MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark each question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

General comments
The standard of answers to the short-form questions (SFQ) dropped slightly compared with recent sessions. The answers to SFQs 4 and 6 were particularly disappointing. A significant number of candidates failed to make use of the facility to present their answers to SFQs in note form and wasted time writing lengthy answers thereby leaving themselves short of time for the long-form questions.
Candidates performed well on most areas of the syllabus although many answers to question 8b were disappointing.

Question 1

Total Marks: 3

Benefits of voluntary external audit
Discipline over maintaining accounting records which reduces
- risk of material misstatement and
- non-compliance with statutory responsibilities

More reliable business information
leading to better business decisions by management
Enhances credibility of the FS
Assurance to third parties such as tax authorities/lenders
Enhanced value of FS for business valuation purposes in the event of a sale
Assurance for 25%minority shareholders
who may not be involved in managing the business
Business is scrutinised by a professional helping to:
- reduce business risk
- improve controls/identify deficiencies
- improve efficiency/performance

Deterrent to fraud

This question was generally well answered as the majority of candidates identified the points relating to the credibility of the financial statements, assurance to third parties, deficiencies in internal controls and fraud deterrent. The points most commonly overlooked were those relating to discipline over maintaining accounting records, more informed business decisions and assurance for the 25% minority shareholders. Many candidates cited "company may need an audit in the future" without further elaboration, failing to appreciate that this in itself is not a benefit.

Total possible marks	8
Maximum full marks	3

Question 2

Total Marks: 3

Threats to independence and objectivity Intimidation threat - intention of influencing/exerting pressure on the audit team/inducement/bribe Self-interest threat - audit team may be reluctant to take actions/decisions adverse to their interests - ie fear of not being extended this type of hospitality again Familiarity threat - audit team may be insufficiently questioning of Flayke's finance team Perception of lack of independence/not seen to be independent Four nights not insignificant **Firm's response** Seek guidance from ethics partner if uncertain Decline offer	
This was the best answered of all the SFQs with many candidates scoring full marks. The majority of candidates identified the self-interest and familiarity threats and provided plausible explanations of these threats. The intimidation threat was commonly overlooked by weaker candidates and even those candidates that did identify the intimidation threat often struggled to explain it. It was pleasing to note that most candidates concluded that the value of the hospitality represented a significant amount and consequently should be rejected.	
Total possible marks Maximum full marks	5½ 3

Question 3

Total Marks: 4

Factors re resourcing Need engagement team members who: - understand the specific regulatory environment - have relevant technical/scientific skills/qualifications - have information systems expertise if systems are complex May require use of an external/auditor's expert Reasonable assurance engagement requires more work/resources May need: - an engagement quality control review - to plan site visits to the factories - to rely on the work of another firm in respect of the factory in Poland if the firm does not have representation in Poland Potential language issues	
This question was generally well answered as the majority of candidates identified the points relating to technical expertise, regulatory environment, geographical coverage and the use of an auditor's expert. However, the majority of candidates overlooked the information in the question regarding the fact that it was a reasonable assurance engagement and failed to consider whether the firm would be able to undertake the amount of work necessary to provide this high level of assurance. A significant number of candidates assumed, incorrectly, that it would be a limited assurance engagement and wasted time writing about the type of procedures undertaken on such engagements. Weaker candidates failed to relate the factors to the specific engagement and included only generic points that might be relevant to resourcing any engagement. Fewer marks were available for such generic points.	
Total possible marks Maximum full marks	9 4

Question 4

Total Marks: 3

Further audit procedures Review report of health and safety regulator Ascertain if failure relates to events before the year end Ascertain likely actions to be taken against Ice, such as: - withdrawal of licence/closure and whether temporary or permanent - fines and likely amounts Review the outcome of similar cases Discuss with directors how they propose to respond to the failed inspection Review press coverage for any adverse comment Review post year-end management accounts to assess impact on company performance Obtain and review updated cash flow forecasts and consider implications for Ice's ability to meet debts as they fall due Consider whether financial statements need amending
Answers to this question were of a mixed standard. Those candidates who used the techniques of enquiry and inspection to generate audit procedures scored well. However, many candidates failed to focus on audit procedures. For example, the majority of candidates identified that going concern might be an issue if the breach resulted in large fines or the regulator closed the business, but failed to generate procedures to provide assurance about the going concern status. Consequently, the majority of candidates overlooked procedures in respect of cash flow forecasts and post year-end management accounts.

