



# **COMPETENCE PRACTICE EXAMINATION**

## **FULL AUDIT**

**DECEMBER 2010**

## **SUGGESTED SOLUTIONS**

## SUGGESTED SOLUTIONS

### QUESTION 1

SECTION A
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1)

**(a) Regulatory environment**

- Strengthened regulatory frame work, laws and standards. For instance, promoting confidence in corporate reporting and governance especially high quality corporate reporting, high quality auditing and corporate governance among others.
- To develop high quality standards that minimizes manipulations and reduced quality audits.
- Increased public oversight both locally and internationally and enhanced corporate governance
- Strengthened audited committees that are able to deal with the audit committee roles and responsibilities independently and adequately
- Enhance the effectiveness of the internal controls as they relate to risk management, responsibilities of directors and that of auditors.
- Put in place effective laws dealing with money laundering from the international perspective, additional guidance and the accountant's obligations as they relate to money laundering.
- Strengthened laws and regulations as they relate to companies, responsibility of management for compliance and auditor's consideration of compliance.

**(b) Professional and ethical considerations**

- Generally, stricter enforcement of both ethics and fundamental principles for professional accountants. This may involve ensuring that there is complete adherence to the following threats to compliance with the fundamental principles:
  - **Self-interest** by not allowing auditors to have any financial interest in a client regardless of the percentage involved or allowed by the company involved.
  - **Self-review** by not auditing financial statements prepared by the firm even if they were prepared by another team within the firm. The so called Chinese wall should be discouraged.
  - The **threat of advocacy** by not allowing the audit firm having shares in a listed entity when that entity is a financial statement audit client.
  - **Familiarity threat** by ensuring that the audit team member does not have family at the client

- **Intimidation threat** by ensuring that auditors are not threatened with replacement due to disagreement between auditors and clients.
- Sufficient safeguards must be put in place to ensure that professional and ethical considerations are sufficiently adhered to.

**(c) Practice Management**

- Enhanced quality control at the firm's level to ensure that international standards are followed to the last, leadership responsibilities for quality within the firm by ensuring that the firm appoints an individual or group of individuals to oversee quality in the firm. Such individuals must have sufficient and appropriate experience, ability to carry out the job, and the necessary authority to carry out the job.
- Qualified human resources with the necessary capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards. There is normally a tendency by audit firms to recruit low paid staff.
- Sufficient policies and procedures must be put in place that ensures that assignment of engagement teams have key members of client staff and those charged with governance are aware of the identity of the audit engagement partner, the audit engagement partner has appropriate capabilities, competence, authority and time to perform the role and that the engagement partner is aware of his responsibilities as engagement partner.
- Ensure that there is good engagement performance by providing sufficient direction, supervision, review, consultation and be able to resolve disputes
- Ensure that the audit firm has in place quality control procedures that are relevant, adequate, operating effectively and are complied with. The system of quality control must be adhered to.
- Individual audit quality control must sufficiently be checked and ensured. These may include leadership responsibilities, ethical requirements etc.

**(d) Procedures involved in a range of audit and assurance engagements.**

- Strengthen the requirements of obtaining and accepting professional appointments. These may include those relating to change in auditors, advertising and fees, tendering, acceptance and agreeing terms pertaining to audits.
- Enhanced planning and risk assessment especially focusing on audit methodologies, materiality, risk and analytical review procedures. ISA 315

- Obtaining audit evidence that sufficiently supports financial statements assertions. Audit evidence must be sufficient and appropriate and documented sufficiently.
- Conducted in detail an evaluation and review of audit assignments and assurance engagements and matters relating to specific accounting issues.
- Strengthen laws relating to fraud and additional requirements on the part of the auditor as opposed to the current requirements under the ISA 240.
- Device stricter requirements for the auditor to follow and apply when it comes to reporting and ultimately giving of an audit opinion.

