Advanced Audit and Assurance – International

Specimen Exam – September 2022

Get to know your exam

These graphical representations are intended to give an indication of exam requirements and associated question content.

Please note that you will not be able to complete answers within these documents and in isolation they will not sufficiently prepare you for your exam.

We encourage you to visit the ACCA Practice Platform in order to attempt up to date practice exams within the computer-based exam environment.

Instruction screens

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Welcome **${user.fullName}** to the **${examInformation.title}** exam.

You will now be presented with four instruction screens followed by an exam summary screen. The five screens will be available for 10 minutes in total.

Instructions (1 of 4)

The Workspace

- Your exam consists of a number of questions. Each question is presented in a workspace. Each workspace will include:
  - Introductory information for the question.
  - Exhibits – these contain the question scenario content broken down into sections or sources of information you will need to answer the question requirement(s).
  - Requirements – these list the requirement(s) you are expected to answer in the workspace.
  - Response Options – you may be presented with one or more word processor and/or spreadsheet response options within which to construct your answer.
- When selected, the exhibits, requirements and response options will display in windows, which can be moved and resized as required.
- You can close each window individually or close all windows at once by selecting **Close All** on the top toolbar. Note that any answers you have entered into the response options will be saved and you can re-open them and change your answers at any time.
- There is a splitter bar which can be used for you to see more or less of the left or right hand side of the screen, as required.
- When using PDF exhibits in the exam, and you want to select text to highlight, strikethrough or copy, you need to select the 'text tool' button at the top of the exhibit.
- You can highlight or strikethrough text in the introductory information, PDF exhibits or requirements by selecting **Highlight** or **Strikethrough**
- You can copy and paste between exhibits, requirements and response options by using the Ctrl-C (Copy) and Ctrl-V (Paste) shortcuts. **Note**: When pasting into a spreadsheet response from elsewhere in the workspace you must double-click the cell or select the formula bar.

Note: In a number of countries ACCA works in partnership with the national professional accountancy organisation in the delivery of examinations.

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Instruction screens (continued)

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Instructions (2 of 4)

Navigation

- The question number you are viewing is displayed in the top display bar. You can hide or restore this display by selecting
- You can navigate between screens by selecting **Next →** or **← Previous**, or by clicking on a question number from the Navigator or Item Review screens.
- You can revisit questions and change your answers at any time during the exam.

Time Remaining

- The time remaining for your exam continually updates and is displayed in the top display bar. You can hide or restore this display by clicking
- You will be presented with a message confirming when you have 15 minutes remaining.

Flag for Review

- If you wish to revisit/review a question later in the exam, click **Flag for Review**
- Click the button again to remove the flag.

Help

- Click the **Help** button provided to access:
  - A copy of these exam instructions.
  - Help and guidance on workspaces.
  - Formulae sheets/tax tables if your exam requires these. Note that the name of the Help button will indicate if formulae sheets/tax tables are available i.e. **Help**, **Help/Formulae Sheet** or **Help/Tax Tables**

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Instruction screens (continued)

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Instructions (3 of 4)

Workings/Scratch Pad

- You may use an on-screen Scratch Pad to make notes/workings by selecting **Scratch Pad**
- You can cut and copy text from the Scratch Pad and paste into your response options using the Ctrl-C (Copy), Ctrl-X (Cut) and Ctrl-V (Paste) shortcuts, or the on-screen buttons. **Note**: When pasting into a spreadsheet response you must double-click the cell or select the formula bar.
- The Scratch Pad retains all notes/workings entered for all workspaces. These are available for the duration of the exam but will not be submitted for marking.
- You will also be provided with paper for notes/workings should you prefer to use it. This will be collected at the end of the exam and must not be removed from the exam room.
- **Important:**
  - The notes/workings entered onto the Scratch Pad or your workings paper will not be marked.
  - If you want the marker to see any notes/workings for question requirements you must show them within the relevant response options.

Symbol

- You can add a selection of currency symbols to your answers by selecting **$ Symbol** on the top toolbar.

Navigator Screen

- Navigator can be accessed at any time during the exam by selecting **Navigator**
- This screen allows you to jump to any question number in the exam.
- It also allows you to see the status of each question and whether it has been viewed, attempted or flagged for review.

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Instruction screens (continued)

Instructions (4 of 4)

Exiting the Exam

- The exam will automatically end when the allocated time has been reached.
- If, however, you wish to end the exam before this time you must:
  - Navigate to the **last question** in the exam.
  - Click **Next →**
- This takes you to the Item Review screen:

  Item Review Screen

  - This screen gives you an opportunity to see the flag and completion status of all questions before you finally exit the exam.
  - You can select individual questions you wish to revisit, or quickly access groups of questions from this screen.
  - During the item review period Navigator is not available however you can navigate to questions by selecting **Next →**, **← Previous** or **⇥ Review Screen**
  - Once you have completed your item review and wish to finally end the exam click **End Exam**

Select **Next** to move to the Exam Summary screen.

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Exam summary screen

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Exam Summary

Time allowed: 3 hours 15 minutes.

This exam is divided into two sections:

Section A

- One question, worth 50 marks.
- 50 marks in total.

Section B

- Two questions, each worth 25 marks.
- 50 marks in total.

All questions are compulsory.

Select **Next** to start your exam.

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Exam questions

Section A – summary screen

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Flag for Review

Section A

This section of the exam contains **one question**.

This question is worth **50 marks** and is compulsory.

This exam section is worth **50 marks** in total.

Important:

You must:

- Indicate which requirement each of your responses relate to so that this is clear for markers.
- Show all notes/workings that you want the marker to see within your responses. Remember, any notes/workings made on the Scratch Pad or on your workings paper will not be marked.

Select **Next** to continue.

Navigator Next

Section A – question 1

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

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Symbol ▼ Highlight Strikethrough Calculator Scratch Pad Close All Flag for Review

Exhibits

- 1. Partner's email
- 2. Background information
- 3. Selected financial information
- 4. Audit team meeting notes

Requirement

- Requirement (50 marks)

Response Options

- Briefing notes
- Spreadsheet

It is 1 July 20X5. You are a manager in the audit department of Pegasus & Co, a firm of Chartered Certified Accountants. You are assigned to the audit of the Crux Group (the Group), which has a financial year ending 30 September 20X5, and is a listed entity.

Pegasus & Co was appointed auditor to the Group in January 20X5.

The Group operates in the travel industry, offering a selection of worldwide itineraries and has a fleet of 20 cruise ships. The Group operates three brands which provide different types of cruise experience.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Partner's email - an email which you have received from Norma Star, the Group audit engagement partner.
2. Background information - information and matters relevant to audit planning.
3. Selected financial information - extracts from the Group management accounts.
4. Audit team meeting notes - extracts from meeting notes taken at a recent audit team meeting.

This information should be used to answer the question **requirement** within your chosen **response option(s)**.

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Requirements

Requirement (50 marks)

Respond to the instructions in the email from the audit engagement partner.

Note: The split of the mark allocation is shown in Exhibit 1 - Partner's email.

(40 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, professional scepticism and judgement and commercial acumen in your answer.

(10 marks)

Exhibit 1

1. Partner's email

Page: 1 of 1 110%

To: **Audit manager**
From: **Norma Star, Audit engagement partner**
Subject: **Audit planning for the Crux Group**
Date: **1 July 20X5**

Hello

I have provided you with some information which you should use to help you with planning the audit of our new client, the Crux Group (the Group), for the financial year ending 30 September 20X5. Based on the analysis I have done on this industry, it is appropriate for overall materiality to be based on the profitability of the Group as this is a key focus for investors and providers of finance.

I require you to prepare briefing notes for my own use, in which you:

(a) Using the information in all exhibits, evaluate and prioritise the significant audit risks to be considered in planning the Group audit.

