced by signature on the employees' weekly overtime sheets.	Review a sample of employee weekly overtime sheets for evidence of signature by relevant department head.
Time taken off as payment for overtime worked should be agreed by payroll clerks to the overtime worked report; however, this has not always occurred. Employees could be taking unauthorised leave if they take time off but have not worked the required overtime.	Payroll clerks should be reminded of the procedures to be undertaken when processing the overtime sheets. They should sign as evidence on the overtime sheets that they have agreed any time taken off to the relevant overtime report.	Select a sample of overtime sheets with time taken off and confirm that there is evidence of a check by the payroll clerk to the overtime worked report.
The overtime worked report is emailed to the department heads and they report by exception if there are any errors. If department heads are busy or do not receive the email and do not report to payroll on time, then it will be assumed that the overtime report is correct even though there may be errors. This could result in the payroll department making incorrect overtime payments.	All department heads should report to the payroll department on whether or not the overtime report is correct. The payroll department should follow up on any non-replies and not make payments until agreed by the department head.	For a sample of overtime reports emailed to department heads confirm that a response has been received from each head by reviewing all responses.

Deficiencies	Controls	Test of controls
Department heads are meant to arrange for annual leave cover so that overtime sheets are authorised on a timely basis; however, this has not always happened. If overtime sheets are authorised late, then this can lead to employee dissatisfaction as it will delay payment of the overtime worked.	Department heads should be reminded of the procedures with regards to annual leave and arrangement of suitable cover. During annual leave periods, payroll clerks should monitor that overtime sheets are being submitted by department heads on a timely basis and follow up any late sheets.	Discuss with payroll clerks the process they follow for obtaining authorisation of overtime sheets, in particular during periods of annual leave. Compare this to the process which they should adopt to identify any control exceptions.
The finance director reviews the total list of bank transfers with the total to be paid per the payroll records. There could be employees omitted along with fictitious employees added to the payment listing, so that although the total payments list agrees to payroll totals, there could be fraudulent payments being made.	The finance director when authorising the payments should on a sample basis perform checks from payroll records to payment list and vice versa to confirm that payments are complete and only made to *bona fide* employees. The finance director should sign the payments list as evidence that he has undertaken these checks.	Obtain a sample of payments list and review for signature by the finance director as evidence that the control is operating correctly.

(b) Differences between an interim and a final audit

Interim audit

The interim audit is that part of the audit which takes place before the year end. The auditor uses the interim audit to carry out procedures which would be difficult to perform at the year end because of time pressure. There is no requirement to undertake an interim audit; factors to consider when deciding upon whether to have one include the size and complexity of the company along with the effectiveness of internal controls.

Typical procedures undertaken during the interim audit include consideration of inherent risks, documenting and testing of internal controls, testing of profit and loss transactions for the year to date and identification of potential problems which may affect the final audit work.

Final audit

The final audit will take place after the year end and concludes with the auditor forming and expressing an opinion on the financial statements for the whole year subject to audit. It is important to note that the final opinion takes account of conclusions formed at both the interim and final audit.

Typical work carried out at the final audit includes follow up of items noted at the inventory count, obtaining confirmations from third parties, analytical reviews of figures in the financial statements, substantive procedures of account balances and transactions, review of events after the reporting period and going concern review.

(c) Payroll substantive procedures

- Agree the total wages and salaries expense per the payroll system to the trial balance, investigate any differences.
- Cast a sample of payroll records to confirm completeness and accuracy of the payroll expense.
- For a sample of employees, recalculate the gross and net pay and agree to the payroll records to confirm accuracy.
- Re-perform the calculation of statutory deductions to confirm whether correct deductions for this year have been made in the payroll.
- Compare the total payroll expense to the prior year and investigate any significant differences.
- Review monthly payroll charges, compare this to the prior year and budgets and discuss with management for any significant variances.
- Perform a proof in total of total wages and salaries, incorporating joiners and leavers and the annual pay increase. Compare this to the actual wages and salaries in the financial statements and investigate any significant differences.
- Select a sample of joiners and leavers, agree their start/leaving date to supporting documentation, recalculate that their first/last pay packet was accurately calculated and recorded.
- Agree the total net pay per the payroll records to the bank transfer listing of payments and to the cashbook.
- Agree the individual wages and salaries per the payroll to the personnel records for a sample to confirm *bona fide* employees.
- Select a sample of weekly overtime sheets and trace to overtime payment in payroll records to confirm completeness of overtime paid.