2) *For (a) and (b) the following circumstances and cause of concern can be deduced.*

Circumstances	Cause for concern
Reduction in gross profit percentage (29.4%)	<ul style="list-style-type: none"> <li>• The absolute fall in revenue has been explained.</li> <li>• However, the fall in gross profit margin is more serious.</li> <li>• This seems to be a continuing problem as expenses seem constant and interest costs are growing.</li> <li>• The future return to profitability is likely to be difficult.</li> </ul>
Losses of K225 million	<ul style="list-style-type: none"> <li>• Difficulty in obtaining finance from the bank. This has been made even more difficult with the loss of a dependable customer.</li> </ul>
Increase receivable balance (25%) and increased ageing. 2008 – 78.8% days 2009 – 98.6%	<ul style="list-style-type: none"> <li>• Worsening debt collection period</li> <li>• Company is making losses</li> <li>• Liquidity has deteriorated</li> <li>• Bad debts likely to arise due to high debt collection period possibly due to lost customer during the year</li> <li>• Bad debts write-off would cause much increase in losses.</li> </ul>
Increased reliance on short –term financing. E.g. Overdraft	<ul style="list-style-type: none"> <li>• This is not a guarantee in terms of steady flow of finance. Future bank overdraft negotiations may be difficult thus expose the company to a higher risk</li> </ul>
Worsening liquidity ratio 2008 – 1.03 2009 – 0.88	<ul style="list-style-type: none"> <li>• Current ratio may worsen further if bad debt provision is made or required</li> <li>• Company has obtained a loan and has also lease obligations that may not be met.</li> </ul>
Increased gearing	<ul style="list-style-type: none"> <li>• Problem of meeting interest payments thus impact on profits and in turn increase losses</li> <li>• Negotiating for new financing may be a problem</li> </ul>

Loss of major customers to competitor	<ul style="list-style-type: none"> <li>• More customers may pull out thus worsening company's future prospects</li> <li>• There may be need to make further provisions for bad debts</li> </ul>
Loss of commercial farmer in Mkushi	<ul style="list-style-type: none"> <li>• Loss of an established and big farmer who may have been providing regular income is a blow to the company. Thus repayment commitment may suffer as a result.</li> </ul>
Draft accounts are provided and some final adjustments are outstanding.	<ul style="list-style-type: none"> <li>• This is likely to affect the net assets position in the event non-current assets are written down to recoverable amount</li> <li>• Repairs inventory written down to net realizable value</li> <li>• Further bad debts provision may be necessary</li> <li>• The closure may necessitate redundancy provisions</li> <li>• Ultimately, all these may lead to increased losses.</li> </ul>
Review of overdraft facility after three (3) months. Time is short	<ul style="list-style-type: none"> <li>• No meaningful improvements may be seen</li> <li>• For reporting purposes, auditors to face the problem of fundamental uncertainty as the auditors may not clearly ascertain the bank's decision at the time.</li> </ul>
Anticipated future return to profitability	<ul style="list-style-type: none"> <li>• Is this over optimistic for the company?</li> <li>• Whether to place too much reliance on management representation. High risk or not.</li> </ul>

- (c) **Audit procedures** – the procedures should relate to issues of subsequent events, review of bad debt ageing, the managing director's future plan, bank correspondence, sales orders, cash flow forecast and written representations.
- (i) Cut-off procedures to determine whether sale proceeds for non-current assets, inventory and cash received from customers occurring after the end of the reporting period.
  - (ii) Review outstanding amounts from lost customers whether they are recoverable or not. Is there any provision made for the amounts? How are the bad debts ageing in relation to the cash recovery lists?
  - (iii) Review bank records and correspondence to determine as to whether loan and lease commitments have been met.
  - (iv) Review the bank records to determine as to whether the company is operating within the overdraft facility after the end of the reporting period.

