Question 1

Marking scheme

(i) Materiality
Up to 1 mark for each comment:
- Recognise materiality is subjective
- Auditor's business understanding may change during the audit, making some balances and transactions material
- Client's circumstances may change during the audit, making some balances and transactions more material
- Adjustments to the accounts mean materiality has to be revised
- Recognise the high-risk status of the client

Maximum 4

(ii) Audit completion issues
Up to 2 marks for each audit completion issue assessed:
- Property disposal/sale and leaseback
- Property revaluation
- Actuarial loss
- Goodwill impairment
- Goodwill classification into assets held for sale
- Associate
- Presentation of assets held for sale (separate and not netted off)
- Measurement of assets held for sale
- Lack of disclosure of discontinued operation
- Non-controlling interest
- Finance cost and loan

Maximum 16

(i) Revising materiality
Auditors must reassess materiality if they become aware of new information that would have resulted in a different materiality level being set at the planning stage.

Planning materiality is likely to have been based on draft financial statements, but during the course of the audit it could become clear that the final financial statements will be substantially different. For example, the carrying amount of assets held at fair value could be much lower than originally expected, which would affect the amounts in the statement of financial position. In that case, the auditor would need to set materiality again, on the basis of the actual results and position.

Alternatively, something could happen during the audit, e.g., the client could decide to dispose of a subsidiary. This could change the appropriate materiality level, as well as performance materiality. The auditor should take this into account and revise materiality.

(ii) Statement of profit or loss and other comprehensive income

Geeta revenue
Geeta's 25% drop in revenue indicates that goodwill relating to this subsidiary may be impaired. There is a risk that this goodwill has not been impaired when it should have been.

Property disposal
At GHS2m, the property disposal is material.

The option to repurchase the property in five years' time points to the possibility that this could not be a genuine sale, but a finance arrangement whose economic substance is that of a secured loan. In this case the audit evidence obtained is inadequate, and further evidence needs to be obtained to determine the substance of the transaction.
If this is indeed a secured loan (in substance), then the asset will be recognised in the statement of financial position, and the cash receipt will be recognised as a loan (liability). Finance costs will be accrued over the period of the loan – five years.

If this is the case, then profit has been materially overstated, and liabilities understated.

Property revaluation

The gain of GHS800,000 was just below initial materiality of GHS900,000, but above the current materiality level of GHS700,000. Audit procedures must now be performed in this area, as it is possible that there could be a material misstatement here.

Actuarial loss

The actuarial losses are material, at GHS1.1m, as is the defined benefit liability of GHS10.82m.

Sanj Co is a service organisation, and ISA 402Audit considerations relating to an entity using a service organisation requires the auditor to obtain an understanding of this organisation. This can be obtained:

- From the Group itself, we should gain an understanding of how Sanj Co arrives at its valuation, its systems and its controls
- By obtaining a report from the auditor of Sanj Co (the service auditor), which contains an opinion on the description of Sanj Co's systems and controls

This has not been done, and we have no information about how the plan assets and liabilities were valued, or how reliable their valuation might be. The audit team must therefore obtain this information before the service organisation's representation can be relied upon.

Goodwill impairment

There is an indicator that goodwill relating to the Geeta subsidiary is impaired (ie its revenue has fallen by 25%), but this does not appear to have been considered by the audit team. Audit procedures must be performed on the assumptions used by management in conducting this review. The reasons why the 25% fall in revenue has not resulted in impairment must be specifically addressed.

Associate

The statement of profit or loss includes GHS1.01m share of profit of associate. The figure in the statement of financial position should include (at a minimum) the amount brought forward, plus any profit attributable, less any dividends received. It is thus highly unlikely that this figure would not have changed since last year and audit evidence should be obtained.

Trading division held for sale

The division held for sale is part of a subsidiary. Therefore, some of the goodwill relating to this subsidiary may need to be reclassified as part of the disposal group of assets held for sale. Although it is possible that no goodwill will need to be reclassified, evidence needs to be obtained that this is the case.

