## QUESTION 1

**1** ESINAM Ltd
(a) Briefing Notes
Subject: Principal Audit Risks – Esinam Ltd

**Revenue Recognition – timing**
Esinam Ltd raises sales invoices in three stages. There is potential for breach of IAS 18 *Revenue*, which states that revenue should only be recognised once the seller has the right to receive it, in other words the seller has performed its contractual obligations. This right does not necessarily correspond to amounts falling due for payment in accordance with an invoice schedule agreed with a customer as part of a contract. Esinam Ltd appears to receive payment from its customers in advance of performing any obligation, as the stage one invoice is raised when an order is confirmed i.e. before any work has actually taken place. This creates the potential for revenue to be recognised too early, in advance of any performance of contractual obligation. When a payment is received in advance of performance, a liability should be recognised equal to the amount received, representing the obligation under the contract. Therefore a significant risk is that revenue is overstated and liabilities understated.

Tutorial note: *Equivalent guidance is also provided in IAS 11* Construction Contracts *and credit will be awarded where candidates discuss revenue recognition under IAS 11 as Esinam Ltd is providing a single substantial asset for a customer under the terms of a contract.*

**Disputed receivable**
The amount owed from Baba Mine Ltd is highly material as it represents 50·9% of profit before tax, 2·3% of revenue, and 3% of total assets. The risk is that the receivable is overstated if no impairment of the disputed receivable is recognised.

**Legal claim**
The claim should be investigated seriously by Esinam Ltd. The chief executive officer's (CEO) opinion that the claim will not result in any financial consequence for Esinam Ltd is naïve and flippant. Damages could be awarded against Esinam Ltd if it is found that the machinery is faulty. The recurring high level of warranty provision implies that machinery faults are fairly common and therefore the accident could be the result of a defective machine being supplied to Sawyer Ltd.

The risk is that no provision is created for the potential damages under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, if the likelihood of paying damages is considered probable. Alternatively, if the likelihood of damages being paid to Sawyer Ltd is considered a possibility then a disclosure note should be made in the financial statements describing the nature and possible financial effect of the contingent liability.

As discussed below, the CEO, Kofi Smart, has an incentive not to make a provision or disclose a contingent liability due to the planned share sale post year end.

A further risk is that any legal fees associated with the claim have not been accrued within the financial statements. As the claim has arisen during the year, the expense must be included in this year's income statement, even if the claim is still ongoing at the year end.

The fact that the legal claim is effectively being ignored may cast doubts on the overall integrity of senior management, and on the integrity of the financial statements. Management representations should be approached with a degree of professional scepticism during the audit.

Sawyer Ltd has cancelled two orders. If the amounts are still outstanding at the year end then it is highly likely that Sawyer Ltd will not pay the invoiced amounts, and thus receivables are overstated. If the stage one payments have already been made, then Sawyer Ltd may claim a refund, in which case a provision should be made to repay the amount, or a contingent liability disclosed in a note to the financial statements.

Sawyer Ltd is one of only five major customers, and losing this customer could have future going concern implications for Esinam Ltd if a new source of revenue cannot be found to replace the lost income stream from Sawyer Ltd. If the legal claim becomes public knowledge, and if Esinam Co is found to have supplied faulty machinery, then it will be difficult to attract new customers.
A case of this nature could bring bad publicity to Esinam Ltd, a potential going concern issue if it results in any of the five key customers terminating orders with Esinam Co. The auditors should plan to extend the going concern work programme to incorporate the issues noted above.

**Inventories**
Work in progress is material to the financial statements, representing 8·9% of total assets. The inventory count was held two weeks prior to the year end. There is an inherent risk that the valuation has not been correctly rolled forward to a year end position. The key risk is the estimation of the stage of completion of work in progress. This is subjective, and knowledge appears to be confined to the chief engineer. Inventory could be overvalued if the machines are assessed to be more complete than they actually are at the year end. Absorption of labour costs and overheads into each machine is a complex calculation and must be done consistently with previous years. It will also be important that consumable inventories not yet utilised on a machine, e.g. screws, nuts and bolts, are correctly valued and included as inventories of raw materials within current assets.

**Overseas supplier**
As the supplier is new, controls may not yet have been established over the recording of foreign currency transactions. Inherent risk is high as the trade payable should be retranslated using the year end exchange rate per IAS 21 *The Effects of Changes in Foreign Exchange Rates*. If the retranslation is not performed at the year end, the trade payable could be significantly over or under valued, depending on the movement of the dollar to euro exchange rate between the purchase date and the year end. The components should remain at historic cost within inventory valuation and should not be retranslated at the year end.