- (v) Review the bank correspondence for terms and conditions of the facility. Note down any concerns from the bank and suggestions concerning the current position of AGRIC – EQUIP.
- (vi) Review the bank certificate for terms and conditions of the facility
- (vii) Determine if at all the company has made efforts to increase its customer base after the pull out of the major customer
- (viii) Review the cash flow and profit forecasts and determine whether prudence has been considered. For instance, are future profits able to meet future obligations such as bank overdraft, lease charges etc.
- (ix) Review the sales ledger and related books of accounts to determine whether there has been additional loss of customers. This may be seen from debts outstanding for some time.
- (x) Get management representation as to whether the modern equipment and machinery will lead into generating more cash and ultimately increasing profits.
- (xi) Obtain management representation as to whether the company is most likely going to operate for the next 12 months from the date of approval of the financial statements.
- (xii) Review the budgets against the actual results for reasonableness
- (xiii) Ensure that all commitments have been cleared in line with the legal requirements.
- (xiv) Ensure that the income forecast and profits are reasonable and that they will result in reduced short-term financing such as overdrafts.

## SECTION B

1)

**(a) (i) and (ii) - Identifying and explaining business risks and linking them to financial statements risks.**

Identifying and explaining	Linkage to financial statements risks
The renewable licence and service contract which is depended on meeting council requirements and the ending of tax rebates represent <b>compliance risk</b> and if they are not renewed and paid respectively, AGRIC-EQUIP will not be able to operate legally	The risk associated to this is that the renewable licence may be wrongly treated in the financial statements possibly as an expense instead of capitalizing it as an intangible asset. There is also a risk of not amortizing the asset or carrying out an impairment review and subsequently carrying the asset at an inappropriate high value. It is therefore important that the requirements of IAS 36 (impairment) and IAS 38 (intangible assets) are adhered to.
The unpaid leave for staff in Nakonde may represent a <b>compliance risk</b> possibly as per labour laws in Zambia. Further implications would be that violation of labour laws may result in litigations.	The company may need to make provisions for the amount that is likely to be paid out in the event that workers opt for litigation where a dispute arises. The risk is that the unpaid leave issues may have an effect on contingent liabilities and that disclosure in the financial statements may not be appropriate. Disclosure may be required.
Some customers seem to be dissatisfied with some services being provided as some seed cannot germinate properly. With the expected coming in of other warehouse operators, AGRIC-EQUIP may is likely to lose some customers. An <b>operational risk</b> therefore arises.	The risk here is that of going concern for the company. The business may fail thus the need to have the financial statements prepared properly in line with this expectation. The litigation that may arise also may have an effect on the going concern. There is need therefore for disclosure.
<b>Cash flow</b> problems cam also result in <b>going concern</b> problems thus the need to make disclosure of the same.	The risk is that the company may not have sufficient cash flow to embark on remedying the problem of training and refurbishing of its warehouses. The cash flow problem may even be worsened
The closure of the Nakonde warehouse and the partial closure of the Mkushi warehouse	The risk is that relating to discontinuing activity and as an impact on the revenue base.

is an <b>operational risk</b> . This may affect the company's operations due to the reduced activities and may not gain some of its customers after re-opening.	There is need to disclose this issue separately.
Staff turnover, non –training of staff and part-time employees are all signs of <b>operating risks</b> . The company may not operate properly with few permanent staff, and less current skills in the warehouse service industry. Part-time workers may not be as royal as the full-time employees. This may impact on the company's operations.	The risk may relate to reduced cash flow due to lose of customers arising from reduced bankable service from skilled workers. The going concern will need to be questioned. In the long run, the savings as a result of using part-time employees may not be sufficient to cushion the lost business and revenue.
Reduced warehouse service activities are an <b>operational risk</b> and the company revenue trends may reduce and in turn affect the working capital	The risk may be that of going concern arising from reduced cash inflow.
The advanced payments are not refundable. However in the event that they are not utilized on other company's services, farmers may claim for a refund or partial refund. A <b>finance risk</b> therefore arises as money may not be available for refunds.	<p>The financial statements risk is that the advance payments should be accounted for correctly. The need to avoid misstatement and ensure that they are recognized properly arises.</p> <p>The reduced trends in revenue as per reports arising from the warehouses are a source of concern. The control risk seems to be eminent as delays are noted on a monthly basis. The monthly reports are likely to be inaccurate and these inaccuracies should not be reported in the financial statements.</p>
The issue of competition is an <b>operating risk</b> . It is evident that more companies will be issued with licences and service contracts to operate in warehousing.	The risk may be that of cash flow. Insufficient cash flow is a source of liquidity problems and ultimately going concern problems.

