SOLUTION 1

(a) **Ethical and professional issues and measures to be implemented to mitigate any threats to objectivity**

Issues	*Safeguards*
• The fact that this client generates the largest fee income and additional services are provided gives rise to a fee dependency/self-interest threat.	• Regular review should be performed to ensure that regular fees are below recommended thresholds/the firm's own threshold.
• Fear of losing such a large fee may influence the auditors' judgement.	• Regular fees must not exceed 10% for a listed company (15% for non-listed)
• Acting for a client for 20 years gives rise to familiarity/trust/complacency threats.	• Periodic rotation of senior staff.
• The auditors may be over-influenced by the personality and qualities of the directors and management, and consequently may be too sympathetic towards them.	• If Prosperity Ltd is a listed company, engagement partners are required to be rotated after five years, extended to seven years for key audit partners.
• The auditors may become too trusting of written representations by management so as to be insufficiently rigorous in testing them because they are too familiar with the issue.	
• The provision of additional services also gives rise to - A self-review threat – the auditors may be reluctant to challenge adversely the outcome of a previous engagement or report on colleagues' work - A management threat (re tax planning) - Possible lowballing – a low audit fee may be set in order to retain lucrative consultancy work.	• The use of different teams with separate reporting lines. • Independent partner review of the audit. • 'Informed management" to be designated by Prosperity Ltd. • No management decision/role to be taken/perceived to be taken.

• Valuation services (which may form part of the consultancy work) are not permitted by ES5 where the valuation would both - Involve a significant degree of judgement, and - Have a material impact on the financial statements.	
• There is a conflict of interest by acting for individual directors and the company – the firm may be tempted to favour one party at the expense of the other.	• Use of different personnel to act for the individual directors.
• A former employee having joined the client in the last two years gives rise to - A familiarity threat (too much reliance on representations of former employee) - A former self-interest threat (as manager this person may have been too sympathetic) - Intimidation threat	• Assess the composition of the audit team in the light of this (may need to remove team members who have/had a close association with this ex-employee). • Quality control procedures should be in place to ensure a healthy professional skepticism at all times

(b) **Implications for audit firms and their clients if the provision of all non-audit services to audit clients is banned and mandatory periodic rotation of audit firms is introduced**

Audit Firms

Non-audit services

Although a ban on the provision of non-audit services removes the threats to objectivity, it may impair firms' ability to

- Recruit high caliber personnel who value the broad-based training provided by firms undertaking a variety of services
- Audit tax and computer systems
- Draw upon the wider intellectual capital which currently exists in firms.

This may result in a loss of income

Mandatory Rotation

Rotation stimulates the auditors' courage and independence because there is no expectation of a long-term relationship (that is they do not fear dismissal).

However, there will be increased risk due to the number of first time audits as the auditors may miss things due to their lack of experience with a particular client.

Their clients

Non-audit services

The use of a different firm may provide different perspective/skill sets.

However, it may result in

- A lower quality of service as the firm will not be in possession of whole picture
- Increased costs due to a lack of pooling of background information
- A loss of convenience/one-stop shop
- A lack of comfort from having all services provided by one trusted source.

Mandatory Rotation

Recurring first-time audits are likely to

- Be disruptive to the client (process of selection/answering questions)
- Result in increased costs (introducing new auditors is costly to the client as the team builds detailed knowledge of the client, its business and the key issues in its financial statements).

Moreover, the accumulated cumulative knowledge and experience of long term complex issues where the auditors' expertise is needed most is lost on rotation.

Rotation can discourage auditors from specialising to the required depth, thus limiting the choice of available alternatives to the client.

(c) **Ethical Issues**

- The second opinion may compromise the opinion of the existing auditor
- Client may be opinion shopping which may indicate lack of management integrity
- Giving a second opinion may be a threat to professional competence and due care, if firm is not in possession of all the facts
- Self interest threat – audit firm may be tempted to give the opinion the client desires in order to obtain future work

How to deal with ethical issues

- Obtain client's permission to contact the existing auditor
- Notify auditor of the work to be undertaken, so that the firm is in full possession of all the facts

If client refuses permission, must normally decline to act

SOLUTION 2

(a) Prior to accepting appointment as auditor, the audit firm should consider whether there are any circumstances which may impair objectivity such as:

- Relationships which may give rise to the familiarity threat
- The size of the regular fee income which may give rise to the self interest threat
- Potential conflicts of interest (eg competing clients) to ensure the firm acts in the best interest of clients

The audit firm should also consider the risk of misstatements in the financial statements by assessing the integrity of the prospective client.