The statement of financial position contains one line within assets for ‘assets classified as held for sale’. This disclosure is incorrect: the assets held for sale should be a separate section within ‘assets’.

It appears that this GHS7.8m could be a net figure, which again is incorrect – there should also be a separate section within ‘liabilities’ showing the liabilities from the disposal group. Audit procedures should be performed to ascertain whether this in fact a net figure, in order to get the classification right.

The assets held for sale are described as being from a trading division’. It is possible that they meet the criteria of discontinued operations per IFRS 5Non-current Assets Held for Sale and Discontinued Operations. This requires the post-tax profit or loss of discontinued operations to be shown as a single line. Discontinued operations are defined as being a component that is classified as held for sale which represents a separate line of business or geographical operations, or is part of a single coordinated plan to dispose of a separate line of business or its geographical operations. This could potentially be the case here. If such disclosure is required then the lack of it is a material misstatement. Audit procedures should be performed to determine whether the trading division qualifies as discontinued operations and is disclosed in this way.
Non-controlling interest

There is no disclosure in relation to the non-controlling interest in the statement of profit or loss and other comprehensive income. Both profit for the year and total comprehensive income attributable to the non-controlling interest should be disclosed.

New loan

Finance costs should be included of GHS8m × 2% × 9/12 = GHS120,000. However, finance costs have only risen by GHS40,000. No loans appear to have been paid off during the year, as long-term borrowings have increased by exactly the GHS8m received for the new loan. Therefore, finance costs appear to be understated.

The amount is not material of itself, but should be accumulated together with any other misstatements that are discovered as they could become material in aggregate.

Question 2

Marking scheme

(a) Winston Co

Generally 1 mark each per comment and action point
- Poor credit control
- Independence threat – free audit/loan
- Independence threat – self-interest in 20X8 report
- Financial distress leads to going concern threat for the company
- Non payment due to financial distress does not necessitate resignation
- Discuss with client – ethical problem/payment arrangements
- Ethics partner notification
- Assess significance of amount outstanding
- Policy to check prior invoices paid
- Continue to improve credit control
- Second partner review
- Review of audit work performed on going concern

Maximum 9

(b) Trevor Co

Generally 1 mark each per comment and action point
- Non arm's length commercial transaction
- Material to audit manager
- Self-interest/intimidation threat
- Question audit manager's integrity
- Potential disciplinary action
- Remove Julia from audit team
- Review all work performed on Wallace Co
- Consider Julia’s relationship with and likelihood of bias towards her other clients
- Disclosure of ethical threat to those charged with governance
- Provide clear communication to all staff regarding transactions with clients

Maximum 6
(c) **Computer Supply Co**

Generally 1 mark each per comment and action point

- Self review threat
- Self-interest threat
- Independence check
- Client disclosure and acknowledgement
- QC monitoring

Maximum 5

---

(a) **Winston Co**

**Credit control**

The fees for the 20X7 audit have been outstanding for over twelve months and it seems that little has been done to collect them. Since the file note states that Winston Co is suffering poor cash flows, the balance may no longer be recoverable. Credit control has been poorly managed at Comp & Co with regards this client and the debt should not have remained outstanding for so long.

**Action**

Credit control procedures at the firm need to be reviewed to prevent this situation reoccurring. It appears that some improvements have already been made with the audit manager now being responsible for reviewing client invoices raised and monitoring credit control procedures.

**Independence**

The overdue fees for the 20X7 audit may make it appear the audit has been performed for free or could effectively be seen as a loan from Comp & Co to Winston Co. The IESBA *Code of Ethics for Professional Accountants* specifically states that an audit firm should not enter into a loan arrangement with a client that is not a bank or similar institution. It highlights overdue fees as an area where a self-interest threat could arise and independence is threatened. Comp & Co should not have allowed outstanding fees to build up as their independence is now compromised.

**Action**

Comp & Co should discuss the recoverability of the 20X7 audit fee with the audit committee (if one exists) or those charged with governance. A payment plan should be put into place.