Note: You are NOT required to consider audit risks relating to foreign exchange transactions and balances as this will be planned separately.

(25 marks)

(b) Design the principal audit procedures to be performed on the segmental information relating to the Group's revenue.

(5 marks)

Using the information in Exhibit 4:

(c) Evaluate the matters to be considered in deciding whether Pegasus & Co should accept the engagement to provide advice on the Group's social and environmental information.

(10 marks)

Thank you

Exhibit 2

2. Background information

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Group operations

The Group operates cruises under three brands which offer passengers a variety of cruise itineraries with a wide choice of destinations. Cruises typically last for two weeks, though some last for up to six weeks.

The brands are internally generated and therefore are not recognised as intangible assets within the Group financial statements.

Information about the three brands operated by the Group is as follows:

Sunseeker Cruises – Cruises which visit beach destinations in the Caribbean, Europe and North America.

Explorer Cruises – Cruises which focus on visiting cities and landmarks around the world.

Pioneer Cruises – Cruises which take in areas of natural beauty including the Antarctic and Alaska.

Business developments in the year

Sunseeker Cruises

In this financial year, the Group will spend $75 million on upgrading and maintenance of the Sunseeker Cruise ships. These luxury ships have to adhere to a very high standard, so the Group regularly incurs high expenditure on their maintenance. As well as refurbishment, several ships have been enhanced by the installation of new entertainment facilities including cinemas and gyms. Equipment in the gyms will need to be replaced on average every three years.

Explorer Cruises

The Explorer Cruise ships, while still luxurious, are the oldest ships in the fleet, and the Group is gradually replacing these with new ships. During this financial year, two new ships with a total cost of $110 million will come into use. The ships took three years to build, and were constructed by Vela Shipbuilders Co, a company which is not owned by the Group. However, the chairman of the Group, Max Draco, is also the chairman of Vela Shipbuilders Co, and his son is the company's chief executive officer. The purchase of the ships was financed through a $110 million loan with a fixed interest rate of 6% per annum. A further three ships are currently under construction by Vela Shipbuilders Co. The Group has taken out a loan of $180 million with a 6·5% fixed interest rate to finance this capital expenditure.

Pioneer Cruises

These cruises are for more adventurous travellers and are growing in popularity. In order to visit certain destinations on these specialist cruises, the Group has to acquire operating licences from the local governments. The cost of licence acquisition is capitalised as an intangible asset.

Exhibit 3

3. Selected financial information

Edit Format

A1

Crux Group - Extracts from the Group management accounts

	Note	Projected to 30 September 20X5	Actual to 30 September 20X4
		$ million	**$ million**
Group revenue	1	764	670
Operating profit		145	101
Profit before tax		**81**	**65**
Total assets		**1,800**	**1,780**
Included in total assets:			
Intangible assets – operating licences	2	56	57
Property, plant and equipment	3	1,520	1,510

Note 1

Revenue includes passenger ticket sales, which accounts for approximately 85% of revenue. When customers book a cruise they are required to pay a refundable 20% deposit, which is initially recognised as deferred revenue. The balance of 80% is paid at least six weeks before the cruise commences and at that point it is also recognised as a deferred revenue. The full amount of the ticket price is transferred to revenue when the cruise starts irrespective of the duration of the cruise.

The remaining 15% of revenue is derived from on-board sales of food, drinks, entertainment and other items to passengers. Management monitor this revenue stream closely as it achieves a high gross profit margin, and staff are encouraged to maximise these sales to customers.

Revenue is presented on a segmental basis in the notes to the financial statements, with segments based on the three brands of the Group:

Revenue per operating segment	Projected to 30 September 20X5	Actual to 30 September 20X4
	$ million	**$ million**
Sunseeker Cruises	320	288
Explorer Cruises	180	190
Pioneer Cruises	264	192
Total	**764**	**670**

Note 2

Operating licences are required for the Pioneer Cruise ships to visit certain destinations. Licences are amortised over the specific period to which each licence relates.

Note 3

Property, plant and equipment is comprised as follows:

Property, plant and equipment	Projected to 30 September 20X5	Actual to 30 September 20X4
	$ million	**$ million**
Ships in use	2,041	2,010
Ships under construction	83	62
Other property, plant and equipment	180	173
	2,304	**2,245**
Accumulated depreciation	(784)	(735)
Carrying amount	**1,520**	**1,510**

Exhibit 4

4. Audit team meeting notes

A meeting took place yesterday in which the audit engagement partner discussed several issues:

Recent development affecting Pioneer Cruises

Last week, the governments of several countries which form a major part of the Pioneer Cruise itineraries withdrew their operating licences with immediate effect. The governments have stated that this is likely to be a temporary measure being put in place to limit the number of tourists visiting areas of natural beauty, but they will not confirm when the Group can resume operations in these countries.

Cyber-security attack

Last month, the Group suffered a cyber-security attack in which the personal information of 1,400 customers, including their credit card details, were stolen. According to a representative of the Group audit committee, the Group's internal audit team had not properly assessed the risks relating to cyber-security, which is a requirement of recently introduced data protection legislation in the jurisdiction in which the Group operates. The issue which led to the cyber-security attack has now been resolved.

Social and environmental information

The Group audit committee has enquired whether Pegasus & Co can provide an additional service, to advise management on how to measure certain social and environmental information which is to be published on the Group's website and is required by new regulations in the industry and is required to be submitted to regulatory authorities. The social and environmental information relates to matters such as water efficiency, energy consumption, charitable donations and initiatives which support diversity in the workplace. In recognition that this work is quite urgent, as the deadline for submission to the regulatory authorities falls within the next month, the Group audit committee has stated it is willing to pay an 'enhanced fee' for this service.

Section B – summary screen

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

Flag for Review

Section B

This section of the exam contains **two questions**.

Each question is worth **25 marks** and is compulsory.

This exam section is worth **50 marks** in total.

Important:

You must:

- Indicate which requirement each of your responses relate to so that this is clear for markers.
- Show all notes/workings that you want the marker to see within your responses. Remember, any notes/workings made on the Scratch Pad or on your workings paper will not be marked.

Select **Next** to continue.

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Section B – question 1

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

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Exhibits

1. Team and fees
2. Going concern

Requirement

Requirement (25 marks)

Response Options

Word Processor

It is 1 July 20X5. You are an audit manager in Welford & Co, a firm of Chartered Certified Accountants. Your role includes performing post-issuance audit quality reviews, and you have been asked to review the audit work performed on Rivers Co for the financial year ended 31 January 20X5.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Team and fees – information regarding the audit team composition, the time spent on the audit and fees charged to the client.
2. Going concern – details some matters you have identified during your review of the going concern section of the audit file.

This information should be used to answer the question **requirement** within the **response option** provided.

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Requirements

Requirement (25 marks)

Evaluate the quality of the planning and performance of the audit of Rivers Co, discussing the quality control, ethical and other professional issues raised and recommending appropriate actions to be taken.

(20 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, professional scepticism and judgement and commercial acumen in your answer.

(5 marks)

Exhibit 1

1. Team and fees

Page: 1 of 1 110%

Rivers Co is a listed company operating in the construction industry. The company complies with corporate governance regulations and has an audit committee. Rivers Co has been an audit client of Welford & Co for eight years, and Bob Newbold has been the audit engagement partner during this time.

Rivers Co's auditor's report was signed by Bob Newbold and issued last week. The report contained an unmodified opinion.

Welford & Co requires its staff to record each hour they spend working on each client in the firm's time management system. From reviewing the time records relating to the audit of Rivers Co, you are aware that Bob and the other audit team members recorded the following amount of time on the audit:

Bob Newbold – audit engagement partner	2 hours
Pat Canley – senior audit manager	6 hours
Anesa Kineton – audit manager	35 hours
Six audit assistants	130 hours
Total time spent on audit	173 hours

It is apparent from your review that almost all of the detailed review of the audit working papers was completed by Anesa Kineton, who has evidenced her review by stating 'final review' on each page of the audit file. She has recently been promoted to audit manager.