Total possible marks	7
Maximum full marks	3

Question 5

Total Marks: 4

Audit report Addressed to members/shareholders Conducted in accordance with ISAs Reasonable/high assurance Positive opinion as to whether: - FS give true & fair view/free from material misstatement - prepared properly in accordance with relevant reporting framework - prepared in accordance with CA06 Signed in name of senior statutory auditor Opinion as to whether directors' report consistent with FS **Report on examination of PFI** Addressed to management Conducted in accordance with ISAE 3400 Restricted distribution Limited/moderate assurance Negative expression of statement as to whether the assumptions provide a reasonable basis for PFI Opinion as to whether: - forecast properly prepared on basis of assumptions - presented in accordance with relevant financial reporting framework Caveat re achievability of results Signed in name of firm
This question was generally well answered particularly by those candidates who adopted a columnar approach. The columnar approach tended to produce a more systematic and comprehensive list of differences between the two types of report. The most common misunderstanding was to cite the

differences between the two engagements instead of the reports. For example, many candidates cited that the audit is based on historical financial information and the examination of prospective financial information is based on forecasts. There were no marks for these points.	
Total possible marks Maximum full marks	10 4

Question 6

Total Marks: 3

Actions firm should take

Discuss reasons for inconsistency with directors

Ascertain if error/material misstatement arises in FS or directors' report

If material misstatement in FS consider whether further audit procedures required

Request FS/directors' report corrected

Document further audit procedures/resolution

Potential implications for auditor's report

If error in directors' report and is:

- corrected, no impact on audit report
- not corrected:
    - modify CA06 opinion on consistency of directors' report
    - opinion on FS not modified

If material misstatement in FS and is:

- corrected, no impact on audit report
- not corrected:
    - modify audit opinion on FS
    - consider if reporting by exception required under CA06

Answers to this question were very disappointing as most candidates failed to consider whether it was the directors' report or the financial statements that needed amending. The vast majority incorrectly assumed that failure to correct the inconsistency must result in a modified opinion on the financial statements. Candidates did not appreciate that if there is an error in the directors' report, the financial statements are not misstated and, consequently, there would be no need to modify the opinion on the financial statements. In such circumstances, the auditor's responsibility is discharged by reporting on the inconsistency between the directors' report and the financial statements. A significant number stated, incorrectly, that if the directors do not amend the directors' report the auditor should refer to the issue in an emphasis of matter paragraph. These candidates fail to appreciate that an emphasis of matter paragraph is only used to draw users' attention to a matter disclosed in the notes to the financial statements.

Total possible marks Maximum full marks	8 3

Question 7

Total Marks: 40

General comments

This was the second best answered long-form question on the paper. However, part (c) was poorly answered by a significant number of candidates. In part (b) candidates' answers in respect of trade receivables generally scored more highly compared with their answers in respect of WIP.

Part (a)

List the matters your firm should have considered and the procedures it should have performed before accepting appointment as external auditor

Matters that the firm should have considered:

- Weselton is a new audit client which means the firm has a lack of cumulative audit knowledge and experience, resulting in increased detection risk and no comfort over opening balances
- The reason the previous auditor didn't seek reappointment, such as disagreements, intimidation, unpaid fees or illegal acts
- Management's integrity and whether there is any risk to the firm's reputation from association with Weselton
- The level of fees as a self-interest threat may arise especially as Weselton is the firm's largest audit client. The firm should have established whether recurring fees earned from Weselton are below 10% of the firm's gross practice income. If fees are in excess of 5% of the firm's gross practice income the firm should have considered the resources required to implement additional safeguards, such as monitoring fees on a regular basis
- Ethical issues including any threats to the firm's independence and objectivity, such as conflicts of interest , whether the firm's employees hold shares in Weselton and whether Weselton's management will try to influence the audit process by insisting on a controls approach. Where ethical issues were identified the firm should have considered its ability to implement appropriate safeguards
- Adequacy of the firm's resources given the global nature of Weselton's business and whether the firm can undertake an engagement quality control review and meet the relevant reporting deadlines for a listed company
- Adequacy of the firm's experience and knowledge of the overseas regulatory framework(s) to ensure the audit can be performed competently and reduce the risk of an inappropriate audit opinion
- Level of audit risk, especially in light of the problems arising in the year with the job costing system
- Level of engagement risk given Weselton is listed and is subject to public interest

Procedures

The firm should have:

- enquired of management why the previous auditor did not seek reappointment
- obtained professional clearance to act by:
  - obtaining permission to contact the previous auditor and
  - communicating with the previous auditor and considering any points raised in the response
- inspected the statement of circumstances deposited by the previous auditor
- performed a preliminary risk assessment to ascertain the extent of audit work required to reduce risk to an acceptable level
- held discussions with the directors to ascertain their attitude towards areas such as internal control and tax issues
- performed client identification procedures
- performed a Companies House search/reviewed press cuttings/internet for evidence regarding management's integrity
- reviewed Weselton's prior year's financial statements and the auditor's report