Warranty Provision
(b) ISA 540 *Audit of Accounting Estimates* requires that auditors should obtain sufficient audit evidence as to whether an accounting estimate, such as a warranty provision, is reasonable given the entity's circumstances, and that disclosure is appropriate. One, or a combination of the following approaches should be used:

Review and test the process used by management to develop the estimate

– Review contracts or orders for the terms of the warranty to gain an understanding of the obligation of Esinam Co
– Review correspondence with customers during the year to gain an understanding of claims already in progress at the year end
– Perform analytical procedures to compare the level of warranty provision year on year, and compare actual to budgeted provisions. If possible disaggregate the data, for example, compare provision for specific types of machinery or customer by customer
– Re-calculate the warranty provision
– Agree the percentage applied in the calculation to the stated accounting policy of Esinam Co

- Review board minutes for discussion of on-going warranty claims, and for approval of the amount provided
- Use management accounts to ascertain normal level of warranty rectification costs during the year
- Discuss with Kofi Opoku the assumptions she used to determine the percentage used in her calculations
- Consider whether assumptions used are consistent with the auditors' understanding of the business
- Compare prior year provision with actual expenditure on warranty claims in the accounting period
- Compare the current year provision with prior year and discuss any fluctuation with Kofi Opoku. Review subsequent events which confirm the estimate made
- Review any work carried out post year end on specific faults that have been provided for. Agree that all costs are included in the year end provision.
- Agree cash expended on rectification work in the post balance sheet period to the cash book – Agree cash expended on rectification work post year end to suppliers' invoices, or to internal cost ledgers if work carried out by employees of Esinam Co
- Read customer correspondence received post year end for any claims received since the year end.

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(ii) Quality Control

- Consultation – it may not be possible to hold extensive consultations on specialist issues within a small firm, due to a lack of specialist professionals. There may be a lack of suitably experienced peers to discuss issues arising on client engagements. Arrangements with other practices for consultation may be necessary.
- Training/Continuing Professional Development (CPD) – resources may not be available, and it is expensive to establish an in-house training function. External training consortia can be used to provide training/CPD for qualified staff, and training on non-exam related issues for non-qualified staff. Review procedures – it may not be possible to hold an independent review of an engagement within the firm due to the small number of senior and experienced auditors. In this case an external review service may be purchased. Lack of specialist experience – where special skills are needed within an engagement; the skills may be bought in, for example, by seconding staff from another practice. Alternatively if work is too specialised for the firm, the work could be sub-contracted to another practice.
- Working papers – the firm may lack resources to establish an in-house set of audit manuals or standard working papers. In this case documentation can be provided by external firms or professional bodies.

## QUESTION 2

(a) 'Forensic auditing'

Definition

The process of gathering, analysing and reporting on data, in a pre-defined context, for the purpose of finding facts and/or evidence in the context of financial/legal disputes and/or irregularities and giving preventative advice in this area.

Tutorial note: *Credit will be awarded for any definition that covers the key components: An 'audit' is an examination (eg of financial statements) and 'forensic' means used in connection with courts of law. Forensic auditing may be defined as 'applying auditing skills to situations that have legal consequences'.*

Application to fraud investigation

As a fraud is an example of an irregularity, a fraud investigation is just one of many applications of forensic auditing, where evidence about a suspected fraud is gathered that could be presented in a court of law. The pre-defined objective of a fraud audit is:

– to prove or disprove the suspicions; and, if proven,

– to identify the persons involved;

– to provide evidence for appropriate action, possibly criminal proceedings.

As well as being 'reactive', forensic auditing can be 'proactive' by being preventative. That is, the techniques of forensic auditing can be used to identify risks of fraud with a view to managing those risks to an acceptable level.

(b) Prior to commencement of the investigation

- Discuss the assignment with Adepa's management to determine the purpose, nature and scope of the investigation. In particular, discuss whether any irregularity (theft/fraud) is suspected and, if so, whether evidence gathered will be used:

– in criminal proceedings;
– in support of an insurance claim.

- Obtain clarification of terms of reference (TOR) in writing from Adepa's management.
- The TOR should give the investigating team full access to any aspect of Papa Engineering's operations relevant to their investigation.
- Investigation will involve consideration of:

– possible understatement of inventory value at 30 September 2009;
– high material consumption for the quarter ended 30 September 2009.