You are also aware that Bob Newbold booked a total of 40 hours to Rivers Co in respect of non-audit work performed. The only information you can find in the documentation is that the non-audit work related to a 'special investigation', and that Bob confirms that it does not create a threat to auditor objectivity.

The total fee charged for the audit was $250,000 and the fee for the 'special investigation' was $890,000.

Exhibit 2

2. Going concern

From reviewing the audit working papers, you are aware that going concern was identified as a significant audit risk at the planning stage of the audit due to low profit margins or losses being made on many of the company's construction contracts and increasing economic uncertainty. The company typically has 20 contracts ongoing at any time.

Most of the audit work on going concern was performed by Mary Loxley, an audit assistant who has just taken her last professional exam and is not yet qualified. The majority of the audit work performed on going concern focused on a review of five major contracts to determine their profitability. The management of Rivers Co identified the major contracts for review and provided Mary with forecasts indicating that the contracts would all make a small profit. Mary confirmed that the assumptions used in the forecasts agreed to assumptions used in previous years. Mary also used the firm's data analytics tool to confirm the mathematical accuracy of the forecasts and that the assumptions set out by management had been appropriately reflected in the forecasts. Following this work, Mary concluded that the contracts which she had reviewed support the going concern status of the company.

Having reviewed these major contracts, Mary completed the conclusion on going concern, stating that there is no significant uncertainty over going concern.

Mary commented that due to the effectiveness of the data analytics tool, she only had to record eight hours in relation to the work she had performed on going concern.

Section B – question 2

Advanced Audit and Assurance - International (AAA - INT) Specimen Questions – from September 2022 onwards

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Exhibits

1. Completion matters

2. Chairman's statement

Requirements

Requirements (25 marks)

Response Options

Word Processor

It is 1 July 20X5. You are the manager responsible for the audit of Myron Co, a listed company and you are in the process of completing the audit of the financial statements for the year ended 31 March 20X5. The auditor's report is due to be signed in the next few weeks. The company's principal operating activity is the publication of trade and scientific journals.

The draft financial statements recognise revenue of $108 million (20X4: $102 million), profit before tax of $9.3 million (20X4: $8.2 million) and total assets of $150 million (20X4: $149 million). Materiality has been set at $0.5 million.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Completion matters - details regarding an issue you have discovered during your review of the audit working papers.
2. Chairman's statement - management has provided you with an extract from the chairman's statement which they intend to publish in the annual report.

This information should be used to answer the question **requirements** within the **response option** provided.

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Requirements

Requirements (25 marks)

(a) Using the information contained in Exhibit 1:

(i) Comment on the completion matters to be considered in relation to the issue described and recommend the further actions necessary before the auditor's report can be signed; and

(ii) Evaluate the implications for the auditor's report if no adjustments are made to the financial statements.

(10 marks)

(b) Using the information contained in Exhibit 2:

(i) Describe the auditor's responsibilities in relation to the other information presented with audited financial statements and evaluate the matters arising from the extract from the chairman's statement; and

(5 marks)

(ii) Assuming no changes are made to the chairman's statement, evaluate the implications for the completion of the audit and the auditor's report.

(5 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, and professional scepticism and judgement in your answer.

(5 marks)

Exhibit 1

1. Completion matters

Page: 1 of 1 110%

You are in the process of reviewing the audit working papers and have identified the following potential issue:

Sale of division

Myron Co is at the advanced stage of negotiations to sell its scientific publishing division to a competitor. This division contributed revenue of $13 million and profit before tax of $1·4 million during the year to 31 March 20X5. The draft sale agreement which is due to be finalised by 1 August 20X5 shows an agreed sale price after costs of disposal of $42 million. The division is a separate cash generating unit of Myron Co. None of the assets of the division are held under a revaluation policy and depreciation is charged on a straight-line basis over the determined useful life of the assets.

The finance director of Myron Co has not made any disclosures with respect to the upcoming sale in the financial statements for the year ended 31 March 20X5 as he considers it to be part of next year's accounting transactions. However, the division has been written down from its current carrying amount of $45 million to its estimated value in use of $41 million in the financial statements for the year ended 31 March 20X5.

Exhibit 2

2. Chairman's statement

As part of your review of Myron Co, you have also been presented with an extract from the draft Chairman's statement which will be published in the annual report alongside the financial statements for the year.

Extract from Chairman's statement

The company's results for the year are extremely positive. Our year on year revenue growth is 5·9% and our profit growth is even stronger at 13·4%. All our revenue streams have performed well, especially the scientific publishing division, and we are looking forward to exciting and sustained growth levels again next year. As you can see from our auditor's report, the auditors agree that our results are strong and a sound basis for taking the company to an even greater place next year.

We have also made significant progress with our social and environmental aims of reducing our carbon footprint and encouraging re-use and recycling across our divisions. We are proud to announce that we have now moved all our printed products to recycled paper.

To help with your review of the information, you also have the following analysis of the results for the year.

	Year ended 31 March 20X5			Year ended 31 March 20X4		
	Other divisions	Scientific publishing division	Total	Other divisions	Scientific publishing division	Total
	$million	$million	$million	$million	$million	$million
Revenue	95	13	108	93	9	102
Profit before tax	7·9	1·4	9·3	7·5	0·7	8·2

A file note from the audit supervisor states that at least three of the publications Myron Co sells are not prepared on recycled paper.

Answers

1 Briefing notes

To: Audit engagement partner
From: Audit manager
Subject: Crux Group – audit planning

Introduction

These briefing notes are prepared to assist with planning the audit of the Crux Group (the Group) for the financial year ending 30 September 20X5. The notes contain an evaluation of the audit risks which should be considered in planning the Group audit, which has been structured to prioritise the risks in terms of the likelihood and magnitude of misstatement in relation to each risk. The notes also recommend the audit procedures to be performed on the Group's segmental disclosure of revenue. Finally, there is a discussion of the matters to be considered by Pegasus & Co in relation to a proposed additional engagement to advise management on the Group's social and environmental information.

(a) Evaluation of audit risk

Materiality

For the purposes of these briefing notes, the following overall materiality level will be used to assess the significance of identified risks and as requested, this has been based on the profitability of the Group.

Benchmarks

Using profit before tax or operating profit as a suggested benchmark provides the following range:

5–10% of profit before tax = range of $4·05 million – $8·1 million.
5–10% of operating profit = range of $7·25 million – $14·5 million.

These benchmarks are only a starting point for determining materiality and professional judgement will need to be applied in determining a final level to be used during the course of the audit. As this is a new client and therefore an initial audit engagement, due to the increased detection risk, materiality should be set at the lower level of the range at $4 million.

New audit client

The Group is a new client, our firm having been appointed six months ago. This gives rise to detection risk, as our firm does not have experience with the client, making it more difficult for us to detect material misstatements. However, this risk can be mitigated through rigorous audit planning, including obtaining a thorough understanding of the business of the Group.

In addition, there is a risk that opening balances and comparative information may not be correct. As the prior year figures were not audited by Pegasus & Co, if any misstatements existed in relation to the opening balances, this would have a significant impact on our ability to gather sufficient and appropriate evidence over closing balances. As such, we should plan to audit the opening balances carefully, in accordance with ISA 510 *Initial Audit Engagements – Opening Balances*, to ensure that opening balances and comparative information are both free from material misstatement.