If the overdue fees are not paid, the firm should consider resigning as auditors. In this case a valid commercial reason appears to exist as to why the fees remain unpaid. Comp & Co can remain as auditors provided that adequate safeguards are in place and the amount outstanding is not significant. If the overdue fees are significant, it may be that no safeguards could eliminate the threats to objectivity and independence or reduce them to an acceptable level.

The ethics partner at Comp & Co should be informed of the situation. The ethics partner should evaluate the ethical threat and document the conclusions including the significance of the overdue fees.

**20X8 audit**

The 20X7 audit fee and arrangements for payment should have been agreed before Comp & Co formally accepted appointment as auditor for the 20X8 audit. Since the 20X8 audit has now almost been completed, it appears this could not have happened.

**Action**

The ethics partner at Comp & Co should take steps to ensure that there are no outstanding audit fees before commencing new client work. This could involve a new firm-wide policy that audit managers check payment of previous invoices.

**Self-interest in 20X8 report**

The 20X8 audit report has not yet been signed. This creates a self-interest threat to Comp & Co's objectivity and independence because the issue of an unqualified audit report may enhance their prospects of securing payment of the overdue 20X7 audit fees.
Action
The working papers for the 20X8 audit of Winston Co should undergo an independent review by the engagement quality control reviewer.

Going concern
Winston Co is known to be having cash flow problems and so there is an issue of whether the company is a going concern for the 20X8 audit report.

Action
Comp & Co should carry out a review of the 20X8 audit working papers on going concern. It may be necessary to carry out further audit procedures to ensure that sufficient evidence has been gathered to support the audit opinion.

(b) Trevor Co

Business relationship
Under the IESBA's Code of Ethics, persons in a position to influence the conduct and outcome of the audit should not enter into business relationships with a client, except where they involve the purchase of goods and services from the client in the ordinary course of business, are on an arm's length basis and are clearly inconsequential to each party.

As audit manager of Trevor Co, Julia Carr has influence over the outcome of the audit and should only rent the warehouse space if the conditions prescribed by the Code are met. Since the warehouse space is already known to be used for rental income, this transaction is in the ordinary course of business. However, the note on the invoice about only charging a nominal sum indicates that the transaction is not on an arm's length basis. The criteria in the Code have therefore been breached. It is also worth noting that the transaction may represent a material discount for Julia Carr.

Action
Julia Carr should not retain the position of audit manager at Trevor Co and a new manager should be assigned. All planning work for the 20X8 audit should be independently reviewed as planning decisions may have been influenced by the transaction. The situation should be disclosed to those charged with governance at Trevor Co and the audit committee, if one exists.

Self-interest threat
Julia Carr has created a self-interest threat, by renting the warehouse space at a reduced rate. Julia's objectivity could be biased by her desire to please Trevor Co so that she can benefit financially.

Action
Julia Carr may need to be disciplined for her actions by Comp & Co who could also send her for ethics training. Comp & Co should investigate for evidence of bias in other audits where Julia Carr has had influence.

(c) Computer Supply Co

Self-interest threat
Comp & Co may have entered into an inappropriate close business relationship by accepting a fee for recommending Computer Supply Co to audit clients. This could be seen as a self-interest threat and compromise the independence and objectivity of Comp & Co. The business relationship can be allowed to continue provided that Comp & Co put safeguards in place.

Action
Comp & Co should ensure that where Computer Supply Co has been used by a client the following safeguards exist.

- Audit staff have no financial or personal interest in Computer Supply Co.
- The arrangement between Comp & Co and Computer Supply Co has been fully disclosed.
- Comp & Co should obtain written confirmation that the client is aware of the referral fee.