**(b) Internal controls**

1. **Monitor the quality of seed/inputs sold.** There could be instances were some seed are expired as observed that some are not germinating properly.

2. **The need to promptly submit monthly accounting and inventory returns.** The revenue trends have already started going down thus the need to react to reasons and facilitate decision making.
3. **The need to review the discount arrangements.** This will assist in knowing whether discounts are given to those who qualify.
4. **Review of advance payments arrangements** to ensure that the system is working as per management intentions.
5. **Regular reconciliation of customers paying in advance** to ensure that there are no over and understatement of amounts.
6. **Review the quality of service being provided to farmers.** The late delivery of seeds and related inputs are a source of concern and could be avoided and not lose revenue.
7. **Review of incentives provided to new employees.** This may have an effect on revenue considering that already revenue is going down. Possibly, sales arising from this incentive may be used to cushion the impact of reduced revenue.
8. **Ensure that land rates are paid to the council.** This will ensure that the licence is renewed as the renewal is depended on this condition.
9. **Ensure that farmers groups are properly separated.** Those under the 10% advance payment and those under the 15% discount upon making full payment may need to be reconciled.
10. **Ensure the trade-off arrangements are done properly** as some trade off may cost much higher than paid or less.

## QUESTION 2

<b>SECTION A</b>
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- 1)
  - (a) The matters to consider should be first the assessment of materiality then the relevant IFRSs such as IAS 1, 8, 10, 16, 36, 37 and IFRS 5. Other matters may involve risks.

**(i) Closure of Mufurila branch**

**Matters to consider – F/S 1, note 1:**

- The income from the ceased operations from the Mufurila branch is material to the income statement and represents 1.4% of the revenue.

- Since the Mufurila branch is part of BOLTs Metal Fabrications Ltd, thus qualifies to be a component. It would qualify as discontinued operations in accordance with IFRS 5. Discontinued operations would need to be disclosed in the financial statements.
- The provision meant for compensation of employees to be declared redundant of K200 million is material to the income statement as it represents 11.11% of profit before tax.
- It would be important for the auditor to consider the timing associated with the redundancy costs to ensure that the provision meets the criteria of IAS 37. However, if the branch has completely closed down by 31 December 2009, then there would be a liability arising as a result of past event.
- Whether the provision has been understated or overstated
- Consider whether the asset should be classified as held for sale. IFRS 5 states that the asset should so considered if it is highly probable that they will be sold.
- Consider whether if the carrying amount of the asset held for sale will be recovered principally through a sale transaction rather than through continuing use. It looks like management have made the asset to be available for immediate sale in its present condition and that the sale is highly probable as management seems to be committed to a plan to sell the asset, that include an active programme to locate a buyer, an active market and expectations to take place within one year.
- Consider whether BOLTs Metal Fabricators will carry the asset at fair value that is higher than the carrying value. IFRS 5 also states that a non-current asset that is held for sale should be measured at the lower of its carrying amount and fair value less costs to sell. Fair value less costs to sell is equivalent to net realizable value.
- Consider the materiality of the difference between the carrying value and fair value. The difference is approximately 1% of total assets and is therefore not material to the balance sheet.
- However, if the difference of K300 million is taken to the income statement, it would be material as it represents 16.7% of profit and should therefore be revised.