Revenue recognition

An audit risk arises in relation to the timing of revenue recognition. Given the requirement of ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, that when assessing audit risks the auditor shall presume there are risks of fraud in relation to revenue recognition, this could be a significant area of concern. It is appropriate that customer deposits are recognised as deferred revenue when they are received. This is in line with IFRS® 15 *Revenue from Contracts with Customers* which requires that revenue is recognised when a performance obligation is satisfied, and therefore any amounts paid to the Group by customers before a cruise begins are not revenue and should be deferred. However, the policy of recognising all of the revenue from a ticket sale when the cruise starts may not be in line with the principles of IFRS 15 because the Group is performing its obligations over time, which may be as long as a six-week period for some cruises. This is a problem of cut-off, meaning that recognition of all revenue at the start of a cruise could result in overstated revenue and understated liabilities.

Upgrade and maintenance costs

The Group incurs high costs in relation to upgrade and maintenance of its fleet of ships. For the Sunseeker ships, $75 million is being spent this year. Based on initial materiality calculations, this amount is material to the financial statements and represents 92·6% of profit before tax and is therefore extremely significant. There is an audit risk that costs are not appropriately distinguished between capital expenditure and operating expenditure. Upgrade costs, including costs relating to new facilities such as gyms, should be capitalised, but maintenance costs should be expensed. There is a risk that assets are overstated, and expenses understated, if operating expenses have been inappropriately capitalised. A further risk relates to depreciation expenses, which will be overstated if capital expenditure is overstated.

Component depreciation

IAS® 16 *Property, Plant and Equipment* requires that each part of an item of property, plant and equipment (PPE) with a cost which is significant in relation to the total cost of the item must be depreciated separately. There is a risk that ships in use are not broken down into component parts for the purpose of determining the individual cost, useful life, and residual value of each part. For example, if significant, the gym equipment should be depreciated over three years and therefore requires separate consideration from other assets such as ship exterior, engine, etc. There is an audit risk that depreciation is not correctly determined on this component basis, meaning that the assets and their associated depreciation expense could be over or understated in value. This risk is also heightened due to the unusual movement in relation to the accumulated depreciation figure, which has only increased by $49 million in the year. Information is not given on the Group's depreciation policy, however, compared to the total cost of PPE at the financial year end of $2,304 million, this equates to only 2·1%, which appears quite low, suggesting understatement.

Cyber-security attack

The recent cyber-security attack could highlight that internal controls are deficient within the Group. Even though this particular problem has now been rectified, if the Group internal audit team had not properly identified or responded to these cyber-security risks, there could be other areas, including controls over financial reporting, which are deficient, leading to control risk. The situation could also indicate wider weaknesses in the Group's corporate governance arrangements, for example, if the audit committee is not appropriately discharging its responsibilities with regards to internal audit.

Tutorial note: *Based on best practice, the audit committee should review and approve the annual internal audit plan and monitor and review the effectiveness of internal audit work. The audit committee should ensure that the internal audit plan is aligned to the key risks of the business. Credit will be awarded for discussion of these issues in the context of the cyber-security attack.*

In addition, the cyber-security attack could have resulted in corrupted data or loss of data relating to the sales system, if the customer details were integrated with the accounting system. There is an audit risk that reported revenue figures are inaccurate, incomplete, or invalid. Though the issue could be confined to the sales system, it is possible that other figures could also be affected.

Finally, the cyber-security incident is likely to result in some fines or penalties being levied against the Group as it seems the risk was not properly dealt with, leaving customer information vulnerable to attack. It may be necessary for the Group to recognise a provision or disclose a contingent liability depending on the likelihood of a cash payment being made, and the materiality of any such payment, in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The related audit risk is understated liabilities and understated expenses or incomplete disclosures if any necessary liability is not recognised or disclosure not made in the notes to the financial statements.

Related party transaction

It appears that Vela Shipbuilders Co, which is building new Explorer Cruise ships for the Group, is a related party of the Group. This is because Max Draco is the chairman of both the Group and Vela Shipbuilders Co. According to IAS 24 *Related Party Disclosures*, a related party relationship exists where a person has control or joint control, significant influence, or is a member of the key management personnel of two reporting entities. The fact that Max Draco's son is the chief executive officer of Vela Shipbuilders Co also indicates a related party relationship between the Group and the company.

IAS 24 requires that where there have been transactions between related parties, there should be disclosure of the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. There is an audit risk that the necessary disclosures regarding the Group's purchases of ships from Vela Shipbuilders Co are not made in the Group financial statements.

The related party transactions are material by their nature, but they are also likely to be material by monetary value. The information provided does not specify how much has been paid in cash from the Group to Vela Shipbuilders Co during the year, but the amount could be significant given that the Group has presumably paid any final instalments on the ships which have come into use during the year, as well as initial instalments on the new ships starting construction this year.

Operating licences

The Group's operating licences of $56 million are material to the financial statements. It is appropriate that the licences are recognised as intangible assets and that they are amortised according to their specific useful life. However, an audit risk arises due to the possible impairment of some or all of these licences, which arises from the governments having withdrawn the licences in some countries where the Group operates their Pioneer Cruises. While the licence withdrawal is apparently temporary in nature, the withdrawal is an indicator of impairment and it is possible that the operating licences are worth nothing, so should be written off in full. Management should conduct an impairment review in accordance with IAS 36 *Impairment of Assets* to determine the recoverable amount of the licences and if this is less than the carrying amount, recognise an impairment loss accordingly. If this does not take place, the intangible assets are likely to be overstated, and profit overstated.

Tutorial note: *Credit will also be awarded for discussion regarding de-recognition of the operating licences as well as their reduction in value, and for considering whether the Pioneer Cruise ships also need to be reviewed for impairment.*

Borrowing costs

The ships being constructed fall under the definition of a qualifying asset under IAS 23 *Borrowing Costs*, which defines a qualifying asset as an asset which takes a substantial period of time to get ready for its intended use or sale. This includes property, plant and equipment during the relevant construction period, which for the ships is three years. IAS 23 requires that borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised. The audit risk is that interest costs have not been appropriately capitalised and instead have been treated as finance costs, which would understate assets and understate profit for the year.

The amounts involved appear to be material. The information does not state precisely when the loans were taken out and when construction of the ships commenced or when they come into use by the Group on completion, so it is not possible to determine exactly when capitalisation of finance costs should commence and cease. However, looking at the loan of $180 million taken out for the ships currently under construction, the interest for the year would be $11·7 million, which is a material amount.

Revenue and profit trends

Group revenue is projected to increase by 14% in the year. The segmental information shows that this overall increase can be analysed as:

– Revenue from Sunseeker Cruises increasing by 11·1%.
– Revenue from Explorer Cruises decreasing by 5·3%.
– Revenue from Pioneer Cruises increasing by 37·5%.

The different trends for each segment could be explained by business reasons, however, there is a potential risk that revenue has been misclassified between the segments, e.g. revenue from Explorer Cruises could be understated while revenue from Pioneer Cruises is overstated.

In particular, the projected revenue for Pioneer Cruises could be impacted by the recent withdrawal of operating licences which affects the operation of these cruise itineraries. Management may not have factored this into their projections, and there is a risk that this segment's revenue is overstated.

Operating profit is projected to increase by 43·6% in the year, and profit before tax is projected to increase by 24·6% in the year. While the increased margins could be due to economies of scale, the increase in profit appears out of line with the increase in revenue and could indicate that expenses are understated or misclassified.

On-board sales

On-board sales of food, drink, and entertainment account for approximately 15% of revenue. There is a risk that this is a reportable operating segment, but the projected operating segment information does not disclose this revenue separately. According to IFRS 8 *Operating Segments*, an operating segment is a component of an entity which engages in business activities from which it may earn revenues and incur expenses, whose operating results are reviewed regularly by the entity's chief operating decision maker and for which discrete financial information is available, which seems to be the case in this instance.