Additionally, Comp & Co should monitor the quality of the products supplied to ensure they are not associated with inferior goods.
## Question 3

### Marking scheme

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<thead>
<tr>
<th>(i)</th>
<th>Matters</th>
<th>Marks</th>
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<tbody>
<tr>
<td></td>
<td>Generally 1 mark each comment</td>
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</tr>
<tr>
<td></td>
<td>Maximum 5 marks any one issues × 3</td>
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<tr>
<td></td>
<td><strong>Ideas</strong></td>
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<tr>
<td></td>
<td>– Materiality (assessed)</td>
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<tr>
<td></td>
<td>– Relevant IASs (eg 1, 10, 12, 24, 36)</td>
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<tr>
<td></td>
<td>– Risk (eg completeness assertion)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>– Implications for auditors’ report (eg explanatory para)</td>
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</tr>
<tr>
<td></td>
<td>Maximum</td>
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<table>
<thead>
<tr>
<th>(ii)</th>
<th>Audit evidence</th>
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</thead>
<tbody>
<tr>
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<td></td>
</tr>
<tr>
<td></td>
<td>Maximum 5 marks any one issues × 3</td>
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<tr>
<td></td>
<td><strong>Ideas</strong></td>
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<tr>
<td></td>
<td>– Oral vs written</td>
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<tr>
<td></td>
<td>– Internal vs external</td>
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<tr>
<td></td>
<td>– Auditor generated</td>
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</tr>
<tr>
<td></td>
<td>– Procedures (relevant, reliable, sufficient)</td>
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</tr>
<tr>
<td></td>
<td>Maximum</td>
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</tbody>
</table>

### Total

| Maximum for part (a) | 7 |
| Maximum for part (b) | 7 |
| Maximum for part (c) | 6 |

### 20

(a) **Sale of cargo carrier to Cad**

(i) **Matters to consider**

A cargo carrier has been sold to a party which is potentially related to Orneriac under the requirements of IAS 24. A loss has been made on that disposal of a non-current asset.

**Materiality**

The loss on disposal has reduced profit before tax by GHS400,000. This 14% reduction is material to profit.

**Related party transaction?**

Frederic Bounder, the finance director who approved the sale of the cargo carrier, has a substantial equity interest in Cad, the company to whom it was sold. As such, Cad appears to fall within the criteria of a related party under IAS 24.

This connection would appear stronger if Mr Bounder owned shares in Orneriac or was a director in Cad, and if Cad was controlled by his close family members.

**Implication**

The transaction should be disclosed in the financial statements as a related party transaction. This disclosure should include:

- The names of the transacting related parties
- A description of the relationship between the parties
- A description of the transactions
- The amounts involved
- Any money outstanding due to the company/related party
Other related parties
The auditors should consider, and be alert for evidence of, other related parties and transactions.

Reasons for the sale
The fact that a large loss has been made on the sale raises other matters for the auditor to consider:

- Whether the sale has been made at an undervalue (this may have tax implications)
- Why the machine was sold:
  - Maintenance problem
  - Reduction in operations
  - Movement in technology rendering others obsolete
- Whether the depreciation policy was incorrect (over 20 years)

These questions will lead the auditor to review the remaining non-current assets to ensure that they are not impaired and that the depreciation policies are reasonable.

Disclosure of loss on sale
As this item is material it would be disclosed separately in accordance with IAS 1 Presentation of financial statements.

(ii) Audit evidence
The following evidence will be sought:

- A copy of the sales agreement
- A copy of any valuation report carried out on the asset
- Evidence of receipt of the proceeds through the bank
- The calculation of the loss (this should be checked for accuracy)
- Notes of discussions with management about procedures and the related internal controls for the identification of related party transactions
- Results of reviews of board meetings, share registers and other statutory records
- Written representations from management regarding the completeness and accuracy of related parties and transactions and that they have been accounted for appropriately
- A copy of the disclosure note which is to be included in the financial statements

(b) Light aircraft
(i) Matters to consider
Onneriac owns two light aircraft which are used to service a contract which will not be renewed when it comes up in six month's time.

Materiality
The total cost of the aircraft was GHS900,000. They have been owned in the region of three years, and have been depreciated over 15 years. Therefore, their carrying value is in the region of GHS720,000. This represents 7% of total assets and is therefore material to the statement of financial position.