Prior to accepting appointment as auditor, the audit firm should perform the following procedures:

- Check the adequacy of its resources to enable work to be completed on time to a high standard
- Check whether it has staff with the necessary expertise to provide the services required
- Check whether it has the staff that have the necessary independence to perform the audit
- Complete a risk assessment to assess the risk of giving inappropriate opinion
- Undertake client identification procedures so as to comply with money laundering requirements
- Seek clearance from outgoing auditors to ensure that there are no matters of concern that may impact on the decision to accept appointment.

(b) (i) **Reasons**

The prevention and detection of errors and fraud are primarily the responsibility of management and the auditor is not responsible for preventing or detecting fraud. The purpose of audit procedures is not to discover errors and fraud but to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Auditors must hover plan their work to have a reasonable expectation of discovering error and fraud and to detect any material misstatement in the financial statements. The loss through fraud in this scenario is 1.75% of the profit before tax and therefore is not material to the financial statements. An audit involves sample testing and so not all transactions are tested. Fraud often involves attempts to conceal evidence or requires collusion therefore making it hard for auditors to detect.

(ii) **Effect on the financial statements, audit work and audit report for the year ending 28 February 2012.**

The financial impact of the fraud will be reflected in the current year's financial statements. Last year's financial statements do not need adjustment (unless the fraud was found to be considerably more extensive meaning that the balances at 28 February 2011 were materially misstated).

The potential effect of control deficiencies should be reviewed each year. At GHC35,000 it is not considered material enough to warrant a modification in either last year or this year's financial statements. A modified opinion is possible in the current year if there is a significant breakdown in controls and evidence cannot be obtained by substantive procedures or if the fraud has continued from last year into the current year and has a material impact on the financial statements.

Because of the discovery of the fraud, the auditors will place less reliance on the internal control system and increase substantive audit procedures with possibly larger sample sizes.

(c) **Main areas of attention and explanation**

Area	*Explanation*
Test all supplier accounts to establish which ones are fictitious	To establish which suppliers were involved and the amounts involved.
Likelihood of false claims from credit customers (having heard of the fraud, customers claim to have settled their accounts	To establish any knock-on monetary loss.
How long the particular manager has worked at the branch	To establish how long the fraud is likely to have gone on.
Relationships between staff at the branch	To establish the possibility of collusion.
Other branches with poor control environments.	To establish the general likelihood of fraud at other branches.
Relationships between staff at the branch and staff at other branches	Could the fraud have been 'sold' to staff at other branches?
Whether the branch manager in question runs other branches	Could indicate other branches where fraud might be undetected.
How the fraud was discovered (by chance or management control).	If by management control, then provides some comfort that other frauds would be detected and therefore, generally fraud is less widespread.
Recoverability of the amount from the manager	To establish the actual monetary loss.
Adequacy of fidelity insurance	To establish if the loss is recoverable.
Controls over purchasing	If controls are robust, fraud is less likely to be widespread.

SOLUTION 3

(a) **Risk**

Different Elements of Audit Risk

Inherent risk: the risk of material error arising regardless of related internal controls/risks associated with the nature and characteristics of the business.

Control risk: the risk that internal controls fail to prevent or detect a material misstatement

Detection risk: the risk that the auditor's procedures, performed to reduce risk of an acceptably low level will fail to detect a material misstatement.

Why auditor needs to consider

Risk assessment

- Enables the auditor to plan his audit effectively
- Ensures audit attention is devoted to appropriate areas.

The higher the risk, the greater the amount of assurance work required. If inherent risk is high, then the auditor must take steps to reduce detection risk. Steps taken will affect the nature, timing and extent of audit procedures.