A reportable segment exists where the segment's revenue is 10% or more of the combined revenue of all operating segments. There is a risk of incomplete disclosure of revenue by reportable segments if on-board sales meet the definition of an operating segment and it is not disclosed in the notes to the financial statements as such.

(b) Principal audit procedures to be performed on the segmental information

– Review the financial reports sent to the highest level of management to confirm the basis of segmental information which is reported internally and confirm that this basis is used in the notes to the published financial statements.

– Review the Group's organisational structure to confirm the identity of the chief operating decision maker.

– Discuss with management the means by which segmental information is reviewed by the chief operating decision maker, e.g. through monthly financial reports and discussion at board meetings.

– Review board minutes to confirm that the segments as disclosed are used as the basis for monitoring financial performance.

– Discuss with management whether the on-board sales should be reported separately given that it appears to constitute a reportable segment contributing more than 10% of total Group sales and is actively monitored.

– Obtain a breakdown of the revenue, e.g. by cruise line or individual ship, to confirm that revenue has been appropriately allocated between the reportable segments.

– Perform analytical procedures to determine trends for each segment and discuss unusual patterns with management.

– Recalculate the revenue totals from the breakdown provided to confirm that they are reportable segments, i.e. that they each contribute more than 10% of revenue.

(c) Additional service to advise management on measurement of social and environmental information

The Group's request for Pegasus & Co to advise management on its social and environmental reporting creates an ethical threat to objectivity. Providing additional, non-audit services to an audit client can create several threats to the objectivity and independence of the auditor.

The IESBA *International Code of Ethics for Professional Accountants* (the *Code*) does not specifically discuss this type of additional engagement, so the audit firm should apply the general framework to consider whether it is appropriate to provide the service. This means that the firm should evaluate the significance of the threats to independence and consider whether safeguards can reduce the threats to an acceptable level.

Perhaps the most significant ethical issue is that providing advice to management, which would involve determining how social and environmental information is measured and published, could be perceived as taking on management responsibilities, which is prohibited by the *Code*. To avoid taking on management responsibilities, the audit firm must be satisfied that client management makes all judgements and decisions which are the proper responsibility of management. Measures to achieve this could include:

– Ensuring that a member of the Group's management with appropriate skill, knowledge and experience is designated to be responsible for the client's decisions and to oversee the service,
– Management oversees the work performed and evaluates the results, and
– Management accepts responsibility for any actions arising as a result of the service provided.

A self-review threat could also arise if Pegasus & Co provides the service to the Group. Some of the social and environmental information could be related to transactions or balances within the financial statements which will be subject to audit, for example, the value of charitable donations. The self-review threat means that less scrutiny may be used in performing procedures due to over-reliance on work previously performed by the audit firm. This potentially impacts on the level of professional scepticism applied during the audit and the quality of work carried out.

There could be a further self-review threat depending on whether the social and environmental information will form part of the Group's annual report. If this is the case, the audit team is required by ISA 720 *The Auditor's Responsibilities Relating to Other Information* to read the other information included in the annual report and to consider whether there is a material inconsistency between the other information and the financial statements and to also consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit. This requirement creates a self-review threat if members of the audit team have been involved with the additional service to provide advice on the measurement of the social and environmental information.

A self-interest threat can also be created by the provision of non-audit services where the fee is significant enough to create actual or perceived economic dependence on the audit client. The Group is willing to pay an 'enhanced fee' for this service due to its urgent nature, and while this does not necessarily create fee-dependency, there could be a perception that the audit firm has secured a lucrative fee income in addition to the income from providing the audit.

The Group needs the work to be carried out to a tight deadline, which could impact on the scope and extent of the procedures which the firm can carry out, also impacting on the quality of work and the risk of the engagement. This pressure to perform work quickly within the next month could be viewed as intimidation by the client.

All of these threats are heightened by the fact that the Group is a listed entity, therefore a public interest entity in the terminology of the *Code*.

Other safeguards could possibly be used to reduce the threats identified to an acceptable level. These may include having a team separate from the audit team, including a separate partner, perform the work on the social and environmental information; and conducting a review of both the audit and additional service by the engagement quality control reviewer.

The audit firm should discuss the request with the Group audit committee, who ultimately will need to approve that the firm can perform the service. The corporate governance code under which the Group operates may restrict or prohibit the provision of non-audit services by the audit firm in the case of listed entities, so the audit committee should consider if any such restrictions exist.

Discussions should also be held regarding the new regulatory requirements. The audit firm should be clear on the reliance which will be placed on the report by the regulatory authorities and matters such as whether an assurance report is required, and if so, who will be performing this work. In addition, there may be specific requirements which impact on the scope of the work, for example, whether any specific key performance indicators are required to be published.

Finally, even if the ethical issues can be overcome, the firm should consider whether it has the skills and competencies to provide the advice to management. This can be quite specialised work and it is not necessarily the case that the firm will have staff with the appropriate skills available to carry out the work, especially if the work is to be carried out to a tight deadline.

In conclusion, in terms of providing advice to management on social and environmental information, this will be difficult to do without breaching ethical principles and should be further discussed with the Group audit committee.

Conclusion

These briefing notes highlight a number of significant audit risks, including those relating to property, plant and equipment, revenue recognition and disclosure requirements. A number of audit procedures have been recommended in relation to the audit of segmental information provided in relation to revenue. As mentioned, the provision of the additional service should be further discussed with the Group audit committee.

2 Rivers Co

A review of the information relating to the audit of Rivers Co indicates many problems with how the audit has been planned and performed which implies that the audit has not been conducted in accordance with ISA 220 *Quality Control for an Audit of Financial Statements*, ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Services Engagements*, and the IESBA *International Code of Ethics for Professional Accountants* (the *Code*).

Audit partner rotation

Bob Newbold has been acting as audit engagement partner for eight years. As Rivers Co is a listed company, this goes against the requirements of the *Code* which requires that an individual shall not act as the engagement partner for more than seven years. The problem is that long association of the engagement partner with the client leads to a self-interest threat to auditor objectivity, whereby the audit firm's judgement is affected by concern over losing the long-standing client. There may also be a familiarity threat due to close relationships between the audit engagement partner and management of Rivers Co, meaning that the partner ceases to exercise sufficient professional scepticism, impacting on audit quality. This is especially the case, given that Bob Newbold is performing additional non-audit services for the client, which will be discussed further below. Bob Newbold should be replaced as soon as possible by another audit engagement partner.

The fact that Bob has been allowed to continue as audit engagement partner for longer than the period allowed by the *Code* indicates that Welford & Co does not have appropriate policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, as required by ISQC 1. The firm should review whether its monitoring of the length of time that audit engagement partners act for clients is operating effectively and make any necessary improvements to internal controls to ensure compliance with ISQC 1.

Tutorial note: *The* Code *does allow a key audit partner to serve an additional year in situations where continuity is especially important to audit quality, as long as the threat to independence can be eliminated or reduced to an acceptable level. Credit will be awarded for appropriate discussion on this issue.*

Supervision and review

Bob Newbold has booked only two hours for audit work performed on Rivers Co. This is not sufficient time for the audit partner to perform their duties adequately. The audit partner is required to take overall responsibility for the supervision and performance of the audit. He should have spent an appropriate amount of time performing a review of the audit working papers in order to be satisfied that sufficient appropriate audit evidence had been obtained; this is a requirement of ISA 220. Instead, it appears that most of the final review was performed by a newly promoted audit manager who would not have the necessary experience to perform this review. It is possible that there is insufficient evidence to support the audit opinion which has been issued, or that inappropriate evidence has been obtained.