This part of the question was well answered with most candidates able to identify a number of relevant matters that the firm should have considered and a range of procedures that it should have performed before accepting appointment as external auditor. The points commonly identified were the reasons why the previous auditor resigned and the procedures associated with the professional clearance process, the level of fees and the adequacy of the firm's resources and its expertise. The points most commonly overlooked were those relating to the first-year audit ie a lack of cumulative audit knowledge resulting in higher detection risk and no comfort over opening balances. A number of candidates wasted time citing procedures to be undertaken once the firm was appointed as auditor such as agreement of the engagement letter with the client and procedures to be undertaken during the audit. Candidates who followed the instruction to 'list' produced succinct answers which covered a wide range of points. These candidates generally scored more highly than those candidates who provided very detailed explanations of each point made in their answers.

Total possible marks	22
Maximum full marks	10

Part (b)
Justify why work in progress and trade receivables have been identified as areas of audit risk and, for each one, describe the procedures that should be included in the audit plan in order to address those risks.

Work in Progress (WIP) **Justification**	**Procedures**

WIP appears to be overstated because:
- mark-up for 2015 is 47.6% compared to 35% in 2014 which is inconsistent with the policy of a 35% mark-up
- WIP days in 2015 are 85 days compared to 60 days in 2014
- customers are likely to challenge any costs incorrectly allocated to their project, arising from:
  - project managers managing multiple projects
  - invoices for the cost of overseas packers covering multiple projects
	Ascertain from management the reasons for the increase in WIP
	Vouch a sample of temporary packer costs recorded in the job costing system to purchase invoices
	
	Trace hours recorded on a sample of project managers' timesheets to the job costing system
	Trace invoices for temporary packer costs to the job costing system
	Check that each is allocated to the correct unique code

- customers are more likely to dispute future invoices for amounts included in WIP at 28 February:
  - where they have already been invoiced for a project meaning any un-invoiced WIP may not be recoverable
  - as they are not required to confirm in writing changes to their requirements and there is no monitoring of actual costs compared to estimates
	Inspect the aged WIP report to identify any unbilled/irrecoverable WIP
	Compare actuals to estimates to identify any projects with costs significantly above the initial estimate
	Ascertain whether WIP at the year end has been billed after the year end and subsequently settled by Weselton's customers

There is a potential for understatement of WIP at 28 February due to: - cut-off issues arising from invoices received from suppliers after the year end which relate to services received before the year end - unrecorded invoices resulting from the back log of recording costs	Inspect supplier invoices received or recorded after the year end and trace to the job costing system/WIP balance at 28 February where they relate to pre year-end activity Ascertain from management whether the backlog has been cleared Inspect the additional customer invoices raised in March and ascertain if the related costs were included in WIP at 28 February Review correspondence with these customers to ascertain if there are any disputes
Overseas suppliers invoice in local currencies which may result in translation errors	Reperform the translation of a sample of foreign currency invoices using an exchange rate obtained from a reliable 3rd party
Errors may arise from the implementation of the new job costing system due to: - incorrect transfer of balances from the old to the new system - lack of parallel run to check the new system was operating correctly - delays in training	Compare a sample of balances transferred to the new job costing system with the old job costing system for accuracy Enquire of Weselton's employees whether they have identified any issues with the functioning of the new system

Errors may have arisen during the year due to the use of the outdated project costing system	
Trade receivables **Justification** Trade receivables may be overstated because: - trade receivables days in 2015 are 44 days compared to 33 days in 2014 - this appears to be inconsistent with the credit terms of 30 days - customers may refuse to pay the additional invoices, relating to the unrecorded costs - Bulda is refusing to pay an invoice for £1.8m. This is 4% of revenue and therefore material. It may only be £0.5m in dispute which is 1.1% of revenue and therefore also material - there may be other disputed invoices at the year end where actual costs are significantly above those estimated - the risk of disputes is higher due to the lack of written confirmations of changes and inadequate monitoring of costs Sales invoices may be inaccurate due to: - misallocation of project manager time/temporary packer costs between projects in the job costing system - errors arising due to the implementation of the new system and the back log of recording costs both of which may result in customers refusing to pay or a high volume of credit notes being raised after the year end - errors in calculating the 35% mark-up	**Procedures** Undertake direct confirmation of trade receivables balances at the year end. Include the balance due from Bulda and customers who received additional invoices in February. Investigate any discrepancies Identify cash received from customers after 28 February which relates to trade receivables at the year end Inspect correspondence with Bulda to ascertain the amount in dispute and review the contract with Bulda to ascertain whether it is contractually bound to pay the full amount invoiced Review the aged receivables analysis to identify any old outstanding amounts. Discuss with management the basis for any allowance against receivables or for any old balances for which an allowance is not included at the year end. Recalculate the allowance against receivables Inspect correspondence with customers other than Bulda for evidence of any disputes. Inspect credit notes raised after the year end for evidence of amounts disputed/errors at 28 February For a sample of invoices: - trace amounts to costs recorded in the job costing system - re-perform the mark-up calculation