Impairment
The aircraft were purchased to service a contract which will not be renewed when it expires six months after the end of the reporting period. This significant change in the market in which the assets operate indicates impairment of the asset and requires management to carry out an impairment review under IAS 36. The auditors need to establish whether this has been carried out.

Management intentions
The auditors need to discover what management's future intentions for the assets are:

- Sale
- Alternative use
These intentions will impact on the impairment review.

**Impairment loss**

If an impairment loss has been identified, the auditors need to discover:

- Whether it is material (≥ GHS100,000, say)
- Whether it has been properly disclosed in the financial statements

**(ii) Audit evidence**

- A copy of the service contract and any correspondence
- Results of inspection of the aircraft (to ascertain condition)
- Notes of enquiries of management to ascertain
  - Future intentions
  - Whenever an impairment review was carried out
- Evidence from the impairment review – for example, any draft sales agreements, cash flow projections relating to value in use, any contracts relating to new uses for the aircraft

**(c) Deferred tax**

**(i) Matters to consider**

Deferred tax has been provided for in respect of accelerated capital allowances in accordance with IAS 12.

**Materiality**

The tax provision amounts to 21% of profit before tax and is therefore material. The increase in the provision, of GHS76,000, is not material to profit before tax.

**IAS 12 – rate of tax to use**

IAS 12 requires that deferred tax is calculated at a rate of tax that is ‘substantively enacted’ and expected to apply to the period when the deferred tax is to be settled. Substantively enacted generally means that it has been made into law, not merely suggested or announced.

In this instance, therefore, the directors are proposing to amend the provision to apply a tax rate that is not substantively enacted, but has merely been announced.

**Implication**

If the directors do make the provision bigger, they will no longer be complying strictly with the requirements of IAS 12. The auditors should discuss the matter with the directors and dissuade them from making such an addition to the provision.

However, the additional provision is immaterial to the financial statements, so the auditors are unlikely to conclude that the deferred tax balance does not give a true and fair view.

**(ii) Audit evidence**

- A copy of all the calculations made in relation to the tax balances
- The client's schedules relating to the tax basis used
- Agreement of tax rate to tax legislation
- Schedules of non-current assets used in tax calculations agreed to non current asset register/general ledger
- Audit programme for non-current assets with evidence of verification of changes (eg additions)
- A reconciliation of the tax expense with the accounting profit
- Minutes of directors' meetings confirming details of any major additions etc in non current assets
Question 4

Marking scheme

(a) (i) Leases
Generally 1 mark per matter/evidence point:
Matters:
– Correct calculation and assessment of materiality
– Classification of lease
– IAS 17 indicators of finance lease
– Finance charge
– Depreciation
– Disclosure
Evidence:
– Lease clauses re risk and reward
– Recalculate Present Value of Minimum Lease Payment v fair value
– Recalculate depreciation and finance charge
– Cash book for payments
– Review of disclosures
– Split current/non-current payable
Maximum 9

(ii) Financial assets
Generally 1 mark per matter/evidence point:
Matters:
– Correct calculation and assessment of materiality
– Classification as held for trading
– Assets shown at fair value – could be subjective
– Disclosure
Evidence
– Agree purchase price
– Agree fair value
– Recalculate gain
– Review of disclosures in notes
– Review of disclosure in OFR/other information published with financial statements
Maximum 6

(b) Interim financial information
Generally 1 mark per procedure:
– Comparisons with past data eg to preceding period, to corresponding interim last year, to last audited accounts
– Comparisons to anticipated results
– Comparisons of non financial data/ratios
– Comparisons to similar entities
– Disaggregation of data
Maximum 5

(a) (i) Matters to consider

Materiality

Both the non-current assets recognised and the total finance lease payable are material at 8% and 7.1% of total assets respectively (breaching the 2–5% threshold).
**Accounting treatment**

- Whether the leases have been classified correctly as finance leases in line with IAS 17 Leases

  The assertion that the leases are finance leases means that they are in substance assets rather than expenses. This means that Jerome Co must have the risks and rewards of ownership, including:
  - Responsibility for repairs and maintenance
  - Transfer of legal title at the end of the lease term
  - The lease is for most of the assets' useful life
  - The present value of the minimum lease payments is substantially all of the assets' fair value

- The leases result in finance charges against profit and loss, calculated using the actuarial method.