There is also a related issue regarding the delegation of work. Possibly some of the detailed review of the working papers could have been delegated to someone other than the audit partner, in which case the senior audit manager, Pat Canley, would be the appropriate person to perform this work. However, Pat only recorded six hours of work on the audit. Thus, confirming that too much of the review has been delegated to the junior audit manager, especially given that going concern was identified as a significant audit risk, meaning that the partner has even more reason for involvement in the final review of audit work.

There is also an issue around the overall amount of time which has been recorded for the audit work performed on this client. A total of 173 hours does not seem sufficient for the audit of a listed company, suggesting that audit quality could have been impacted by inadequate time spent in planning and performing the audit work.

Special investigation

Bob Newbold's focus appears to have been on the special investigation performed for Rivers Co, to which he booked 40 hours of time.

There is insufficient documentation as to the nature of this non-audit work, and it could relate to the provision of a non-audit service which is not allowed for a public interest entity. Rivers Co is a listed company, and the *Code* prohibits the audit firm from providing certain non-audit services, for example, certain internal audit services, valuation services and tax services. The lack of documentation means that Welford & Co could have provided a prohibited service and therefore be in breach of the *Code*.

The fact that $890,000 was charged for this special investigation indicates that it was a substantial engagement and just the matter of inadequate documentation is a cause for concern. There is also a possibility that in actual fact no work has been performed, and the firm has accepted this money from the client but provided no service. This would be a very serious issue, could be perceived as a bribe, and it should be investigated with urgency.

However, there are also possible threats to auditor objectivity including a self-interest threat due to the monetary value of the service provided, meaning that Bob Newbold's attention seems to have been focused on the special investigation rather than the audit, leading to the problems of inappropriate delegation of this work as discussed above. His additional involvement with Rivers Co by providing this work compounds the familiarity threat also discussed previously. Depending on the nature of the work performed for the client, there may also be other threats to objectivity including self-review and advocacy.

A self-interest threat is created as the value of the services provided is substantial compared to the audit fee. The fact the non-audit fees are so high would create a proportionately bigger intimidation threat because they would form a larger part of the firm's income and the audit firm may not be objective for fear of losing the client.

Welford & Co should ensure that its policies and documentation on engagement acceptance, especially in relation to additional services for existing audit clients, are reviewed and made more robust if necessary.

Engagement quality control review

As this is a listed audit client, an engagement quality control review should have been performed. It is not clear whether this took place or not, but no time has been recorded for this review. If a pre-issuance review was carried out, then it should have picked up these problems prior to the audit opinion being issued.

Audit of going concern

The audit work on going concern has been inappropriately delegated to an audit assistant who would not have the necessary skill or experience. This is especially concerning given that going concern was identified as a significant audit risk, and that the work involves using judgement to evaluate information relating to contract performance. The work should have been performed by a more senior member of the team, probably one of the audit managers, who is more able to exercise professional scepticism and to challenge management where necessary on the assumptions underpinning the forecasts. Mary certainly should not have documented the conclusion on going concern, the conclusion should be reached by a more experienced auditor having reviewed all of the evidence obtained.

It is concerning that the audit work appears to have been based on a review of contracts which were selected by management. First, only five contracts were reviewed but the company is typically working on 20 contracts at one time. So, it is likely that the coverage of the audit work was insufficient, and more contracts should have been subject to review. Given the risk attached to going concern, perhaps all of the contracts currently being carried out should have been reviewed, or the sample selected based on the auditor's evaluation of the risk associated with each contract and their materiality.

Second, management may have selected the better performing contracts for Mary to review. This would create a false impression of the performance of the company as a whole, leading to an inappropriate conclusion on going concern being reached. Mary, or one of the more senior members of the audit team, should have challenged management on the selection of these contracts.

Finally, the work performed by Mary on this small selection of contracts appears insufficient and inappropriate. The audit assistant also appears to have placed too much reliance on the firm's data analytics tool and demonstrates a lack of understanding of how the data analytics tools should be used to obtain audit evidence. By simply using the data analytics tool to agree the mathematical accuracy of the forecasts and the assumptions, insufficient testing has been carried out in relation to these key documents. Assumptions should not just be agreed as consistent with the previous year, especially in a situation of increasing economic uncertainty as applies in this case. Assumptions should be challenged, and other work performed as required by ISA 570 *Going Concern*. The data analytics tool could have been used more appropriately, e.g. to perform sensitivity analysis which would have allowed for identification of areas of concern or requiring further investigation.

The lack of further audit procedures means that the audit evidence is not likely to be sufficiently robust in this significant area. This is further demonstrated by the fact that Mary only spent eight hours on this critical area of the audit work and has commented that this was due to the evidence generated by the data analytics tool. This again demonstrates the over-reliance placed on this tool, raising a concern that staff require further training in the use of and interpretation of evidence generated in this way.

Audit committee

It is concerning that the audit committee of Rivers Co does not appear to have raised concerns about the issues discussed, especially the provision of the non-audit service and the length of time which Bob Newbold has served as audit engagement partner. One of the roles of the audit committee is to oversee ethical issues relating to the external auditor and to be involved with the engagement of external providers. Welford & Co should ensure that these matters are discussed with the audit committee so that further ethical issues do not arise in the future.

Conclusion

From the discussion above, it can be seen that there are many problems with the audit of Rivers Co. Bob Newbold appears to have ignored his responsibilities as audit engagement partner, and the audit firm needs to discuss this with him, consider further training or possibly taking disciplinary action against him. Welford & Co needs to implement procedures to ensure all work is carried out at the appropriate level of personnel with the appropriate experience and that training is given to staff to ensure they understand the client does not pick or specify the audit work to be carried out in any area, it is to be selected by the audit team in accordance with the audit firm's methodology and sampling tools. Training may also need to be provided in the appropriate use of audit data analytics tools as a basis for obtaining audit evidence.

3 (a) Matters, further actions and auditor's report implications

Matters

The company is at an advanced stage of negotiations with a competitor to sell its scientific publishing division. Currently, the finance director has not included any reference to the sale in the financial statements for the year ended 31 March 20X5 and there is no appropriate justification for this. The finance director's assessment that the sale only affects next year's financial statements is incorrect.

Materiality

The revenue of the scientific publishing division of \$13 million and the profit of the division of \$1·4 million are both material. The assets of the division are also significant, as they represent 27·3% of the company's total assets, based on their value in use which is recognised in the financial statements.

Discontinued operation and classification of assets held for sale

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* defines a discontinued operation as a component of an entity which either has been disposed of or is classified as held for sale, and:

– represents either a separate major line of business or a geographical area of operations;
– is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operation.

IFRS 5 requires specific disclosures in relation to assets held for sale and discontinued operations, including that the assets are recognised as current assets and the results of the discontinued operation are presented separately in the statement of profit or loss and the statement of cash flows.

According to IFRS 5, a disposal group of assets should be classified as held for sale where management plans to sell the assets, and the sale is highly probable. Conditions which indicate that a sale is highly probable are:

– Management is committed to a plan to sell;
– The asset is available for immediate sale;
– An active programme to locate a buyer is initiated;
– The sale is highly probable, within 12 months of classification as held for sale (subject to limited exceptions);
– The asset is being actively marketed for sale at a sales price reasonable in relation to its fair value;
– Actions required to complete the plan indicate that it is unlikely that the plan will be significantly changed or withdrawn.

In respect of the scientific publishing division, management has decided to sell the division and a buyer has been found. The advanced stage of negotiations would suggest the sale is highly probable.

As a result, important disclosures are currently missing from the financial statements which could mislead users with respect to the future revenue, profits, assets and cash flows of the company. Failing to provide information about the sale of the division could be seen as a significant omission from the financial statements, especially given the materiality of the assets of the division to the company's assets as a whole.

There is therefore a material misstatement as the scientific publishing division has not been classified as held for sale and its profit presented as a discontinued operation and the necessary disclosures have not been made in the financial statements.