- Determine the level of experience of staff required for the investigation and the number of staff of each grade.
- The availability of suitable staff may affect the proposed start of the investigation. Alternatively, the timing of other assignments may have to be rescheduled to allow this investigation to be started immediately.
- Adepa's management will presumably want the investigation completed before the next inventory count (at 31 December 2009) to know if the findings have any implications for the conduct of the count and the determination of year-end inventory.
- The investigation may have been commissioned to give credence to the period-end's accounts. The investigation may therefore be of the nature of a limited audit.
- Produce a budget of expected hours, grades of staff and costs. Agree the anticipated investigative fee with Adepa's management.
- The depth of the investigation will depend on matters such as:

– the extent of reliance expected to be placed on the investigation report;
– whether the report is for Adepa's internal use only or is it likely to be circulated to bankers and/or shareholders.

- The type of assurance (eg 'negative', reasonable) is likely to have a bearing on:

– any caveats in the report;
– the level of risk/potential liability for any errors in conclusions given in the final report;
– the level of necessary detailed testing required (even if an audit is not requested).

- An engagement letter must be drafted and Adepa's management must agree to its terms in writing before any investigative work can begin. The letter of engagement should include:

- – details of work to be carried out;
- – likely timescale;
- – basis of determining fee;
- – the reliance that can be placed on the final report and results of the investigation;
- – the extent of responsibilities agreed;
- – any indemnity agreed;
- – the information to be supplied as a basis for the investigation; and
- – any areas specifically excluded.
- • Assess the appropriateness of an exclusion clause; for example: 'CONFIDENTIAL – this report has been prepared for the private use of Adepa only and on condition that it must not be disclosed to any other person without the written consent of the preparing accountant'.

(c) (i) Inventory undervaluation – matters to consider

Physical inventory count

- • Inventory will be undervalued at 30 September 2009 if all inventory is not counted. The investigation should consider the adequacy of quarterly physical count procedures. For example, whether or not:
- – all items are marked when counted;
- – management carries out test checks;
- – stocksheets are pre-numbered and prepared in ink;
- – a complete set of stocksheets is available covering all categories of inventory;
- – Papa Engineering's management uses the stocksheets to produce the inventory value.

Tutorial note: *Inventory will not be undervalued if it does not exist (eg because it has been stolen). Theft would be reflected in higher than normal materials consumption (see (d)).*

Cutoff

• Inventory will be undervalued at 30 September 2009 if:

– any goods set aside for sale in July were excluded from the count;

– a liability was recognised at 30 September 2009 for goods that were excluded from inventory (eg in transit from the supplier);

– production did not cease during the physical count and raw materials being transferred between warehouse and production were omitted from inventory.

Scrap materials

- • Inventory will be undervalued if any scrap from materials used in production that has a value (eg because it can be recycled) is excluded. Inventory may be undervalued compared with the previous quarter if there is any change in Papa's scrap/wastage policy (eg if previously it was valued in inventory but now it is excluded).
- • If production problems increased wastage in the last period this would account for the lower value of inventory and higher materials consumption.

(ii) Tests to quantify the amount of any undervaluation

Tutorial note: *Any tests directed at quantifying an overstatement and/or instead of understatement will not be awarded credit.*

Physical count

- • Inspect the warehouse/factory areas to identify high value inventory items and confirm their inclusion on the stocksheets at 30 September 2009 (or otherwise vouch to a delivery note raised after that date).

- Recast all additions and recalculate all extensions on the stocksheets to confirm that there have been no omissions, transposition errors or other computational discrepancies that would account for an undervaluation.

Cutoff

- Ascertain the last delivery notes and despatch notes recorded prior to counting and trace to purchase/sales invoices to confirm that an accurate cutoff has been applied in determining the results for the quarter to 30 September 2009 and the inventory balance at that date.
- Trace any large value purchases in June to the 30 June stocksheets. If not on the stocksheets inquire of management whether they are included in production (or sold). Verify by tracing to production records, goods despatch notes, etc.

Analytical procedures

- Compare large volume/high value items on stocksheets at 30 June with those at 30 September to identify any that might have been omitted (or substantially decreased). Inquire of management if any items so identified have been completely used in production (but not replaced), scrapped or excluded from the count (eg if obsolete). Any inventory excluded should be counted and quantified.
- Compare inventory categories for 30 September against previous quarters. Inventory value at 30 September is 10% less than at 30 June, though revenue is 28% higher. An increase in inventory might have been expected to support increased revenue if there is a general increase in trading activity. (Alternatively, a decrease in inventory may reflect difficulties in obtaining supplies/maintaining inventory levels if demand has increased).

Scrap materials

- Make inquiries of Papa Engineering's warehouse and production officials regarding the company's scrap/wastage policy and any records that are kept.
- Review production records on a month-on-month basis and discuss with the factory manager whether any production problems have increased wastage in the quarter to 30 September 2009.