(d) Accrual for income tax payable on employment income

Procedures the auditor should adopt in respect of auditing this accrual include:

- Agree the year-end income tax payable accrual to the payroll records to confirm accuracy.
- Re-perform the calculation of the accrual to confirm accuracy.
- Agree the subsequent payment to the post year-end cash book and bank statements to confirm completeness.

– Review any correspondence with tax authorities to assess whether there are any additional outstanding payments due; if so, agree they are included in the year-end accrual.
– Review any disclosures made of the income tax accrual and assess whether these are in compliance with accounting standards and legislation.

2 (a) Value for money audit

In performing a value for money audit, there are three areas which an auditor will commonly focus on being economy, efficiency and effectiveness, and these are known as the 'three Es'.

Economy – Keeping the cost of resources used to a minimum.
Efficiency – The relationship between the output from goods and services and the resources used to produce them.
Effectiveness – How well the organisation's objectives have been achieved.

(b) Audit documentation

– Provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the audit.
– Provides evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.
– Assists the engagement team to plan and perform the audit.
– Assists members of the engagement team responsible for supervision to direct, supervise and review the audit work.
– Enables the engagement team to be accountable for its work.
– Retains a record of matters of continuing significance to future audits.

(c) Audit sampling

Audit sampling is the application of audit procedures to less than 100% of items within a population of audit relevance, such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

Audit sampling can be applied using either a statistical or a non-statistical approach. It involves testing a smaller number of items and using the results to draw a conclusion about the whole balance or class of transactions.

It is necessary for auditors to sample as it is impossible to select all items for testing as this would take the audit team too long and it would cost too much.

In addition, auditors do not provide 100% assurance in their audit report about the financial statements, they only provide reasonable assurance and hence it is not necessary to test every item within a population.

3 (a) Audit risks and responses

Audit risk	Auditor's response
Recorder Communications Co (Recorder) is a new client for Piano & Co. As the team is not so familiar with the accounting policies, transactions and balances of Recorder, there will be an increased detection risk on the audit.	Piano & Co should ensure they have a suitably experienced team. Also, adequate time should be allocated for team members to obtain an understanding of the company and the risks of material misstatement.
Recorder purchases their goods from South Asia and the goods are in transit for two weeks. At the year end there is a risk that the cut-off of inventory, purchases and payables may not be accurate. The company correctly accounts for goods when they receive them. Therefore at the year end only goods which have been received into the warehouse should be included in the inventory balance and a respective payables balance recognised.	The audit team should undertake detailed cut-off testing of goods in transit from the suppliers in South Asia to ensure that the cut-off is complete and accurate.
The company undertakes continuous (perpetual) inventory counts at its central warehouse. Under such a system all inventory must be counted at least once a year with adjustments made to the inventory records. Inventory could be under or overstated if the continuous (perpetual) inventory counts are not complete and the inventory records accurately updated for adjustments.	The completeness of the continuous (perpetual) inventory counts should be reviewed. In addition, the level of adjustments made to inventory should be considered to assess whether reliance on the inventory records at the year end will be acceptable.
A sales-related bonus scheme has been introduced in the year; this may lead to sales cut-off errors with employees aiming to maximise their current year bonus.	Increased sales cut-off testing will be performed along with a review of any post year-end cancellations of contracts as they may indicate cut-off errors.

Audit risk	Auditor's response
Receivables are considerably higher than the prior year and there are concerns about the creditworthiness of some customers. There is a risk that some receivables may be overvalued as they are not recoverable.	Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation. Also consider the adequacy of any allowance for receivables.
In addition, receivables could be overstated as a result of the bonus scheme; some of the customers signed up for contracts may not actually exist.	External confirmation of receivables to confirm that customers exist and represent valid amounts due.
Recorder has a policy of revaluing its land and buildings and these valuations have been updated during the year. Property, plant and equipment could be under or overvalued if the recent valuation has not been carried out in accordance with IAS 16 *Property, Plant and Equipment* and adequate disclosures may not have been made in the financial statements.	Discuss with management the process adopted for undertaking the valuation, including whether the whole class of assets was revalued and if the valuation was undertaken by an expert. This process should be reviewed for compliance with IAS 16. Review the disclosures of the revaluation in the financial statements for compliance with IAS 16.
The directors have each been paid a significant bonus and separate disclosure of this in the financial statements is required by local legislation. The directors' remuneration disclosure will not be complete and accurate if the bonus paid is not disclosed in accordance with the relevant local legislation.	Discuss this matter with management and review the disclosure in the financial statements to ensure compliance with local legislation.