## **(ii) Revaluation**

### **Matters to consider – F/S 1, note 2:**

- According to IAS 16, when assets are revalued, the entire class of those assets must also be revalued. this is not so in the note

- Rolling basis revaluations are permissible once the revaluation basis is in place. However, BOLTs should not carry assets in the same class under different valuation bases. All assets must therefore be valued in the first instance.
- From the information available, BOLTs seem to be seeking to revalue its properties on a rolling basis and that two properties have been revalued in the current year and the remaining scheduled to be revalued in 2010.
- The revaluations carried out represent 17.5% of the total assets. This is material to the balance sheet and would even be more material when the other remaining properties are revalued next year.
- The corresponding credit in equity will also be material to the balance sheet.
- If BOLTs do not value all the assets in the class in the financial statements to 31 December 2009, then the auditors would have to qualify the audit report on this issue.
- In line with IAS 16, when a company revalues the assets, there is need to disclose the following:
  - The date of the revaluation
  - Whether an independent valuer was involved
  - Methods and significant assumptions applied in estimating the items fair values
  - The extent to which the fair values were determined by reference to observable prices on the open market or other techniques.
  - Carrying amount to have been recognized under the cost model
  - Any revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to the shareholders.

**(iii) Disclosure of fines**

**Matters to consider – F/S 1, note 3:**

- The fine of K200 million is 5.5% of profit before tax and is therefore material to the income statement. The corresponding amount is even more material to profit before tax
- Consider the nature of the fine and if there are some indication of continual non-compliance with laws and regulations, it may result in more serious action than a fine.
- Consider disclosure requirements if they are consistent with the previous years. Any changes must be in line with the requirement to show whether a fair view has been taken or to comply with the standard

- Consider disclosing separately the fines as an item in the income statement since it is material in line with IAS 1 or disclose by way of a note to the financial statements
- Consider the issue of non-compliance and effect with laws and regulations as per ISA 250. This may impact on the financial statements if they may what would be the possible effect of that non-compliance.
- Consider whether the non – compliance with issues of pollution may give rise to the problem of going concern considering its impact on the financial statements
- Consider if non- compliance is not intentional by those charge with governance and discuss the matter
- If the non-compliance is intentional for the purpose of money saving, they might be classified as a money laundering offence.
- A risk may arise if the regulators decide to with draw the licence as a result of non-compliance. Withdraw of the licence may impact on the company’s operations thus bring in a going concern problem. BOLTs Metal is already facing reduced business activities.

**(b) (i) Audit evidence expected to find - F/S 1, note 1:**

- There must be sufficient details of the decision pertaining to the close of the division such as board minutes, press notices, communication with employees etc.
- The terms of the redundancy package for the marketers in line with their contracts of employment.
- Proof of the reasonableness of the redundancy provision in line with IAS 37. This must take into account the number of marketers involved, number of years serves and expected payment for each year served.
- Sales amounts attributable to the ceased branch clearly reflected in the management accounts.
- Details of agreement to sell the asset held for sale.
- Evidence to proof that either the carry amount is lower than the fair value or vice versa.
- Physical inspection of the unsold vehicles to check condition and particulars of agreement.
- Evidence that there is a separate disclosure of the vehicle in the balance sheet or the notes.

**(ii) Audit evidence expected to find – F/S 1, note 2:**

- The revaluation report for each of the properties
- Physical inspection of the properties especially the one with a large surplus to confirm condition.
- Sale particulars of comparative assets to verify valuation
- Obtain schedule of depreciated costs of own properties.
- Consider differences between depreciated costs and revaluation of property
- Disclosure in the financial statements in line with IAS 16

**(iii) Audit evidence expected to find – F/S 1, note 3:**

- Look for details of company's health and safety policies
- Look for any correspondence relating to fines in form of penalty notices
- Re-perform calculations that make up the K200 million fines and agree amounts to cash book.
- Proof evidence that the reduction of fine of K300 million for last year is not as a result of understatement in this year's accounts of K200 million.
- Get a written management representation on the penalties to ensure that there are no other penalties not disclosed in the financial statement.
- Check to ensure that there are no threats of licence with draw from the regulators.