Held for sale – valuation

IFRS 5 provides further guidance regarding the valuation of the assets held for sale. Prior to classification as held for sale, the disposal group should be reviewed for impairment in accordance with IAS 36 *Impairment of Assets*. This impairment review would require the asset to be held at the lower of carrying amount and recoverable amount where the recoverable amount is the higher of value in use or fair value less costs of disposal.

In this case, the recoverable amount would be $42 million representing the fair value less costs of disposal. Management has valued the disposal group based on its value in use at $41 million which means that assets and profit are currently understated by $1 million. This represents 10·7% of profit before tax and is material to the profit for the year.

After classification as held for sale, non-current assets or disposal groups are measured at the lower of carrying amount and fair value less costs of disposal which would continue to be $42 million. Depreciation ceases to be charged when an asset is classified as held for sale.

Further actions

– The auditor should request that management adjusts the financial statements to recognise the discontinued operation and to separately disclose the assets held for sale in accordance with IFRS 5.

– In addition, the client should be requested to amend the carrying amount of the assets to the recoverable amount of $42 million in line with IFRS 5 requirements.

– If management refuses to adjust the financial statements, the auditor should communicate the misstatements to those charged with governance. They should repeat the request and inform them of the modifications which would be made to the auditor's report if the adjustments are not made.

– If management still refuses to amend the financial statements, the auditor should request a written representation from management confirming their intent to proceed without amending the financial statements and that they are aware of the potential repercussions.

Auditor's report implications

If the adjustments are not made, then there is a material misstatement in the financial statements. The matter has resulted in an understatement of assets and profits by $1 million which in isolation is unlikely to be pervasive as limited components of the financial statements are affected. This would result in a qualified audit opinion in which the auditor's report would state that 'except for' the material misstatement in relation to the valuation of the assets held for sale, the financial statements are fairly stated.

However, there are also several important disclosures omitted which would be required for users to understand both the current financial position of the company and its ability to generate future revenue and profits. As such, it would be a matter of judgement as to whether the lack of disclosures in conjunction with the material misstatement mentioned above have a pervasive impact on the financial statements. Depending on the auditor's judgement on this issue, this may give rise to an adverse opinion if the auditor considered the impact of these issues to result in the financial statements being wholly misleading.

Depending on the opinion provided, a basis for qualified or adverse opinion paragraph would be added underneath the opinion paragraph to describe and quantify the effects of the misstatements.

(b) (i) Auditor's responsibility for other information presented with the financial statements

ISA 720 *The Auditor's Responsibilities Relating to Other Information* requires the auditor to read other information, defined as financial or non-financial information (other than financial statements and the auditor's report thereon), included in an entity's annual report.

The purpose of reading the other information is to consider whether there is a material inconsistency between the other information and the financial statements or between the other information and the auditor's knowledge obtained during the course of the audit. If the auditor identifies that a material inconsistency appears to exist, or becomes aware that the other information appears to be materially misstated, the auditor should discuss the matter with management and, if necessary, perform other procedures to conclude whether:

(i) A material misstatement of the other information exists;
(ii) A material misstatement of the financial statements exists; or
(iii) The auditor's understanding of the entity and its environment needs to be updated.

The auditor does not audit the other information and does not express an opinion covering the other information.

Matters identified from the chairman's statement

In this case, the chairman's statement refers to strong growth in the year, in particular the scientific publishing division and suggests that the growth will continue. In the current year, the scientific publishing division represented 12% of revenue and 15% of profit before tax and is a material component of the company. As the scientific publishing division will be disposed of early in the next financial period, it will not continue to form part of the basis for revenue or growth, and the chairman's statement could be considered misleading. Further, as a result of the disposal, on a like for like basis it is more likely that the financial statements for the year ended 31 March 20X6 will include a reduction in revenue rather than growth.

In addition, the remainder of the business has experienced a lower level of growth in revenue and profits in the period than the scientific publishing division. Revenue growth of continuing business is 2% compared to 44% in the scientific publishing division. Profit growth of the ongoing business is 5% compared to 100% for the scientific publishing division.

ISA 720 states that a misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading, including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information. In the case of the chairman's statement regarding growth of the company, it could be argued that the way the information is presented obscures the understanding of the growth and profitability of the ongoing business. As mentioned above, this would be considered very misleading.

The chairman has also made an inappropriate reference to the view of the auditor, implying that the auditor's report validates this assertion. The statement also appears to inappropriately pre-empt that the auditor's report will provide an unmodified opinion which, based on the assessment above, may not be the case given the material misstatement and lack of disclosures. This is inappropriate and all reference to the auditor's report should be removed.

In addition, there is also an issue arising with respect to the use of recycled paper. The chairman's statement in this case is inconsistent with the knowledge obtained during the audit. Whether the auditor considers this to be material would be a matter of judgement, depending on how many publications there are in total and the proportion using non-recycled paper and whether the issue may be material by nature rather than by size. This could be the case if it is perceived that there is a deliberate misrepresentation of facts which may be misleading to the users of the financial statements.

(ii) Implications for completion of the audit

The auditor should discuss with management and the chairman the information in the statement which appears to inaccurate or inconsistent. In particular, this should focus on a discussion of the misleading growth analysis given that the scientific publishing division will not be contributing to company performance once it is sold.

In the case of the incorrect disclosure relating to the use of recycled paper, the auditor should seek further information to support the file note regarding publications not using recycled paper. The names of those publications should be obtained, and a discussion held with the production manager to confirm the auditor's understanding.

Following these investigations and discussions, the auditor should then request that any information which is inaccurate, inappropriate, or inconsistent is removed or amended in the chairman's report.

If management refuses to make the changes, then the auditor's request should be escalated to those charged with governance. The auditor should also consider the effect of this situation on their assessment of management integrity and whether it affects the reliance which can be placed on written representations from management. If the issue remains unresolved, then the auditor should take appropriate action, including:

– Considering the implications for the auditor's report and communicating with those charged with governance about how the auditor plans to address the issues in the auditor's report; or

– Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.

Implications for the auditor's report

If the other information remains uncorrected, the auditor would use the other information section of the auditor's report to draw the users' attention to the misstatements in the chairman's statement. This paragraph would include:

– A statement that management is responsible for the other information;

– A statement that the auditor's opinion does not cover the other information and, accordingly, that the auditor does not express (or will not express) an audit opinion or any form of assurance conclusion thereon;

- A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by this ISA; and
- A statement which describes the uncorrected material misstatement of the other information.

As the inconsistency is in the chairman's statement rather than the audited financial statement, the audit opinion is not modified as a result.

Marks

1 (a) Audit risk evaluation

Up to 3 marks for each audit risk (unless indicated otherwise). Marks may be awarded for other, relevant audit risks not included in the marking guide.

In addition, ½ mark for relevant trends or calculations which form part of the evaluation of audit risk (max 3 marks).

Appropriate materiality calculations and justified materiality level should be awarded to a maximum of 2 marks.

– New audit client (2 marks)
– Revenue recognition
– Upgrade and maintenance costs
– Component depreciation
– Cyber-security breach (control risk, corporate governance weakness, data corruption, financial statement implications – max 5 marks)
– Related party transaction disclosure
– Operating licences
– Borrowing costs
– Revenue and profit trends
– On-board sales

Maximum marks 25

(b) Audit procedures on segmental reporting

Up to 1 mark for each relevant audit procedure. Examples are provided below, and marks will be awarded for other relevant points.