(b) Audit procedures for continuous (perpetual) inventory counts

- The audit team should attend at least one of the continuous (perpetual) inventory counts to review whether the controls over the inventory count are adequate.
- The audit team should confirm that all of the inventory lines have been counted or are due to be counted at least once a year by reviewing the schedules of counts undertaken/due to be undertaken.
- Review the adjustments made to the inventory records on a monthly basis to gain an understanding of the level of differences arising on a month by month basis.
- If significant differences consistently arise, this could indicate that the inventory records are not adequately maintained. Discuss with management how they will ensure that year-end inventory will not be under or overstated.
- Consider attending the inventory count at the year end to undertake test counts of inventory from records to floor and from floor to records in order to confirm the existence and completeness of inventory.

(c) Substantive procedures for directors' bonus and remuneration

- Obtain a schedule of the directors' remuneration including the bonus paid and cast the addition of the schedule.
- Agree the individual bonus payments to the payroll records.
- Confirm the amount of each bonus paid by agreeing to the cash book and bank statements.
- Review the board minutes to confirm whether any additional bonus payments relating to this year have been agreed.
- Obtain a written representation from management confirming the completeness of directors' remuneration including the bonus.
- Review any disclosures made of the bonus and assess whether these are in compliance with local legislation.

(d) Conflicts of interest

- Both Recorder Communications Co and its competitor should be notified that Piano & Co would be acting as auditors for each company and, if necessary, consent obtained.
- Advising one or both clients to seek additional independent advice.
- The use of separate engagement teams, with different engagement partners and team members; once an employee has worked on one audit, such as Recorder Communications Co, then they would be prevented from being on the audit of the competitor for a period of time. This separation of teams is known as building a 'Chinese wall'.
- Procedures to prevent access to information, for example, strict physical separation of both teams, confidential and secure data filing.
- Clear guidelines for members of each engagement team on issues of security and confidentiality. These guidelines could be included within the audit engagement letters.
- Potentially the use of confidentiality agreements signed by employees and partners of the firm.
- Regular monitoring of the application of the above safeguards by a senior individual in Piano & Co not involved in either audit.

4 (a) Advantages/disadvantages of outsourcing internal audit department

Saxophone

Advantages

Staffing: Saxophone Enterprises Co (Saxophone) wishes to expand its internal audit department in terms of size and specialist skills. If they outsource, then there will be no need to spend money in recruiting further staff as Cello & Co (Cello) will provide the staff members.

Immediate solution: As the current internal audit department is small, then outsourcing can provide the number of staff needed straight away.

Skills and experience: Cello is likely to have a large pool of staff available to provide the internal audit service to Saxophone. In addition, the audit firm is likely to have staff with specialist skills already available.

Cost savings: Outsourcing can be an efficient means to control the costs of internal audit as any associated costs such as training will be eliminated as Cello will train its own employees. In addition, the costs for the internal audit service will be agreed in advance. This will ensure that Saxophone can budget accordingly.

Flexibility: If the internal audit department is outsourced, Saxophone will have total flexibility in its internal audit service. Staff can be requested from Cello to suit the company's workloads and requirements. This will ensure that, when required, extra staff is readily available for as long or short a period as needed.

Disadvantages

Existing internal audit department: Saxophone has an existing internal audit department; if they cannot be redeployed elsewhere in the company, then they may need to be made redundant and this could be costly for Saxophone. Staff may oppose the outsourcing if it results in redundancies.

Increased costs: As well as the cost of potential redundancies, the internal audit fee charged by Cello may over a period of time increase, proving to be very expensive.