Answers to this part of the question were of a mixed standard. Almost all candidates followed the examiner's guidance to use a columnar format to lay out their answers. In previous examiners' commentaries, it was noted that the procedures cited by candidates to address audit risks were often too vague or unrelated to the justification of the audit risk. This was again a feature of some candidates' answers in this examination. Most candidates made some use of the financial information provided but, disappointingly, a significant minority did not refer to this information in their answers and so lost the marks that were available for applying analytical procedures to illustrate why an item had been selected as an area of audit risk. Where candidates did make use of the financial information, many restricted their answers to simple percentage changes and therefore did not earn the higher skills marks available for considering the analysis of WIP days, trade receivable days or comparison of the mark-up with the company's stated policy. A number of weaker candidates suggested tests of control as part of audit procedures for both work in progress and trade receivables. Such procedures did not earn any marks as the internal control deficiencies highlighted in the scenario and the requirement in part (c) clearly indicated that reliance on internal controls was unlikely to be appropriate.

Work in progress

Most candidates were able to provide some points to justify why work in progress had been identified as a key area of audit risk and described a range of procedures to address the risk. The justification points commonly overlooked were those relating to the backlog of recording costs, the possibility that un-invoiced WIP may not be recoverable and that customers are not required to confirm in writing changes to their requirements. The procedures commonly overlooked were those relating to the inspection of aged work in progress reports, comparison of actual costs to estimates and consideration of whether any work in progress at the year end had subsequently been invoiced and settled by the customer.

A large number of candidates wasted time discussing issues associated with estimates such as the stage of completion of the project and allocation of overheads. Estimates are only relevant to the pricing of each project and not to the valuation of work in progress which is based on actual costs. A number of candidates confused the 35% mark-up with overhead absorption failing to appreciate that the mark-up is only applied once a customer is invoiced. Some candidates failed to appreciate that Weselton provided services rather than goods and wasted time covering points such as the physical verification of work in progress, attendance at the inventory count and the audit of goods in transit, none of which were relevant to the scenario. Some candidates digressed into areas of going concern and cash flow and scored no marks for these points.

Trade receivables

Answers in respect of the justification of audit risks and procedures to address each risk were of a higher standard for trade receivables than those for work in progress and candidates generally made better use of the draft financial information to justify the risk of overstatement of trade receivables. Many candidates also correctly identified the dispute with Bulda as a justification point. However, few candidates used the financial information provided in respect of the disputed invoice to demonstrate that it was material to the financial statements. The procedures commonly identified were those relating to the direct confirmation of balances, the review of cash receipts from customers after the year end, the review of aged receivables to identify old outstanding amounts and discussion with management of the reasons for unprovided old balances. The points commonly overlooked were that customers may refuse to pay additional invoices sent in February for unrecorded costs and the risk of disputes with customers due to cost overruns arising from the failure to monitor costs incurred against estimated costs. Consequently, few candidates considered associated audit procedures such as inspection of correspondence with customers or post year-end credit notes for evidence of disputes. A large number of candidates incorrectly cited the risk of translation errors and the related audit procedures to address that risk. This was not relevant to trade receivables as the scenario clearly stated all customers are invoiced in sterling.

Total possible marks	54½
Maximum full marks	18

Part (c)

Explain why reliance on controls over the job costing system, requested by Olaf, is unlikely to be appropriate in respect of the audit for the year ended 28 February 2015.

The firm is recently appointed and it may therefore be difficult to obtain evidence that controls operated effectively throughout the year.

The new system was only in place for part of the year so controls over both systems would need to be tested which is unlikely to be efficient.

There is high control risk due to the problems with both the old and new job costing systems, in particular:

- the old system had become outdated and therefore may not have been operating effectively
- the lack of familiarity and delays in training on the new system
- there was a backlog in recording costs
- there was no parallel run.