– Review the financial reports sent to the highest level of management to confirm the basis of segmental information which is reported internally
– Review the Group's organisational structure to confirm identify of the chief operating decision maker
– Discuss with management the means by which segmental information is reviewed by the chief operating decision maker
– Review board minutes to see that segmental information is subject to regular review
– Discuss with management whether the on-board sales should be reported separately
– Obtain a breakdown of the revenue to confirm that revenue has been appropriately allocated between the reportable segments
– Perform analytical procedures to determine trends for each segment and discuss unusual patterns with management
– Recalculate the revenue totals from the breakdown provided to confirm that they are reportable segments

Maximum marks 5

(c) Additional service to provide advice on social and environmental information

Up to 1 mark for each relevant answer point explained:

– Assuming management responsibility identified and fully explained
– Assuming management responsibility is prohibited
– Self-review threat identified and fully explained
– Self-review threat increased if the social/environmental information included in annual report
– Self-interest threat identified and fully explained
– Pressure to perform work quickly
– Appropriate safeguards recommended (1 mark each to max 3 marks)
– Group audit committee to approve non-audit work
– It may be prohibited in the jurisdiction of the Group
– Scope of the work, and specific requirements from the regulators
– Level of assurance which may be required and who is going to provide this
– Skill and competence to perform work

Maximum marks 10

Marks

Professional marks

Communication

– Briefing notes format and structure – use of headings/sub-headings and an introduction
– Style, language and clarity – appropriate layout and tone of briefing notes, presentation of materiality and relevant calculations, appropriate use of the CBE tools, easy to follow and understand
– Effectiveness and clarity of communication – answer is relevant and tailored to the scenario
– Adherence to the specific requests made by the audit engagement partner

Analysis and evaluation

– Appropriate use of the information to determine suitable calculations
– Appropriate use of the information to support discussions and draw appropriate conclusions
– Assimilation of all relevant information to ensure that the risk evaluation performed considers the impact of contradictory or unusual movements
– Effective prioritisation of the results of the risk evaluation to demonstrate the likelihood and magnitude of risks and to facilitate the allocation of appropriate responses
– Balanced discussion of the information to objectively make a recommendation or decision

Professional scepticism and judgement

– Effective challenge of information supplied, and techniques carried out to support key facts and/or decisions
– Determination and justification of a suitable materiality level, appropriately and consistently applied
– Appropriate application of professional judgement to draw conclusions and make informed decisions about the courses of action which are appropriate in the context of the audit engagement

Commercial acumen

– Audit procedures are practical and plausible in the context of the Crux Group
– Use of effective examples and/or calculations from the scenario to illustrate points or recommendations
– Recognition of the appropriate commercial considerations of the audit firm

Maximum marks	10
Maximum	**50**

Marks

2 Rivers Co

Generally, up to 1 mark for each well explained point:

- Long association of audit partner breaches the IESBA *Code* seven-year maximum period allowed
- Self-interest threat identified and explained
- Familiarity threat identified and explained
- Recommend replace Bob with a new audit partner as soon as possible
- Firm's monitoring of the length of time partners act for clients seems deficient
- Audit partner should have spent more time on the audit and in particular on the final review
- The total amount of time spent on the audit appears low for the audit of a listed company – implications for audit quality
- Inappropriate delegation of tasks, the junior audit manager lacks experience
- There may not be sufficient, appropriate evidence to support the audit opinion
- Welford & Co may have provided a prohibited non-audit service to Rivers Co, a listed company
- The size of fee for the non-audit service creates a self-interest threat
- Bob's involvement with the non-audit service creates familiarity threats to audit objectivity
- Lack of documentation could indicate that no work has been performed – possibly a bribe from the client
- Welford & Co to review policies, procedures and documentation on engagement acceptance
- Apparent lack of engagement quality control review being carried out before the audit opinion was issued
- Inappropriate delegation of work on going concern to an inexperienced audit assistant
- Sample of contracts reviewed is too small – insufficient evidence obtained
- Management selection of contracts is likely to be subject to bias – the auditor should select which contracts should be reviewed
- Over-reliance on and misunderstanding of use of data analytics tools
- Insufficient work on going concern – assumptions should be challenged not agreed to prior year
- Data analytics could have been used to carry out specific going concern testing such as sensitivity analysis
- Lack of time spent on going concern testing due to over-reliance on data analytics
- Additional training required
- Client audit committee – should have identified the ethical and audit quality issues
- Overall conclusion relating to the quality of the engagement

Maximum marks 20

Professional marks

Analysis and evaluation

- Appropriate assessment of the ethical and professional issues raised, using examples where relevant to support overall comments
- Effective appraisal of the information to make suitable recommendations for appropriate courses of action

Professional scepticism and judgement

- Effective challenge and critical assessment of the evidence supplied with appropriate conclusions
- Demonstration of the ability to probe into the reasons for quality issues including the identification of missing information or additional information which would be required
- Appropriate application of professional judgement to draw conclusions and make informed comments regarding the quality of the work carried out

Commercial acumen

- Inclusion of appropriate recommendations regarding the additional quality control procedures required by the firm
- Appropriate recognition of the wider implications on the engagement, the audit firm and the company

Maximum marks 5

Maximum **25**

Marks

3 (a) Matters, further actions and auditor's report implications

Up to 1 mark for each point unless otherwise stated.

Matters
- Assessment of finance director's approach
- Assessment of materiality
- Disclosure rules re held for sale/discontinued operations
- Application to the scenario to conclude asset is held for sale (HFS)
- Material misstatement of classification and disclosure
- Accounting rule on valuation of held for sale assets
- Rule that depreciation should cease when asset meets criteria of HFS
- Application to the scenario to derive correct value
- Materiality of the error in valuation

Further actions
- Request adjustment from management to recognise the discontinued operation and to separately disclose the assets held for sale
- Request management to amend the carrying amount of the assets to the recoverable amount of $42 million
- If management refuses escalate to those charged with governance (TCWG)
- If still refuses, obtain written representation confirming intent to proceed

Auditor's report implications
- Qualified on basis of material misstatement
- Justification of whether pervasive and possible adverse impact due to lack of significant disclosures
- Basis of opinion paragraph position and content

Maximum marks — 10

(b) (i) Auditor's responsibilities in relation to other information presented with the financial statements

Assessment of ISA requirements including:

- Auditor must read other information for inconsistency with financial statements or understanding of the business
- Consider the source of the inconsistency
  - (i) A material misstatement of the other information exists;
  - (ii) A material misstatement of the financial statements exists; or
  - (iii) The auditor's understanding of the entity and its environment needs to be updated
- Auditor does not give opinion on the other information

Matters arising from chairman's statement

- Growth discussion ignores discontinued operation
- Calculations to support the ongoing growth
- Statement obscures actual growth, hence misleading/material misstatement in other information
- Inappropriate reference to the content of the auditor's report
- Misstatement of fact regarding recycled paper usage
- Judgement as to whether it is material misstatement of other information

Maximum marks — 5

(ii) Implications for the completion of the audit

- Seek further information to confirm understanding
- Request management to correct
- Escalate to TCWG
- Impact on assessment of management integrity and written representations
- Notify TCWG effect on auditor's report
- Consider resigning

Implications for the auditor's report arising from the draft chairman's statement

- Addressed in other information section to draw attention to issue covering
  - o Statement other information not audited
  - o Responsibilities of auditor regarding other information
  - o Description of uncorrected misstatements
- Auditor's opinion is not modified

Maximum marks — 5

Marks

Professional marks

Analysis and evaluation

- Appropriate use of the information to support discussion, draw appropriate conclusions and design appropriate responses
- Identification of omissions from the analysis or further analysis which could be carried out
- Balanced assessment of the information to determine the appropriate audit opinion in the circumstances

Professional scepticism and judgement

- Effective challenge of information, evidence and assumptions supplied and techniques carried out to support key facts and/or decisions
- Appropriate application of professional judgement to draw conclusions and make informed decisions about the actions which are appropriate in the context and stage of the engagement

Maximum marks	5
Maximum	**25**