**2)**

**(a) (i) Matters to consider – F/S 2 – 1/3, note 4:**

**Deferred tax adjustment**

- The deferred tax balance has not been adjusted to reflect current period balances
- Adjustment of deferred tax would result in the following balances;
  - Deferred tax liability of K1.8 billion ( $K4.4 \text{ b} - 10.4 \text{ b} = K6 \text{ b} \times 30\% = K1.8 \text{ b}$ )
  - Debit in the income statement K100 million ( $K1.8 - K1.7 \text{ b} = K0.1 \text{ billion}$ ).
- With the change in liability representing approximately 5.5% of the profit before tax and 0.3% of total assets the adjustment is material to the income statement but not to the

statement of financial position. An adjustment should be considered for the income statement.

- Consider whether the tax rate of 30% is the correct rate to apply
- Whether the net book values and tax written down values provided are correct
- Whether there are any additional taxable temporary differences or deductible temporary differences that should be taken into account.
- Consider whether adequate disclosure is provided in accordance with IAS 12.

**(ii) Matters to consider – F/S 2 – 2/3, note 5**

**Provisions and contingencies disclosure requirements**

- Disclosure in line with IAS 37
- Provision should be recognized in the accounts if:
  - An entity has a present obligation (legal or constructive) as a result of a past event
  - A transfer of economic benefits will probably be required to settle the obligation
  - A reliable estimate can be made of the amount of the obligation
- Under IAS 37 contingent liabilities should not be recognized. They should however be disclosed unless the prospect of settlement is remote. The entity should disclose:
  - The nature of the liability
  - An estimate of its financial effect
  - The uncertainties relating to any possible payments
  - The likelihood of any re-imbursement.

**(iii) Matters to consider, F/S 2 – 3/3, note 6:**

**Borrowing costs**

- Borrowing costs should be capitalized as part of the cost of the asset if they are directly attributable to acquisition/construction/production. Other borrowing costs must be expensed

- The cost of borrowing will stand at K1.05 billion  

$$((9 \times 15 \times \frac{1}{2}) + (15 \times 15 \times \frac{1}{2}) - (15 \times 1 \times \frac{1}{2})) = \text{K1.05 billion.}$$
- Consider expenditure incurred (K15 billion + K1.05 billion = K16.05 billion)
- Only those borrowing costs that would have been avoided otherwise are eligible for capitalized
- Amount of borrowing costs available for capitalization is actual borrowing costs incurred less any investment income from temporary investment of those borrowing.
- Consider whether there was active development and no interruptions for extended periods. If then capitalization should be suspended.
- Consider whether there are future plans to continue capitalizing the costs after December 2009.
- Consider if there has been any fall of the carrying amount below cost. If then, it must be written off.
- Consider if there has been sufficient disclosure in line with IAS 23.

(b) **(i) Audit tests or procedures – F/S 2 – 1/3, note 4:**

- Evidence to show that management has adjusted the deferred tax liability for the period and if they have not to request them to do so.
- Evidence to show that brought forward balance for deferred tax to the previous year's financial statements is as reflected
- Evidence to show that the temporary differences relating to the plant and equipment agree to tax computations and asset register.
- Evidence to show that actually the 30% tax rate was applied in accordance with IAS 12 as a substantially enacted rate of tax.
- Enquire into management and review tax computations to establish whether there are any further differences that needed to be adjusted.
- Review disclosure notes to ensure that they comply with IAS 12 including disclosure of the components of the deferred tax liability and the change in the liability.

**(ii) Audit test or procedures – F/S 2 – 2/3, note 5:**

- Review the director's service contract and ascertain the maximum amount to which he would be entitled and any provisions in the service contract that would prevent him making a claim particularly those relating to grounds for justifiable dismissal
- Review the results of the disciplinary hearing. Consider whether the company has acted in accordance with employment legislation and its internal rules, the evidence presented by the company and the defense made by the directors.
- Review correspondence relating to the case and determine whether the company has acknowledged any liability to the director that would mean that an amount for compensation should be accrued in accordance with IAS 37
- Review correspondence with the company's solicitors and obtain legal advice, either from the company's solicitors or another firm about the likelihood of the claim succeeding.
- Review correspondence and contact the company's solicitors about the likely costs of the case.
- Consider the likelihood of costs and compensation being re-imbursed by reviewing the company's insurance arrangements and contacting the insurance company.
- Consider the amount that should be accrued and the disclosures that should be made in the accounts. Legal costs should be accrued, but compensation payments should only be accrued if the company has admitted liability or legal advice indicates that the company's chances of success are very poor. However, the claim should be disclosed unless legal advice indicates that the director's chance of success appears to be remote.