Answers to this part of the question were of a mixed standard. The points commonly identified were those relating to the outdated system, delays in training, lack of parallel run and the backlog of costs. Most candidates failed to conclude that overall sufficient evidence of effectiveness was unlikely to be obtained. Other points commonly overlooked were those relating to the recent appointment ie, the difficulty of obtaining evidence that controls operated effectively throughout the year and that both systems would require testing which was unlikely to be efficient. Weaker candidates did not make use of the information provided in the scenario and made general points concerning inherent limitations of internal control systems and the need for both control and substantive audit procedures which did not score any marks.

Total possible marks	9
Maximum full marks	5

Part (d)
For each internal control deficiency listed as (i) and (ii) in the scenario, draft points for inclusion in your firm's report to those charged with governance and management at Weselton. For each deficiency, you should outline the possible consequence(s) of the deficiency and provide recommendations to address it.

(i) Customers are not required to provide written confirmation of changes to their requirements during a relocation project

Consequences
Weselton will have no evidence that the customer requested the change or that the customer was aware of any implications of the change on costs/price. It will be more difficult to recover monies in the event of a dispute over requirements or a customer refusing to pay. This would lead to a negative impact on profit and cash flow.

Changes in requirements may be misunderstood leading to customer dissatisfaction and loss of future business as well as having a negative impact on Weselton's reputation in the market place.

Recommendations
All changes to customer requirements should be documented. The impact of changes on costs/price should be notified to the customer immediately. The customer should sign the document detailing the changes as evidence of acceptance of the changes before they are implemented.

(ii) Project managers do not monitor actual costs incurred to date compared with the estimated cost of each project
Consequences
Errors in recording costs in the job costing system, such as incorrect allocation of costs between projects, may go undetected. Cost overruns on projects will not be identified in a timely manner and therefore customers cannot be informed of increases in the final price. It is therefore more likely that disputes with customers will arise where there are cost overruns. This will have a negative impact on profit and cash flow and lead to a loss of customer goodwill and a negative impact on Weselton's reputation.

The opportunity to improve the process for estimating costs will be missed.

Recommendations
Project managers should monitor project costs on a regular basis and should prepare a variance analysis to explain cost overruns/errors. Identified cost overruns should be notified to the customer immediately and written authority for cost overruns should be obtained.

Any errors identified should be corrected in a timely manner.

Project managers should produce regular reports for senior management to highlight any significant project cost issues.

General recommendations (awarded only once across (i) and (ii))
- policies should be communicated to staff
- disciplinary procedures should be in place for non-compliance with polices
- monitoring of compliance by management

This part of the question was well answered with most candidates able to identify a range of relevant consequences and recommendations for each internal control deficiency. The recommendations commonly overlooked in respect of deficiency (i) were that the impact of changes on costs should be notified to the customer and that contracts should state that prices may change. The points most commonly overlooked in respect of deficiency (ii) were that errors arising when recording costs in the job costing system may go undetected and that errors identified should be corrected in a timely manner. A number of candidates wasted time by explaining the impact of each weakness on the work in progress and trade receivable balances in the financial statements for which there were no marks available. A significant minority of candidates incorrectly identified susceptibility to fraud as consequences of both control deficiencies.

Total possible marks	15
Maximum full marks	7

Question 8

Total Marks: 20

General comments
This was the least well answered of the long-form questions. Although the ethical issues in part (a) were adequately explained, many candidates wasted time writing more than was required to earn 3 marks. Answers to part (b) were of a very mixed standard and differentiated those candidates who have a good understanding of the purposes of analytical procedures from those who do not.

Part (a) Explain the ethical issues arising from Elsa's comments in respect of (i) providing guidance on the presentation of Arendelle's interim financial information; and (ii) your firm's fee being contingent on Arendelle successfully receiving the loan from its bank.

Ethical issues

(i) A management threat arises as the firm may be expected to make judgements/ decisions. The preparation and presentation of the interim financial information is management's responsibility. The firm's interests may be perceived to be too closely aligned with those of Arendelle.

(ii) There is a self-interest threat to the firm's objectivity and its ability to perform the engagement with professional competence and due care. The firm may be reluctant to state in its conclusion that matters have come to its attention that causes the firm to believe the interim financial information is not true and fair. It will fear that the loan application will then be unsuccessful resulting in the firm not receiving its fee. The firm must not undertake an assurance engagement on a contingency fee basis.