Pricing test

- Raw materials – select a sample of high value items from the 30 June 2009 inventory valuation and confirm that any unit price reductions as shown by the 30 September 2009 valuation are appropriate (eg vouch lower unit price to recent purchase invoices or write down to net realisable value).
- WIP and finished goods – agree a sample of unit prices to costing records (eg batch costings). Recalculate unit prices on a sample basis and vouch make-up to invoices/payroll records, etc.

**QUESTION 3**

a) Audit procedures should focus on the appraisal of the work of the expert valuer. Procedures could include the following:

– Inspection of the written instructions provided by Poppy Co to the valuer, which should include matters such as the objective and scope of the valuer's work, the extent of the valuer's access to relevant records and files, and clarification of the intended use by the auditor of their work.

– Evaluation, using the valuation report, that any assumptions used by the valuer are in line with the auditor's knowledge and understanding of Poppy Co. Any documentation supporting assumptions used by the valuer should be reviewed for consistency with the auditor's business understanding, and also for consistency with any other audit evidence.

- Assessment of the methodology used to arrive at the fair value and confirmation that the method is consistent with that required by IAS 40.
- The auditor should confirm, using the valuation report, that a consistent method has been used to value each property.
- It should also be confirmed that the date of the valuation report is reasonably close to the year end of Poppy Co.
- Physical inspection of the investment properties to determine the physical condition of the properties supports the valuation.
- Inspect the purchase documentation of each investment property to ascertain the cost of each building. As the properties were acquired during this accounting period, it would be reasonable to expect that the fair value at the year end is not substantially different from the purchase price. Any significant increase or decrease in value should alert the auditor to possible misstatement, and Djame to further audit procedures.
- Review of forecasts of rental income from the properties – supporting evidence of the valuation.
- Subsequent events should be monitored for any additional evidence provided on the valuation of the properties.

For example, the sale of an investment property shortly after the year end may provide additional evidence relatingto the fair value measurement.

- Obtain a management representation regarding the reasonableness of any significant assumptions, where relevant, to fair value measurements or disclosures.

Quality & Co
(a) Joint business arrangement

The business opportunity in respect of Bleoo Co could be lucrative if the market research is to be believed.

However, IFAC's *Code of Ethics for Professional Accountants* states that a mutual business arrangement is likely to give rise to self-interest and intimidation threats to independence and objectivity. The audit firm must be and be seen to be independent of the audit client, which clearly cannot be the case if the audit firm and the client are seen to be working together for a mutual financial gain.

In the scenario, two options are available. Firstly, Quality & Co could provide the audit client with finance to complete the development and take the product to market. There is a general prohibition on audit firms providing finance to their audit clients. This would create a clear financial self-interest threat as the audit firm would be receiving a return on investment from their client. The Code states that if a firm makes a loan (or guarantees a loan) to a client, the self-interest threat created would be so significant that no safeguard could reduce the threat to an acceptable level.

The provision of finance using convertible debentures raises a further ethical problem, because if the debentures are ultimately converted to equity, the audit firm would then hold equity shares in their audit client. This is a severe financial self-interest, which safeguards are unlikely to be able to reduce to an acceptable level. The finance should not be advanced to Bleoo Co while the company remains an audit client of Quality & Co. The second option is for a joint venture company to be established. This would be perceived as a significant mutual business interest as Quality & Co and Bleoo Co would be investing together, sharing control and sharing a return on investment in the form of dividends. IFAC's *Code of Ethics* states that unless the relationship between the two parties is clearly insignificant, the financial interest is immaterial, and the audit firm is unable to exercise significant influence, then no safeguards could reduce the threat to an acceptable level. In this case

Quality & Co may not enter into the joint venture arrangement while Bleoo Co is still an audit client.

The audit practice may consider that investing in the new electronic product is a commercial strategy that it wishes to pursue, either through loan finance or using a joint venture arrangement. In this case the firm should resign as auditor with immediate effect in order to eliminate any ethical problem with the business arrangement. The partners should carefully consider if the potential return on investment will more than compensate for the lost audit fee from Bleoo Co.

The partners should also reflect on whether they want to diversify to such an extent – this investment is unlikely to be in an area where any of the audit partners have much knowledge or expertise. A thorough commercial evaluation and business risk analysis must be performed on the new product to ensure that it is a sound business decision for the firm to invest. The audit partners should also consider how much time they would need to spend on this business development, if they decided to resign as auditors and to go ahead with the investment. Such a new and important project could mean that they take their focus off the key business i.e. the audit practice. They should consider if it would be better to spend their time trying to compete effectively with the two new firms of accountants, trying to retain key clients, and to attract new accounting and audit clients rather than diversify into something completely different.