**Audit evidence**

- A copy of Jerome Co's workings in relation to the finance leases
- Check the additions and calculations of the workings.
- To verify that the leases are classified correctly as finance leases, review the lease contracts for indicators of transfer of the risks and rewards of ownership, such as:
  - That Jerome is responsible for repairs and maintenance of the assets
  - That legal title is transferred to Jerome at the end of the lease term
  - Confirmation that the leases are for the major part of the assets' useful lives
  - That the present value of the minimum lease payments is substantially all of the assets' fair value
- Recalculation of the finance charges charged against profit and loss
- Agreement of interest rates used in calculations to lease agreements
- Recalculation of depreciation charges applied to non-current assets
- Recalculation of operating lease expenses, on a straight-line basis over the lease term

(ii) **Matters to consider**

**Materiality**

The financial assets of GHS1.26m are material at 2.8% of total assets. The gain of GHS350,000 is material at 10.9% of profit before tax.

**Accounting treatment**

- IFRS 9 *Financial instruments* sets out the categories that financial instruments must fall into, along with the appropriate accounting treatment for each. The initial classification of the financial assets as 'held for trading investments' is therefore a crucial area of judgement as it determines the accounting treatment – in this case, at fair value. This means measuring the fair value at the year end, and recognising any gains or losses directly in profit or loss.

- The assets should therefore have been purchased in order to sell them in the short term, and must be part of a whole portfolio of instruments that are managed together with a view to short-term profit.

**Audit evidence**

- A schedule showing all the investments held in this category and the fair values of each
- Agreement of the fair values to external evidence such as year end market price (current bid price)
Recalculation of the total gain or loss as the overall movement in fair value over the course of the year

Review of the internal controls and procedures followed by the trading department. Testing to confirm that details (quantities, dates, etc.) shown on the schedule can be relied upon

Analytical procedures to confirm that there is a portfolio of investments that are traded frequently with a view to short-term profit. Corroboration by a review of events after the year end

(b) According to ISRE 2410, the auditor's analytical procedures should include the following.

- Comparing the interim financial information (IFI) with forecasts and budgets, obtaining explanations from management for any discrepancies
- Comparing the IFI with prior periods, such as the same period in the last financial year
- Comparing the IFI with other entities in the same industry
- Analytical procedures designed to identify relationships and unusual items that may reflect a material misstatement
- Considering the nature of any corrected or uncorrected misstatements in last year’s financial statements
- Considering any significant risks that were identified in the audit of the year end financial statements

Question 5

Marking scheme

(a) Matters/actions
Up to 2 marks for each matter/action identified and explained (max 3 marks for identification):
- Poe Co is a significant component
- Matter is material to individual and group financial statements
- Accounting treatment/qualification for Poe Co's financial statements
- Review of audit work performed
- Consideration of further audit work
- Discuss with group management and those charged with governance
- Request that Poe Co's management adjust financial statements
- Adjustment could be made on consolidation
- Impact on group opinion if no adjustment made

Maximum 11

(b) Principal procedures on consolidation
Generally 1 mark per procedure explained:
- Test controls
- Review group instructions
- Recalculate adjustments
- Reconcile inter-company balances
- Review fair values/consider need for expert
- Consider consistency of accounting policies
- Recalculate deferred tax implications
- Agreement to component financial statements
- Consider treatment of non-controlling interests
- Arithmetical accuracy of consolidation schedule

Maximum 9
(a) **Materiality to group**

ISA 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) states that a component is significant (material to a group) where a chosen benchmark is more than 15% of the same figure for the group as a whole.

Poe Co's profit before tax is 20% of group profit before tax (PBT), and total assets are 23.5%. This suggests that Poe is likely to be classed as a significant component by the auditors.