(b) **Factors contributing to high audit risk**

- New audit to your firm
- Fashion is a volatile/seasonal business, especially 'out-of-fashion' inventory
- Large chain of stores
- Company sells luxury goods
- Small number of suppliers
- Large number of cash transaction (sales/wages)
- Company deals in foreign currencies
- Dominant/majority shareholder managing director
- Managing director is 60 years old and may retire soon
- Company's customer returns policy
- Large bank borrowings
- Casual staff employed.

Why a risk

- Lack of knowledge of the business/possible misstatement of opening balances
- Risk of obsolete inventory as company may be stuck with last year's trend (difficult to determine inventory values)
- Inventory control issue with respect to number of stores/inventory lost in transit or double counted

- Luxury items first to go in event of economic downturn – this puts the company at risk
- Risk of stock-out/loss of supplier/large borrowing causing going concern problems
- Risk of incomplete recording of sales
- Risk of misappropriation of cash
- Exposure to foreign exchange risk resulting in misstated inventory/purchases
- Over-dependence on managing director – if unable to work and no succession plan in place
- Managing director's desire for profit may lead to manipulation of results
- Casual staff resulting in misstated PAYE liabilities/fines/interest/misstated payroll figure
- Customer returns could give rise to misstated balances in accounts/inventory valued at greater than it's net realisable value or may be obsolete.

(c) **Internal controls - complete recording of sales and safe custody of cash**

- Sales discount only permitted with manager authorisation
- Use of, and maintenance of electronic till and till rolls (EPOS System)
- Inventory system linked to EPOS system to identify 'missing' inventory items
- Takings to be banked intact/banked daily
- Restricted access to tills/each staff member has unique ID and logs on at start of shift
- Floats checked at beginning and end of shift
- Cask takings collected/counted by at least two staff members/CCTV monitoring of tills
- Two staff members to bank/use security firm
- Adequate on-site security for cash, eg overnight safe
- Daily reconciliation of till rolls to cash takings/bankings
- Regular bank reconciliations
- Management review of all reconciliations
- Staff references taken up
- Spot checks on cash balances

SOLUTION 4

(a) For inclusion in a report to management

(1) Room lettings – corporate customers

Discounts

Possible consequences

- As a direct result, Beach Hotels Ltd is losing income so that margins will be eroded.
- Indirectly, the granting of large discounts not backed up by company policy could lead to customer dissatisfaction with inconsistent pricing.
- A general ethos of non-adherence to management policies could lead to a loss of management control/respect.

Recommendations

- Range/limit checks should be exercised by software (with authorisation linked to identity).
- Exception reporting of discounts granted with independent review thereof.
- All exceptions should be cleared by the reservations manager.
- All branches of company policy should be investigated by a responsible official.
- Employees should be made aware of the importance of adhering to company procedures.

Credit limits

Possible consequences

- Irrecoverable receivables could arise because of sales being made without reference to credit limits.
- Working capital may be unnecessarily tied up, with adverse interest implications.

Recommendations

- Credit limits should be introduced for all customers with credit accounts.
- These limits should be regularly reviewed by head office in conjunction with hotel managers and credit ratings.
- Independent review of aged receivable analysis.
- Follow up of slow payers.

(2) **Property, plant and equipment**

Possible consequences

Property, plant and equipment may not be required on the most favourable terms.

Recommendations

- Independent review of quotes by estate/property manager who should evidence review by signature.
- Employees involved to be informed in writing in respect of breach of company policy.

(3) **Computer system**

File server

Possible consequences

- Increased risk of theft and damage
- Loss of file server will result in systems breakdown/business interruption.

Recommendation

File server should be sited in a lockable room with access restricted to authorised personnel by use of keys/PINs.

Passwords

Possible consequences

Long intervals between password changes increase likelihood of password becoming known, increasing risk of unauthorised access.

Recommendations

- Company should have a policy which requires passwords to be changed every 10/60/90 days (or after a specified number of accesses) and when staff leave.
- Change should be systems-enforced and disallow re-use of former passwords and use of common words.