(ii) **Recruitment service**

IFAC's *Code of Ethics for Professional Accountants* does not prohibit firms from offering a recruitment service to client companies. However several ethical problems could arise if the service were offered. The severity of these problems would depend on the exact nature of the service provided, and the role of the person recruited into the client's organisation.

Specific ethical threats could include:

Self-interest – clearly the motive for Quality & Co to offer this service is to generate income from audit clients, thereby creating a financial self-interest threat. The amount received for the recruitment service depends on the magnitude of the salary of the person employed. The more senior the person recruited, the higher their salary is likely to be, and therefore the higher the fee to be paid to Quality & Co. In addition, the firm could be tempted to advise positively on the recruitment of an individual merely to receive the relevant recruitment fee, without properly considering the suitability of the person for the role.

Familiarity – when performing the audit, the auditors may be less likely to criticise or challenge the work performed by a person they helped to recruit, as any significant problems discovered may make the recruitment appear ill-advised.

Management involvement – there is also a threat that the audit firm could be perceived to be making management decisions by selecting employees. The firm could offer services such as reviewing the professional qualifications of a number of applicants, and providing advice on the applicant's suitability for the post. In addition the firm could draw up a shortlist of candidates for interview, using criteria specified by the client. However in all cases, the final decision as to whom to hire must be made by the client, as the audit firm should not make, or be perceived to be making, management decisions.

The threats discussed above would increase in significance if the recruitee took on a role in key management pertaining to the finance function, such as finance director or financial controller. The threats would be less severe if the audit firm advised on the recruitment of a junior member of the client's finance function. If these threats could not be reduced to a level less than clearly insignificant, then the recruitment service should not be offered.

(c) **Temporary staff assignments**

Lending staff on a temporary basis to an audit client will create the following ethical threats:
Management involvement – Assuming that the manager or senior is seconded to the finance function of the audit client, it is likely that the individual would be in some way involved in decision making in relation to the accounting systems, management accounts or financial statements.

Self-review – On returning to the audit firm, a seconded individual could be a member of the audit team for the client to which they seconded. This would create a self- review threat whereby they would be unlikely to be critical of their own work performed or decisions made. Even if the individual were not assigned to the client where they performed a temporary assignment, the audit team assigned may tend to over rely on areas worked on by a colleague during the period of their temporary assignment.

Familiarity – if the individual is working at the client at any time during the audit, there will be a familiarity threat, whereby audit team members will be unlikely to sufficiently challenge, and therefore not exercise enough professional scepticism when dealing with work performed by the seconded individual.

In addition, due to the over-staffing problem of Quality & Co, the seconded individuals may feel that if they were not on the secondment, they could be made redundant. This may cause them to act in such as way as not to jeopardise the secondment, even if the action were not in the best interests of the firm.

The threats discussed above are increased where a senior person likely to make significant decisions is involved with the temporary assignment, as in this case where audit managers or seniors will be the subjects of the proposed secondment.

In practice, assistance can be provided to clients, especially in emergency situations, but only on the understanding that the firm's personnel will not be involved with:

– Making management decisions,
– Approving or signing agreements or similar documents, and
– Having the authority to enter into commitments on behalf of the company.

In addition, the individual seconded to a client should not then be involved in any way with the audit of that client when they return to the audit firm. This may be a difficult area, as presumably the client would prefer to have an individual seconded to them who has knowledge and experience of their business, i.e. a member of the audit team, and most likely in this scenario to be the audit manager. If this were the case the manager would then have to be reassigned to a different client, causing internal problems for the audit firm. This problem is likely to outweigh any benefits, financial or otherwise, to Quality & Co.

If the temporary staff assignment were to a non-finance department of the client then the threats would be reduced. If Quality & Co decides to go ahead with the secondment programme, the firm must ensure that the staff are suitably experienced and qualified to carry out the work given to them by the client. There could be a risk to the reputation of Quality & Co if the seconded staff are not competent or do not perform as well as expected by the client.

One advantage of a secondment is that the individual concerned can benefit from exposure to a different type of work and work environment. This will provide some valuable insights into accounting within a business and the individual may bring some new skills and ideas back into the audit firm. However, the staff seconded could be offered a permanent position at the client. This

would Djame to the loss of key members of staff, and be detrimental for Quality & Co in the long run.

The other benefit for the audit firm is that a programme of secondments will ease the problem of an over-staffed audit department, and should have cash flow benefits.
Tutorial note*: In answering this question it is relevant to briefly mention corporate governance implications i.e. the client may not be able to accept the services offered by their auditor for ethical, particularly objectivity, reasons*.