Knowledge of company: Cello will allocate available staff members to work on the internal audit assignment; this may mean that each visit the staff members are different and hence they may not fully understand the systems of Saxophone. This will decrease the quality of the services provided and increase the time spent by Saxophone's employees in explaining the system to the auditors.

Loss of in-house skills: If the current internal audit team is not deployed elsewhere in the company, valuable internal audit knowledge and experience may be lost. If Saxophone then decided at a future date to bring the service back in-house, this might prove to be too difficult.

Confidentiality: Knowledge of company systems and confidential data will be available to Cello. Although the engagement letter would provide confidentiality clauses, this may not stop breaches of confidentiality.

Control: Saxophone currently has more control over the activities of its internal audit department; however, once outsourced it will need to discuss areas of work and timings well in advance with Cello.

Cello

Advantages

Additional fees for Cello: The audit firm will benefit from the internal audit service being outsourced as this will generate additional fee income. However, the firm will need to monitor the fees to ensure that they do not represent too high a percentage of their total fee income. As a public interest company, fee income should not represent more than 15% of gross practice income for two consecutive years.

Disadvantages

Independence: If Cello provides both external audit and internal audit services, there may be a self-review threat especially where the internal audit work is relied upon by the external auditor team. The firm would need to take steps to ensure that separate teams are put in place as well as additional safeguards.

(b) Corporate governance weaknesses and recommendations

(i) Weakness	(ii) Recommendation
Bill Bassoon is now the chairman; however, until last year he was the chief executive. The chairman is supposed to be an independent non-executive director and hence cannot have previously been the chief executive. The roles of chairman and chief executive are both very important and carry significant responsibilities; hence this prevents too much power residing in the hands of one individual.	Bill Bassoon should return to his role as chief executive as this will fill the current vacancy and an independent non-executive director should be recruited to fill the role of chairman.

(i) Weakness	(ii) Recommendation
The board is comprised of five executives and only three non-executive directors. There should be an appropriate balance of executives and non-executives, to ensure that the board makes the correct objective decisions, which are in the best interest of the stakeholders of the company, and no individual or group of individuals dominates the board's decision-making.	At least half of the board should be comprised of non-executive directors. Hence the board of Saxophone should consider recruiting and appointing an additional one to two non-executive directors.
Bill Bassoon is considering appointing his close friend as a non-executive director; the friend has experience of running a manufacturing company. Non-executives bring valuable experience to a company, but they must also exercise their independent judgement over the whole board. If this director is a close friend of Bill Bassoon, then it is possible that he will not be independent. In addition, other than being a former chief executive, he does not have any relevant experience of the insurance industry and so it is questionable what value he will add to Saxophone.	Only independent non-executives with relevant experience and skills should be appointed to the board of Saxophone. The close friend of Bill Bassoon is unlikely to meet these criteria, as he has no experience in the insurance industry, and so should not be appointed.
The remuneration for directors is set by Jessie Oboe, the finance director. However, no director should be involved in setting their own remuneration as this may result in excessive levels of pay being set.	There should be a fair and transparent policy in place for setting remuneration levels. The non-executive directors should decide on the remuneration of the executives. The finance director or chairman should decide on the pay of the non-executives.
All directors' remuneration is in the form of an annual bonus. However, the pay should motivate the directors to focus on the long-term growth of the business. Annual targets can encourage short-term strategies rather than maximising shareholder wealth.	The remuneration of executives should be restructured to include a significant proportion aimed at long-term company performance. Perhaps they could be granted share options, as this would help to move the focus to the longer term.
In addition, non-executive directors' pay should not be based on meeting company targets as their pay should be independent of how the company performs.	Non-executives should be paid an annual fee for their services, which is unrelated to how Saxophone performs.
Saxophone does not currently have an audit committee. Audit committees undertake an important role in that they help the directors to satisfy their responsibility of accountability with regards to maintaining an appropriate relationship with the company's auditor.	Saxophone should appoint an audit committee as soon as possible. The committee should be comprised of at least three independent non-executives, one of whom should have relevant financial experience. The three current non-executives should be appointed to the audit committee, assuming they meet the requirements of independence.
A new sales director was appointed nine months ago, however, he has not undergone any board training. All directors should receive induction training when they first join the board so that they are fully aware of their responsibilities.	The new sales director should immediately receive relevant training from Bill Bassoon to ensure that he has a full understanding of his role and responsibilities.
Saxophone is not planning to hold an annual general meeting (AGM) as the number of shareholders are such that it would be too costly and impractical. However, the AGM is an important meeting in that it gives the shareholders an opportunity to raise any concerns, receive an answer and vote on important resolutions. The proposal to send the financial statements and resolutions by email is not appropriate as it does not allow shareholders an opportunity to raise relevant questions.	The company should continue to hold the AGM. Sending information by email in advance of the meeting may be practical and save some costs; however, this should not be seen as a replacement for the AGM.