This part of the question was generally well answered with most candidates correctly identifying and explaining the management threat in respect of the request to provide guidance on the presentation of the financial information and the self-interest threat in respect of the contingency fee. It was pleasing to note that the majority of candidates recognised that contingency fees were not appropriate for assurance work. The most commonly overlooked point was that self-interest posed a threat to the firm's objectivity and professional competence and due care. A significant minority of candidates wasted time providing safeguards, to mitigate each of the threats, which were not required. A number of candidates adopted a scattergun approach and wrote lengthy answers covering a number of ethical issues which were not relevant to the scenario. Such candidates would do well to make note of the mark allocation available for each part of a question when determining how much to include in their response.

Total possible marks	5½
Maximum full marks	3

Part (b)
As part of your review of the interim financial information, perform analytical procedures on the information provided and prepare a list of questions which you wish to ask Elsa at your meeting on 18 March 2015.

Revenue **Analytical procedures** Revenue has increased by 45% compared to the prior year and the six months to 31 January 2015 represents 72.6% of the prior full year. Expected revenue for the interim period would be £3,470k being half of the prior year plus £220,000 in relation to six months of the new nursing home contracts (22 x £20k x $^{6}/_{12}$). Therefore, revenue is £1,250k higher than expected and implies that revenue from non-care home contracts is 38% higher than in the prior year (£1,250k/ (6,500k x $^{6}/_{12}$)).	 **Questions for Elsa** What are the sources of increased revenue other than that from the nursing home contracts? How has nursing home revenue been recognised? How has this additional demand been met given delivery vehicles are already fully utilised?
Margins **Analytical procedures** Gross profit has increased by 84.6% and operating profit has increased by 68.2%.This is out of line with the increase in revenue.	 **Questions for Elsa** Is the margin on nursing home contracts/ other new revenue significantly higher than on contracts in place last year?

Gross profit margin has increased from 21% to 27% and operating profit margin has increased from 11.4% to 13.2%. There may be a misallocation of costs between cost of sales and operating expenses.	Are costs charged by new suppliers lower than existing suppliers? Have bulk purchase discounts been negotiated? Has the proportion of business given to new suppliers increased beyond that needed to fulfil the nursing home contracts? Has the product mix changed? Have selling prices increased? Have market prices of fruit/vegetables fallen significantly?
Warehouse rent **Analytical procedures** Rent has increased by 39% compared to the prior year and the six months to 31 January 2015 represents 69% of the prior full year. There appears to be an additional rental expense of £35k (£125k – (£180k x $^{6}/_{12}$)). An increase in rental expense is expected given that an additional storage facility has been rented to fulfil the new nursing home contracts. However, these contracts only represent a 6.8% increase in revenue. Rent was 2.8% of revenue in 2014 but the extra rental is 15.9% of the additional nursing home contract revenue (£35k/£220k). The increase in rental appears high compared to the extra revenue from nursing homes.	 **Questions for Elsa** Is the additional storage facility charged at a premium rental? How much additional space is being rented compared to the existing storage space? Is the storage space being used for purposes other than the nursing home contracts, such as the sources of other revenue?
Depreciation: delivery vehicles **Analytical procedures** Depreciation is consistent with the prior year (ie half year is 50% of full year). Expected depreciation would be £27.5k for the half year given 20 of the 40 delivery vehicles are now fully depreciated. Depreciation therefore appears overstated.	 **Questions for Elsa** Have the fully depreciated delivery vehicles continued to be depreciated in error?
Marketing expenses **Analytical procedures** Marketing expenses have increased by 104% compared to the prior year and the six months to 31 January 2015 represents 102% of the prior full year. Expected marketing expenses would be £96k (£192k x $^{6}/_{12}$). Marketing expenses therefore appear to be overstated.	 **Questions for Elsa** What marketing activity has taken place in the six months to 31 January 2015 to cause the increase? Are marketing expenses "front loaded" in the year? How has the £100k for marketing in the new delivery areas from April been accounted for? /Has it been expensed in error?
Trade receivables **Analytical procedures** Trade receivables days are 2.4 days. Receivables days are expected due to the 30 day credit terms extended to the nursing homes. However, £62k represents 51 days of nursing home revenues (£62k/£220k x 182.5 days). 30 days of revenue would be £36.7k (£220k/6 months). Therefore trade receivables days appear high compared to the 30 day credit terms extended to nursing homes. Trade receivables may be overstated or some debts may be irrecoverable.	 **Questions for Elsa** Have credit terms been extended to any other customers? Are nursing homes slow payers? Have credit checks been run on nursing homes? Are there any amounts in dispute which may be irrecoverable and therefore require an allowance against them? Has Arendelle introduced any credit control procedures since extending credit?
Trade payables **Analytical procedures** Trade payables have increased by 51.7% compared with the prior year. Trade payables days have increased from 31 days in 2014 to 35 days.	 **Questions for Elsa** Have credit terms since been negotiated with the new suppliers? Is Arendelle paying its creditors more slowly than in