(b) **Attributes for effective communication to those charged with governance**

Timing – Communication should be on a sufficiently prompt basis to enable those charged with governance to take appropriate action. For example, findings from the audit that are relevant to the financial statements should usually be communicated before those financial statements are approved.

Extent, form and frequency – must be appropriate. This will vary depending on the size and nature of the entity and the way in which those running the entity operate.

Expectations – in order that effective communication is established, the expectations of both the auditors and those charged with governance re the form, level of detail and timing of communications should be established at an early stage in the audit process. This should limit the scope for misunderstandings.

Addressee – The auditor will need to use his judgement to decide who the appropriate addressee is. In some cases it may be appropriate to communication to a committee. In others it may be necessary to go directly to the board of directors.

Form of communication - Communication may be orally or in writing. Which is appropriate depends on factors such as the size of the entity, communication lines, nature of the matters being reported, statutory requirements and specific arrangements made.

Comments made by management – should be incorporated in the communication where those comments will aid the understanding of those charged with governance.

Previous year's points – If there is no new relevant information to communicate, the auditors should make those charged with governance aware that this is the case. Alternatively, if the auditors feel that appropriate action has not been taken, they may decide to repeat the point in a current communication.

A disclaimer – should be included to remind third parties who see the communication that it was not prepared with third parties in mind.

SOLUTION 5

(a) **Reasons and benefits of completing a disclosure checklist and carrying out final analytical procedures when conducting final checks on the financial statements.**

The completion of a disclosure checklist ensures that

- The financial statements have been prepared using acceptable accounting policies
- Disclosures in the financial statements are complete and appropriate
- The financial statements are in compliance with statutory requirements and accounting standards

The checklist

- Provides an efficient method of checking
- Provides a quality control procedure
- Ensures that information in the directors' report is consistent with the financial statements

By carrying out final analytical procedures the auditor

- Ensures the financial statements reflect his knowledge of the business
- Looks for any changes in ratios that are unexpected
- Checks consistency with the results of his other audit work
- Ensures that he has all the information and explanations to allow him to form an opinion on the financial statements

(b) **Matters to consider as part of a going concern review of CCEP**

- Whether the going concern basis of preparation is appropriate

- The adequacy of disclosures regarding going concern
- Management's plans to deal with any going concern threat and the likelihood of success of those plans
- Whether management has prepared budgets and cash flow forecasts for at least the next year
- Whether forecasts indicate the ability of the company to pay debts as they fall due
- Consider the reliability of previous budgets/cash flows and the proficiency of the prepare
- Bank facilities and date of renewal
- Ability to comply with terms of covenants in loan agreements
- Forward order book/new customers
- Ability to sell inventory at full price (forced sale of inventory)
- Recovery of receivables (including timescale)
- Post reporting period which may indicate whether a tax liability will arise

(c) **Impact on audit report and explanation**

CCEP Ltd

Type of report and reason

The opinion would be unmodified because

- Full disclosure has been given of the contingent liability
- Which is a material uncertainty which may affect the going concern status

Effect on report

An additional 'emphasis of matter' paragraph should be added to the report, drawing users' attention to the note to the accounts with a specific statement that the opinion is not qualified in this respect.

Prime Volunteers Ltd

Type of report and reason

An adverse opinion should be given due to

- Disagreement over accounting treatment
- Of a material amount way in excess of profit
- Which is therefore likely to be pervasive to the finance statements

Effect on report

- In an additional paragraph before the opinion paragraph state the reason (disagreement over accrual for freehold property) and amount of GHC170,000

- In the opinion paragraph state the financial statements do not give a true and fair view

Worldwide Ltd

Type of report and reason

A modified audit opinion should be given on the grounds of limitation on scope because

- Evidence reasonably expected to be available is not available in this instance
- The issue is material as it represents 60% of inventory

Effect on report

- Give a qualified ('except for') opinion if the matter is not pervasive
- Give a disclaimer of opinion ('we are unable to express an opinion') if the matter is considered to be pervasive
- Describe the limitation on scope in the opinion section of the audit report immediately before the opinion paragraph
- Make statements that all information necessary for the audit has not been received and unable to determine whether adequate accounting records were maintained.