5 (a) Procedures to undertake in relation to the uncorrected misstatement

- The extent of the potential misstatement should be considered and therefore a large sample of inventory items should be tested to identify the possible size of the misstatement.
- The potential misstatement should be discussed with Clarinet Co's management in order to understand why these inventory differences are occurring.
- The misstatement should be compared to materiality to assess if the error is material individually.
- If not, then it should be added to other errors noted during the audit to assess if in aggregate the uncorrected errors are now material.
- If material, the auditors should ask the directors to adjust the inventory balances to correct the misstatements identified in the 2014 year end.
- Request a written representation from the directors about the uncorrected misstatements including the inventory errors.
- Consider the implication for the audit report if the inventory errors are material and the directors refuses to make adjustments.

(b) Going concern indicators

A new competitor, Drums Design Co (Drums), has entered the market and gained considerable market share from Clarinet through competitive pricing. There is a risk that if Clarinet continues to lose market share this will impact on future cash flows. In addition, there may be pressure on Clarinet to drop their prices in order to compete, which will impact profits and cash flows.

A significant customer has stopped trading with Clarinet and moved its business to Drums. This could result in a significant loss of future revenues and profit, and unless this customer can be replaced, there will be a reduction of future cash flows.

A number of Clarinet's specialist developers have left the company and joined Drums and the company has found it difficult to replace these employees due to their experience and skills. The company is looking to develop new products and in order to do this, it needs sufficiently trained staff. If it cannot recruit enough staff, then it could hold up the product development and stop the company from increasing revenue.

Clarinet's main supplier who provides specialist equipment has just stopped trading. If the equipment is highly specialised, there is a risk that Clarinet may not be able to obtain these products from other suppliers which would impact on their ability to trade. More likely, there are other suppliers available but they may be more expensive which will increase the outflows of Clarinet and worsen the cash flow forecast.

Clarinet needs to raise finance to develop new products in order to gain market share; they approached their shareholders for further finance but they declined to invest further. If Clarinet is unable to obtain suitable finance, then it may be that the shareholders deem Clarinet to be too risky to invest in further. They may be concerned that Clarinet will not be able to offer them a suitable return on their investment, suggesting cash flow problems. In addition, if Clarinet cannot obtain alternative finance, then it will not be able to develop the products it needs to.

Clarinet's overdraft has grown significantly during the year. If the bank does not renew the overdraft and the company is unable to obtain alternative finance, then it may not be able to continue to trade.

Clarinet's cash flow forecast shows a significantly worsening position for the coming 12 months. If the company continues to have cash outflows, then it will increase its overdraft further and will start to run out of available cash.

One of Clarinet's customers is planning to sue the company for loss of revenue due to hardware being installed by Clarinet in the customer's online ordering system not operating correctly. If the customer is successful, then Clarinet may have to pay a significant settlement which will put further pressure on cash flows. In addition, it is unlikely that this customer will continue to trade with Clarinet and if the problems become known to other customers, this may lead to a further loss of revenue and cash flows as well as impact on Clarinet's reputation.