**Materiality of issue**

The GHS2m legal claim represents 50% of Poe's PBT, and 10% of total assets. The claim is also material to the group, at 10% of PBT and 2.4% of total assets.

**Qualified opinion – Poe**

Portia & Co have expressed a qualified opinion on Poe in relation to IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Audit evidence was obtained that led the auditor to conclude that the Note 12 to the financial statements of Poe materially misstates the probability of the claim against the company being successful. Presumably Portia & Co must have obtained audit evidence that the claim's chance of success was not 20% as stated, but was 50% or more. This would mean that a liability should have been recognised in accordance with IAS 37.

As this misstatement is material but is unlikely to be deemed pervasive, the qualified opinion is correct provided that the audit evidence obtained is sufficient and appropriate.

**Audit evidence**

Poe Co is material to the group, as is this specific issue. The group auditor should therefore review Portia & Co's audit evidence in relation to it.

The key question is the assessment of the probability of the court-case being lost, and the consequent future outflow of GHS2m. The group auditor should discuss the matter with Portia & Co's audit engagement partner. Audit evidence should include copies of all legal correspondence, as well as written representations from Poe's management regarding their accounting treatment of the matter.

Depending on the strength of this evidence, it may have been appropriate for Portia & Co to have used an auditor's expert to provide a separate legal opinion on the matter.

**Further evidence**

The group auditor may determine that further audit evidence needs to be obtained, such as the opinion of an auditor's expert is this has not been sought. This can be done either by collaboration with the component auditor, or by the group auditor alone.

It is possible that there is not sufficient appropriate evidence to qualify the opinion on this matter, and that Poe Co's management is correct. In this case, Portia & Co would have to redraft its auditor's report to show an unmodified opinion.

**Impact on group – discussion with group management**

The matter should be discussed with group management in order to ascertain what the impact will be on the group financial statements and auditor's report. There are a number of possible outcomes, examined below.

**Poe's financial statements changed**

The group auditor should request that Lance Group's management ask Poe to adjust its financial statements and recognise a provision. This would mean that Portia & Co's audit report, which has not yet been issued, could potentially be issued with an unmodified opinion if the adjusted financial statements are not materially misstated.

**Only group accounts changed**

If Poe's financial statements are not adjusted, then the group financial statements themselves could still be adjusted to avoid the material misstatement. The auditor's opinion on Poe would still be qualified, but the group auditor's report would not have to be modified in relation to this matter, as it would have been adjusted out of the group accounts.
No adjustment made at all

If no adjustment is made to Poe's or the Lance Group's financial statements, then the group audit opinion is qualified ('except for') due to a material misstatement. The work of the component auditor would not be referred to in the group auditor's report.

(b) The audited accounts of each subsidiary should be agreed to the schedules used in the consolidation process, as figures may not have been transposed correctly. Verify that all six subsidiaries are included on the schedule, and that the consolidation schedule agrees to the group financial statements.

The consolidation schedule should be arithmetically checked by casting and cross-casting.

All consolidation adjustments should be reviewed and recalculated, for example pre-acquisition reserves and goodwill for subsidiaries, along with any fair value adjustments. It will be necessary to agree adjustments to underlying documents, eg some of the figures making up goodwill may be agreed to prior year financial statements.

All intercompany balances should be reconciled, and a schedule obtained of intercompany transactions to ensure that they are eliminated from profit and loss.

Procedures should be performed to verify that subsidiary items that should be carried in the group accounts at fair value have been, where they may be measured in the subsidiaries' financial statements on a different basis, eg properties which must be carried at fair value in the group, but which may be at depreciated cost in the subsidiary.

The auditor should verify that accounting policies have been applied consistently across the group, and that where adjustments need to be made for the group accounts these have been made correctly (eg because of foreign subsidiaries which operate under different financial reporting requirements).

The deferred tax consequences of consolidation and fair value adjustments should be reviewed for completeness, and calculations re-performed for accuracy.