This is inconsistent with the fact that new suppliers have not extended credit terms to Arendelle. Consequently it is expected trade payables days would fall. Trade payables may be overstated.	prior year due to disputes for example? Are there cash flow difficulties resulting from paying new suppliers on delivery? **Questions for Elsa** Request: - breakdown of amounts/balances - budget/forecasts for the period

Answers to this part of the question were of a mixed standard. Stronger candidates were able to calculate relevant ratios and perform sensible analysis which enabled them to produce a list of appropriate questions for the client's finance director. Such candidates related the information provided about the business to their analysis and identified issues where the analysis did not appear to support the circumstances of the business. These candidates scored highly. Weaker candidates failed to use the information provided about the business and performed only basic calculations, such as percentage changes, which then led to very basic questions, such as 'why has revenue gone up?'. There were no marks available for questions of this nature. A significant minority of candidates failed to appreciate that the review was in respect of a six-month period. Consequently, their calculations failed to take into account the fact that the prior year financial information was for a full year compared with the current financial information which was for six months. This led to these candidates performing some meaningless comparisons.

Total possible marks	88
Maximum full marks (½ - 1 mark per analysis point, 2 marks per relevant question)	17

Question 9

Total Marks: 20

General comments
This was the best answered long-form question with the majority of candidates demonstrating good knowledge of both threats to the firm's objectivity and audit reports. It was pleasing to note that candidates coped well with the combination of these two syllabus areas within the same scenario.

Part (a)
For each of the situations outlined above identify and explain the threats to your firm's objectivity and state the steps that your firm should take to address them.

Kristoff
Threats
Self- interest threat
The firm may be reluctant to modify its audit opinion for fear of losing the client/fees.

Intimidation threat
Hans appears to be aggressive and to be exerting pressure which may have influenced other areas of the audit work.

Steps
The firm should undertake an engagement quality control review and consider whether intimidation has affected work in other areas of the audit. More senior members of the firm should be included in the audit team and if the intimidation threat is too great the firm should consider resigning.
If the firm is removed it should use its legal right to circulate a written representation to the minority shareholders and to attend/speak at the general meeting where it would have been reappointed.

Reindeer
Self-review threat
The outcome of the work defending the claim may impact on future financial statements. The claim is 4.9% of gross assets and 122% of profit before tax and is therefore material to the financial statements. The audit team may place too much reliance on the work performed by the firm's tax experts or be reluctant to criticise the work if any deficiencies are found during the audit.

Management threat
The tax experts may be expected to make decisions on the best course of action and their views may become too closely aligned with management.

Advocacy threat
The firm may be perceived to be supporting a position held by management if it defends the company against HMRC. Ethical Standard 5 prohibits the provision of such tax services where the firm acts as an advocate before an appeals tribunal.

Self-interest threat
The firm may be reluctant to agree with HMRC's position if it indicates that there are misstatements in prior year financial statements that have been audited by the firm. This may impact adversely on the firm through adverse publicity arising from disciplinary action, fines/penalties and/or damages as a result of negligence.

Steps
Explain to management that the firm cannot act as an advocate at the tribunal but that it may be able to respond to management's specific requests for information in relation to the appeal. The firm must not make management decisions and should document the existence of informed management.

If the advocacy threat is too great it must decline the tax engagement. However, if services of tax experts are provided, these should be performed by employees not involved in the audit and an independent partner review should be performed on the audit team's conclusions on the accounting treatment of the amounts relating to the HMRC claim.

Pabbie
Self-interest threat
Ethical Standard 5 fee thresholds apply to fees earned from both an audited entity and its subsidiaries. The regular fee income from Pabbie group will represent 7% of the firm's total annual fee income which exceeds the 5% threshold for listed companies but does not exceed the 10% threshold. The firm may be reluctant to modify its opinion or challenge management for fear of losing the fees from its largest client.

Steps
The firm needs to consider the significance of the self-interest threat and whether safeguards are required. It should disclose the fee income to those charged with governance and perform an independent internal quality control review as part of the audit. The firm should regularly monitor the percentage of fees earned from Pabbie to ensure there is no risk of breaching the 10% threshold.

General (awarded in any section but once only)
Consult the firm's ethics partner.