(c) Going concern procedures

- Obtain the company's cash flow forecast and review the cash in and outflows. Assess the assumptions for reasonableness and discuss the findings with management to understand if the company will have sufficient cash flows.
- Perform a sensitivity analysis on the cash flows to understand the margin of safety the company has in terms of its net cash in/outflow.
- Discuss with the finance director whether any new customers have been obtained to replace the one lost.
- Review the company's post year-end sales and order book to assess if the levels of trade are likely to increase in light of the increased competition from Drum and if the revenue figures in the cash flow forecast are reasonable.
- Discuss with the directors whether replacement specialist developers have been recruited to replace those lost to Drum.
- Review any agreements with the bank to determine whether any covenants have been breached, especially in relation to the overdraft.
- Review any bank correspondence to assess the likelihood of the bank renewing the overdraft facility.
- Review the correspondence with shareholders to assess whether any of these are likely to reconsider increasing their investment in the company.
- Discuss with the directors whether they have contacted any banks for finance to help with the new product development.
- Enquire of the lawyers of Clarinet as to the existence of any additional litigation and request their assessment of the likelihood of Clarinet having to make payment to their customer who intends to sue for loss of revenue.

– Perform audit tests in relation to subsequent events to identify any items which might indicate or mitigate the risk of going concern not being appropriate.
– Review the post year-end board minutes to identify any other issues which might indicate further financial difficulties for the company.
– Review post year-end management accounts to assess if in line with cash flow forecast.
– Consider whether any additional disclosures as required by IAS 1 *Presentation of Financial Statements* in relation to material uncertainties over going concern should be made in the financial statements.
– Consider whether the going concern basis is appropriate for the preparation of the financial statements.
– Obtain a written representation confirming the directors' view that Clarinet is a going concern.

(d) Audit report

The directors of Clarinet have agreed to make going concern disclosures; however, the impact on the audit report will be dependent on the adequacy of these disclosures. If the disclosures are adequate, then the audit report will be modified as an emphasis of matter paragraph would be required.

The paragraph will state that the audit opinion is not modified, indicate that there is a material uncertainty and will cross reference to the disclosure note made by management. It would be included immediately after the opinion paragraph.

If the disclosures made by management are not adequate, the audit opinion will need to be modified as there is a material misstatement. Depending on the materiality of the issue, this will be either qualified or an adverse opinion.

A paragraph describing the matter giving rise to the modification will be included just before the opinion paragraph and this will clearly identify the lack of disclosure over the going concern uncertainty. The opinion paragraph will be amended to state 'except for' or the financial statements are not fairly presented.

			Marks
1	**(a)**	Up to 1 mark per well explained deficiency, up to 1 mark for each well explained recommendation and up to 1 mark for each well described test of control. Overall maximum of 5 marks each for deficiencies, controls and tests of control. Payroll calculations not checked Payroll clerks update standing data for wages increases Authorisation of overtime sheets only undertaken if overtime exceeds 30% of standard hours Time off as payment for overtime not checked to overtime worked report Review of overtime worked reports by department heads Authorisation of overtime sheets when department heads on annual leave Finance director only reviews totals of payroll records and payments list	15
	(b)	Up to 1 mark per well explained point, maximum of 3 marks each for interim and final audit, overall maximum of 5 marks. Interim audit Final audit	5
	(c)	Up to 1 mark per well described substantive procedure. Agree wages and salaries per payroll to trial balance Cast payroll records Recalculate gross and net pay Recalculate statutory deductions Compare total payroll to prior year Review monthly payroll to prior year and budget Proof in total of payroll and agree to the financial statements Verify joiners/leavers and recalculate first/last pay Agree wages and salaries paid per payroll to bank transfer list and cashbook Agree the individual wages and salaries as per the payroll to the personnel records Agree sample of weekly overtime sheets to overtime payment in payroll records	6
	(d)	Up to 1 mark per well described procedure. Agree to the payroll records to confirm the accuracy of the accrual Re-perform the calculation of the accrual Agree the subsequent payment to the post year-end cash book and bank statements Review any correspondence with tax authorities to assess whether there are any additional outstanding payments due, if so, agree they are included in the year end accrual Review disclosures and assess whether these are adequate and in compliance	4
			30
2	**(a)**	Up to 1 mark per definition. Economy – description Efficiency – description Effectiveness – description	3
	(b)	Up to 1 mark per well described benefit. Evidence of conclusions Evidence of compliance with ISAs Helps team to plan and perform audit Helps supervision Team is accountable Record of matters of continuing significance	4
	(c)	Up to 1 mark per valid point, maximum of 2 marks for definition and maximum of 2 marks for need, overall maximum of 3 marks. Definition of sampling Need for sampling	3
			10

Marks

3 **(a)** Up to 1 mark per well described risk and up to 1 mark for each well explained response. Overall maximum of 5 marks for risks and 5 marks for responses.