**QUESTION 4**

a) Briefing notes to be used at training session
Subject: Money laundering policies and procedures

(i) ***Introduction***
In recent years accountants and auditors have become subject to anti-money laundering regulations. A firm of Chartered Accountants must establish sound policies and procedures to ensure that the firm meets its responsibilities under the relevant regulation in which the firm is operating. It is important that everyone who is a member of an audit engagement team is aware of the regulations, the firm's policies and procedures, and their own responsibilities regarding money laundering activities.

***Definition of money laundering***
Money laundering is a process by which criminals attempt to conceal the true origin and ownership of the proceeds of criminal activities. It is a way in which money earned from criminal activities ('dirty money') is transferred and transformed so it appears to have come from a legitimate source ('clean money'). Money laundering includes a wide range of potential crimes including possessing, dealing with, or concealing the proceeds of crime.

***Illustrations***
Money laundering activities could include:

– Acquiring, using or possessing the proceeds of criminal activities such as drug trafficking and terrorist activities, or retaining control over the proceeds of tax evasion.
– Benefits obtained through bribery or corruption.
– Inciting, aiding, counselling or concealing such activities.

The three stages of the money laundering process are placement, layering and integration:

– Placement is putting money into financial products or instruments, including life policies, pension arrangements, unit trusts, travellers cheques, and bank deposits.
– Layering is creating a series of transactions so that the original source of funds is obscured and difficult to trace.
– Integration is converting the proceeds of money laundering into a legitimate form.

For accountants there are specific ways that they could commit offences relating to money laundering. These could include:

– Handling the proceeds of criminal activity, or advising on the use of such proceeds.
– Failure to report knowledge or suspicion of money laundering activities to the appropriate authority.

- Making a disclosure which is likely to prejudice an investigation into money laundering (known as 'tipping off').
- Failure to comply with the specific regulatory requirements in relation to money laundering in the jurisdiction in which the accountant is operating.

*(ii)* ***Policies and procedures***
*Appointment of a Money Laundering Reporting Officer (MLRO).* The MLRO is a nominated officer who is responsible for receiving and evaluating reports of suspected money laundering from colleagues within the firm, and making a decision as to whether further enquiry is required and if necessary making reports to the appropriate external body. The
MLRO should have an appropriate level of seniority and experience and would usually be a senior partner.

*Customer identification procedures.* This is often referred to as customer due diligence, or 'know your client' procedures. The point of these procedures is to ensure that the firm has verified the identity of clients (whether the client is an individual or an entity), and has obtained evidence of that identity. For an individual, typical evidence of identity would be a passport, driving licence, and evidence of address such as a utility bill. For an entity evidence may include a certificate of incorporation. The identification process for an entity would also involve identification of key management personnel and those people in control of the entity, and an assessment as to whether any connected individuals are politically exposed people.

*Enhanced record keeping*. Records must be kept of clients' identity, the firm's business relationship with them, and details of transactions with the client. All records should be kept for five years after the end of the business relationship or completion of the transactions. Internal and external reports made in connection to money laundering should also be securely kept for five years.

*Communication and training***.** All relevant employees should receive training so that they are aware of the main provisions of money laundering regulations, and so that they know how to recognise and deal with activities which may be money laundering. The training programme should be offered to all members of the firm with an involvement in audit engagements. Training should also be provided on the firm's internal policies and procedures with relation to money laundering. In particular all staff should be aware of appropriate lines of communication, and who they should report suspicions of money laundering activities to. Training should be considered for all staff, including support staff who do not carry out an advisory role.

*Internal controls, risk assessment, management and monitoring.* The firm should establish systems and controls to effectively manage the risk that the firm is exposed to in terms of money laundering activities. This could include:

- Client screening procedures to minimise the risk of taking on a new client with a high risk of money laundering activities
- Systems and controls to ensure that training is taken/attended and understood by all relevant employees – Systems that allow periodic testing that the firms' policies and procedures comply with legislative and regulatory requirements.

All of the above contribute to the acceptance and following of firm-wide practices by all relevant individuals and can be seen as quality control measures.

**Conclusion**
It can be seen that the firm needs to have in place appropriate measures to ensure that complex anti-money laundering regulation is adhered to. It is the responsibility of all relevant staff to be alert for

suspicious activities and to understand their own responsibility to report the activity. Failing to do so places the individual and the firm at risk of a breach of
regulation.

(b) Auditor's responsibilities in relation to subsequent events.
Subsequent events are defined as those events occurring between the date of the financial statements and the date of the auditor's report, and also facts discovered after the date of the auditor's report. ISA 560 (Redrafted) *Subsequent Events* differentiates the auditor's responsibilities in relation to subsequent events depending on when the subsequent event occurs.