**(iii) Audit tests or procedures**

- Re – perform calculations to determine as to whether the interest calculation was properly done and disclosed
- Perform analytical review procedures of the interest or verify it with payment records and any loan agreement documents
- Ensure that the borrowing costs have been properly capitalized in accordance with IAS 23
- Agree figures to interest payments made to statements from lender and or bank
- Ensure interest is directly attributable to construction.

## SECTION B

- 1) It must be appreciated that with the advent of the economic crisis, most affected companies may want to show a rosy picture of their performance. This must be anticipated by the auditors and therefore auditors should ensure that audits are properly planned. In this particular case, it may be important to focus on issues of fair value, going concern problems, auditing accounting estimates, liquidity aspects, fraud considerations, constraints on the availability of capital, marginally achieving explicitly stated strategic objectives etc. In particular, the following audit risk alerts should be considered:

### (a) Audit risk alerts

- (i) BOLTs Metals equipment seems to be obsolete in some way the reason why they want to modify it to suite the current environment. This may have an impact on the asset base. There is a likelihood that **fair value accounting considerations** including measurements of fair value in illiquid markets and auditing those fair value measurements.
- (ii) The need to be alert on issues of **impairment of equipment**. Most likely there is a likelihood of an impairment loss or temporary impairment. The equipment is likely to have fallen in value thus need for impairment determination.
- (iii) The need to be alert on issues of **accounting estimates**. There is likelihood that BOLTs Metal assets may be overstated in order to show a rosy picture of its performance during the year under review.
- (iv) The need to be alert on issues of **liquidity considerations**. BOLTs Metal is currently experiencing low demand for its products and as such low levels of sale. The pull out of major customer and the need to diversify are all signs of cash flow problems.
- (v) The need to be alert on issues of **going concern considerations**. BOLTs Metals is now thriving on overdrafts from the bank but has also imposed conditions. There seem to be complex financing arrangements being experienced. These are constraints to the availability of capital. Increased credit terms are a sign of liquidity problems and the lender are demanding for high turnover and improved asset base.
- (vi) The need to be alert on issues of **fraud considerations**. Some employees may take the situation at hand as an advantage to perpetuate fraud.

### (b) Going concern

The auditor need to consider whether current market conditions give rise to an increased risk of material misstatement of the accounts and, in particular, whether there are events or conditions and related business risks which may cast significant doubt on the entity's ability to **continue as a going concern**. In particular the following:

- (i) Has the entity experienced difficulty in the past in obtaining external finance and/or

complying with covenants? Companies need cash for working capital and salaries. Companies which have a poor credit history or insufficient assets to secure borrowings will face problems.

- (ii) Any covenants breached recently which may lead to facilities being withdrawn?
- (iii) Are finance facilities due for renewal in the next year?
- (iv) Are there alternative plans if finance is not renewed?
- (v) Do borrowing agreements (or other contracts) contain clauses that may trigger early repayment?
- (vi) Have facilities been renewed recently but with higher interest rates or charges?
- (vii) Is borrowing secured on assets which have decreased in value and may no longer cover the amounts owed?
- (viii) Might there be a delay in collections from debtors or an increase in bad debts because customers are affected by the credit crunch?
- (ix) Might suppliers be affected by the current climate and be unable to provide essential goods and services? Are alternative suppliers available?
- (x) Might assets be impaired? This could particularly affect fixed assets, goodwill, stock and debtors.

## **END OF SOLUTIONS**