This part of the question was well answered. Candidates were able to identify and explain the threats to the firm's objectivity in each of the scenarios and recommend appropriate steps to be taken by the firm to address the threats. However, the answers to Kristoff and Pabbie were generally of a higher standard than the answers to Reindeer.
Kristoff
The majority of candidates identified the intimidation and self-interest threats and provided plausible explanations of these threats. However, many candidates were unable to state any appropriate steps to be taken to address the intimidation threat. Statements such as 'do not be intimidated' appeared often from weaker candidates who failed to consider whether more senior members of the firm should be included in the audit team. Few candidates considered that the intimidation threat might affect areas of the audit other than related party transactions. Although the majority of candidates considered the option of resigning, few candidates identified the steps to be taken by the auditor post-resignation or post-removal.
Reindeer
The majority of candidates identified the advocacy threat in respect of the support work relating to the tribunal. The point most commonly overlooked was in relation to the self-interest threat. Candidates failed to appreciate that agreeing with HMRCs position may indicate that misstatements exist in prior year financial statements audited by the firm and that if this came to light it may adversely affect the firm.
Pabbie
The vast majority of candidates identified the self-interest threat arising out of fee dependency and appreciated that Pabbie's fee, as a percentage of the firm's fee income, fell between the 5-10% thresholds applicable to listed companies and consequently listed the appropriate safeguards. A minority of candidates quoted the fee thresholds applicable to unlisted entities. A number of candidates incorrectly identified a self-review threat in respect of Pabbie and went on to make inappropriate recommendations such as having separate teams and information barriers for the audit of the financial statements of the Pabbie Group and Queen.

Total possible marks	29½
Maximum full marks ½ mark per point	12

Part (b)
For each of the situations outlined above, state whether you would modify the audit opinion. Give reasons for your conclusions and describe the modification(s), if any, to each auditor's report.

Kristoff
The audit opinion should be modified. Related party transactions are material by nature and the failure to disclose such transactions results in a material misstatement. The misstatement is not pervasive as it is isolated to one aspect of the financial statements therefore a qualified/except for opinion should be issued. A basis for qualified opinion paragraph should include the reasons and amounts relating to the qualification.

Reindeer
An unmodified opinion should be issued. The claim is 4.9% of total assets and 122% of profit before tax and represents a significant uncertainty. The auditor agrees with management's treatment and there is no limitation on scope. As a successful claim would turn Reindeer's profit into a loss the existence of the claim is fundamental to the users' understanding of the financial statements. Therefore, the audit report should be modified using an emphasis of matter paragraph which should draw the users' attention to the relevant disclosure note. This is included immediately after the opinion paragraph and should indicate that

the auditor's opinion is not modified in respect of this matter.

Pabbie
The audit opinion should be modified. The firm is unable to obtain sufficient appropriate audit evidence over Queen's financial statements. Queen affects a large number of areas of Pabbie's group financial statements and therefore appears to be pervasive to the group financial statements. A disclaimer of opinion should be issued stating that the firm does not express an audit opinion. A basis for disclaimer of opinion paragraph should include the reasons for the disclaimer of opinion. The firm should also report by exception under the Companies Act 2006 that it has not received all information and explanations required for the audit.

This part of the question was well answered with a significant number of candidates scoring maximum marks.

Kristoff
The majority of candidates correctly identified that related party transactions are material by nature and that the audit opinion should be modified due to a material misstatement. Furthermore, most candidates appreciated that it was not pervasive and therefore required a qualified opinion. However, a significant minority wasted time by considering the type of modification if the matter was pervasive.

Reindeer
The majority of candidates correctly identified that the opinion should be unmodified. A minority of candidates confused an emphasis of matter paragraph which deals with matters correctly stated in the financial statements, with an other matters paragraph, which is used by the auditor to communicate a matter other than those that are presented or disclosed in the financial statements. A small minority also incorrectly concluded that the absence of a provision in the financial statements meant the audit opinion should be qualified, in spite of the fact that the scenario stated that the firm had concluded a provision was not necessary and that disclosures in the financial statements were adequate.

Pabbie
The majority of candidates correctly identified that the circumstances represented a limitation on scope and strong candidates appreciated that the information given in the question in the form of "highly material to a large number of items" deemed the matter to be persuasive warranting a disclaimer of opinion. However, a significant minority of those candidates who identified the issue as pervasive stated, incorrectly, that the opinion should be adverse. These candidates failed to appreciate that an adverse opinion relates to material misstatements. Some candidates incorrectly stated that the issue was not pervasive because it related to one area of a much larger group, and therefore proposed a qualified opinion rather than a disclaimer of opinion. However, the scenario clearly stated that the subsidiary is highly material to a large number of items in the group financial statements. Only a minority of candidates earned the marks available for identifying the matters to be reported by the exception under the Companies Act 2006.

Total possible marks	15
Maximum full marks	8