*Events occurring up to the date of the auditor's report.* The auditor has an active duty to perform audit procedures designed to identify, and to obtain sufficient appropriate evidence of all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements. These procedures should be performed as close as possible to the date of the auditor's report, and in addition, representations would be sought on the date that the report was signed. Procedures would include reviewing management procedures for ensuring that subsequent events are identified, reading minutes of meetings of shareholders and management, reviewing the latest interim financial statements, and making appropriate enquiries of management. Where a material subsequent event is discovered, the auditor should consider whether management have properly accounted for and disclosed the event in the financial statements in accordance with IAS 10 *Events After the Reporting Period.*

*Facts discovered after the date of the auditor's report but before the date the financial statements are issued.* The auditor does not have any responsibility to perform audit procedures or make any enquiry regarding the financial statements or subsequent events after the date of the auditor's report. In this period, it is the responsibility of management to inform the auditor of facts which may affect the financial statements. When the auditor becomes aware of a fact which may materially affect the financial statements, the matter should be discussed with management. If the financial statements are appropriately amended then a new audit report should be issued, and procedures relating to subsequent events should be extended to the date of the new audit report. If management do not amend the financial statements to reflect the subsequent event, in circumstances where the auditor believes they should be amended, a qualified or adverse opinion of disagreement should be issued.

*Facts discovered after the financial statements have been issued.* After the financial statements have been issued, the auditor has no obligation to make any enquiry regarding the financial statements. However, the auditor may become aware of a fact which existed at the date of the audit report, which if known at the date may have caused a modification to the auditor's report. In this case, the matter should be discussed with management. This could result in the revision of the financial statements, in which case the auditor should issue a new audit report on the revised financial statements. This report should include an emphasis of matter paragraph referring to a note to the financial statements in which the reason for the revision is fully discussed. If management do not revise the financial statements, the auditor should take legal advice with the objective of trying to prevent further reliance on the auditor's report.

(b) (ii) The announcement of a restructuring after the reporting date is a non-adjusting event after the reporting date, according to IAS 10 *Events After the Reporting Period*. This is because the event does not provide evidence in relation to a condition that existed at the year end.

Materiality calculations in respect of the potential cost of closure are as follows:

Based on revenue: GHC1m/60 million = 1·67%
Based on profit: GHC1m/12 million = 8·3%
Based on assets: GHC1m/320 million = <1%

Therefore this amount is material to the statement of comprehensive income.
Per IAS 10, a note should be provided to the financial statements, which describes the nature of the event, and provides an estimate of the financial effect.

*Tutorial note: credit will also be awarded for discussion of whether a provision for the restructuring costs is required under IAS 37* Provisions, Contingent Liabilities and Contingent Assets.

Audit procedures could include:

– Review any potential note to financial statements which should disclose the non-adjusting event, providing a brief description of the event, and an estimate of the financial effect.
– Discuss the reason for the restructuring with a member of key management personnel, and read minutes of board meetings where the plan was discussed, in order to gain an understanding about the reason for the restructuring.
– Verify the approval of the plan itself, and the approval of the announcement of the plan, which can be performed through a review of board minutes.
– Confirm the date on which the plan was approved, and also the date of the announcement, using supporting documentation such as press release, letters sent to employees, internal meetings held with employees, etc.
– Obtain a copy of the announcement and review for details, particularly a description of the exact nature of the restructuring, including the number of employees to be affected.
– Agree the GHC1 million potential cost of closure to supporting documentation, including a schedule showing the number and grade of staff to be made redundant, which should be supported by payroll/contract details.
– Using the results of the discussion with management, assess the planned restructuring in the context of the auditor's knowledge of the business, considering whether any further costs are likely to be incurred.

(ii) Actions to be taken by the auditor:

**QUESTION 5**

a) A joint audit is when two or more audit firms are jointly responsible for giving the audit opinion. This is very common in a group situation where the principal auditor is appointed jointly with the auditor of a subsidiary to provide a joint opinion on the subsidiary's financial statements.

There are several advantages and disadvantages in a joint audit being performed.

**Disadvantages**

For the client, it is likely to be more expensive to engage two audit firms than to have the audit opinion provided by one firm. From a cost/benefit point of view there is clearly no point in paying twice for one opinion to be provided. Despite the audit workload being shared, both firms will have a high cost for being involved in the audit in terms of senior manager and partner time. These costs will be passed on to the client within the audit fee.