New client leading to increased detection risk
Cut-off of goods in transit
Continuous (perpetual) inventory counts
Sales cut-off
Overstatement of receivables
Valuation of land and buildings
Directors' bonus remuneration — 10

(b) Up to 1 mark per well explained procedure.

Attend one of the continuous (perpetual) inventory counts to review whether the controls are adequate
Review the schedule of counts to confirm completeness of all inventory lines
Review the adjustments made to the inventory records to gain an understanding of the level of differences arising
If significant differences, discuss with management how they will ensure that year-end inventory will not be under or overstated
Attend the inventory count at the year end to undertake test counts to confirm the completeness and existence of inventory — 3

(c) Up to 1 mark per well described procedure.

Cast schedule of directors' remuneration including the bonus paid
Agree the individual bonus payments to the payroll records
Confirm the amount of each bonus paid by agreeing to the cash book and bank statements
Review the board minutes to confirm whether any additional bonus payments relating to this year have been agreed
Obtain written representation from management
Review disclosures and assess whether these are in compliance with local legislation — 3

(d) Up to 1 mark per well explained safeguard.

Notify Recorder Communications Co and its competitor
Advise seek independent advice
Separate engagement teams
Procedures prevent access to information
Clear guidelines on security and confidentiality
Confidentiality agreements
Monitoring of safeguards — 4

20

			Marks
4	(a)	Up to 1 mark per well explained advantage/disadvantage. Overall maximum of 8 marks for Saxophone and 2 marks for Cello.	

Saxophone
Staffing gaps addressed
Immediate solution
Skills and experience increased
Costs savings
Flexibility of service
Existing internal audit department staff, cost of potential redundancies
Increased costs as fees by Cello & Co may increase over time
Knowledge of company and systems reduced
Loss of in-house skills
Confidentiality issues
Control of department reduced

Cello
Additional fees for Cello & Co
Independence issues for audit firm — 10

(b) Up to 1 mark per well explained weakness and up to 1 mark per recommendation. Overall maximum of 5 marks for weaknesses and 5 marks for recommendations.

Chief executive is now chairman
Currently only three of eight directors are non-executive, should be at least half
Chairman considering appointing his friend as a non-executive
Finance director decides on the remuneration for the directors
Remuneration for all directors in form of annual bonus
No audit committee at present
No induction training for new sales director
No AGM planned as felt impractical and too costly — 10

20

			Marks
5	(a)	Up to 1 mark per well described procedure.	
		Test inventory to assess extent of error Discuss with management to understand why errors occurring Compare misstatement to materiality – see if material If not material, add to unadjusted errors schedule, to assess if material in aggregate If material, request directors to amend financial statements Written representation Consider implications for audit report	4
	(b)	Up to 1 mark per explanation of why this could indicate going concern problems, if just identify indicator then max of ½ mark, overall maximum of 6 indicators.	
		New competitor taking market share from Clarinet Loss of large customer Loss of specialist staff Main supplier ceased to trade Shareholders refused to provide further finance for product development Overdraft facility due for renewal and increased significantly Cash flow shows worsening position Customer potentially suing for loss of revenue	6
	(c)	Up to 1 mark per well described procedure.	
		Review cash flow forecasts Sensitivity analysis Discuss if new customers obtained Review post year-end sales and order book Discuss if replacement specialist developers recruited Review bank agreements, breach of covenants Review bank correspondence likelihood of overdraft renewal Review shareholders' correspondence Discuss if alternative finance obtained Enquire of lawyers any further litigation and likelihood of Clarinet making payment to customer who may sue Subsequent events Board minutes Management accounts Additional disclosures required by IAS 1 Consider going concern basis appropriate Written representation	6
	(d)	Up to 1 mark per well described point.	
		Depends on adequacy of disclosures Adequately disclosed – modified report Emphasis of matter paragraph after opinion – opinion unmodified Not adequately disclosed – modified opinion as material misstatement Depending on materiality either qualified or adverse opinion. Add paragraph before opinion and impact on opinion paragraph	4
			20