The two audit firms may use very different audit approaches and terminology. This could make it difficult for the audit firms to work closely together, negating some of the efficiency and cost benefits discussed above. Problems could arise in deciding which firm's method to use, for

example, to calculate materiality, design and pick samples for audit procedures, or evaluate controls within the accounting system. It may be impossible to reconcile two different methods and one firm's methods may end up dominating the audit process, which then eliminates the benefit of a joint audit being conducted.

It could be time consuming to develop a 'joint' audit approach, based on elements of each of the two firms' methodologies, time which obviously would not have been spent if a single firm was providing the audit.

There may be problems for the two audit firms to work together harmoniously. Djame & Co may feel that ultimately they will be replaced by Boama & Co as audit provider, and therefore could be unwilling to offer assistance and help.

Potentially, problems could arise in terms of liability. In the event of litigation, because both firms have provided the audit opinion, it follows that the firms would be jointly liable. The firms could blame each other for any negligence which was discovered, making the litigation process more complex than if a single audit firm had provided the opinion. However, it could be argued that joint liability is not necessarily a drawback, as the firms should both be covered by professional indemnity insurance.

b) (i) **Sea Ltd**
If a letter of support had not been received, then a qualified opinion on the grounds of disagreement (about the appropriateness of the going concern presumption) would be required. As the matter is likely to be pervasive an adverse opinion would be appropriate (ISA 570 *Going Concern*).
However, the company has received a letter of support from its parent company to the effect that it will enable Water to continue trading. If this evidence (together with other evidence such as management's representations) is considered to be sufficient to support the appropriateness of the going concern presumption, a qualified opinion will not be necessary provided that the support is adequately disclosed in a note to the financial statements. If the evidence is sufficient, but the disclosure inadequate, an 'except for' opinion would be required.

If the letter of support does not provide sufficient evidence (eg if there are doubts about Cube's ability to provide the required finance), the significant uncertainty arising should be disclosed in an emphasis of matter paragraph in the auditor's report. This would not result in a qualified opinion (unless the disclosure relating to it were considered inadequate).

Conclusion
The audit senior's proposal is unsuitable. The auditor's report should be unmodified (assuming that disclosures are
adequate).

(ii) **Nhyira Ltd**
In order to show fair presentation, in all material respects, the financial statements of an entity should contain not only accurate figures, but also sufficient disclosure in relation to those figures in order to allow the user to understand them. As required by IAS 1 *Presentation of Financial Statements*, items should be treated on a consistent basis from year to year. If this is not the case, then any change, together with the financial impact of this change, will need to be disclosed in a note to the financial statements. Failure to disclose the reasons for change in policy (ie to comply with IFRS 3 *Business Combinations*) and its effects (eg the lack of annual amortisation) means that the financial statements do not comply with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. A qualified opinion is therefore required on the grounds of disagreement on disclosure (IAS 1 and IAS 8). Assuming the matter to be material (but clearly not pervasive), an 'except for' opinion should be expressed.

The main purpose of an emphasis of matter paragraph is to describe a matter of significant uncertainty which has been taken into account in forming the audit opinion – it does not qualify that opinion. Such a paragraph highlights a note in the financial statements that more extensively discusses the matter. An emphasis of matter paragraph cannot therefore be used to 'make good' a lack of disclosure.

IFRS 3 also requires disclosure of a reconciliation of the carrying amount of goodwill at the beginning and end of the year. This should show no movement for the year ended 30 June 2006.

Conclusion
The audit senior's proposal is unsuitable. Unless all aspects of the change (including reason and effect) are adequately disclosed an 'except for' qualification will be required on the grounds of disagreement.

(iii) **Sompa Ltd**
The audit opinion states whether the financial statements:
– are presented fairly, in all material respects (or give a true and fair view) in accordance with the financial reporting framework; and
– comply with statutory requirements (where appropriate).
The directors' report is not a part of financial statements prepared under International Financial Reporting Standards (IFRS). However, auditors have a professional responsibility to read other information in documents containing audited financial statements (eg the directors' report in an annual report) to identify material inconsistencies with the audited financial statements (or material misstatements of fact). A material inconsistency exists when other information contradicts information contained in the audited financial statements.
Clearly, 'major' is inconsistent with 1.6% If the inconsistency is resolved (eg because the directors' report is corrected to state '... major part of other income...') an unmodified auditor's report will be given.

If the inconsistency is not resolved, the audit opinion on the financial statements cannot be qualified (because the inconsistency is in the directors' report). In this case, an emphasis of matter paragraph may be used to report on this matter that does not affect the financial statements (ISA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*).

Conclusion
An unqualified opinion on the financial statements is appropriate. If, however, the inconsistency is not resolved, it should be reported in a separate emphasis of matter paragraph, after the opinion paragraph.