<table>
<thead>
<tr>
<th>Potential business risk</th>
<th>Factors in assessing significance</th>
</tr>
</thead>
</table>
| 1.1 Proposed software upgrade | • The ability of the company to restore the previous version of the software within an appropriate timeframe.  
• The extent of integration of the upgraded software with other application software.  
• New or changed functionality in the upgraded software may affect the operation of control procedures.  
• As this is a version upgrade rather than a change in application software, there is likely to be no changes to controls.  
• There may be a loss of data during conversion, which would be exacerbated by inappropriate back-up procedures.  
• The availability and quality of IT personnel and conversion methodologies.  
• Data may be processed incorrectly by the upgraded software.  
• The extent of testing of the new software version prior to implementation.  
• Errors may be made by staff due to lack of familiarity with the upgraded software.  
• The extent of staff training and/or adequacy of operating manuals.  |
| 1.2 Increased competition | • Profitability will be impacted if revenue drops, which could result in going concern problems should the loss be significant.  
• The ability of the company to increase sales revenue is dependent on the price elasticity of existing products.  
• The ability of the company to develop new products and/or markets may be constrained by the availability of R&D resources and capital.  
• The ability of the company to access liquidity support, including supplier credit lines.  
• The company may not be able to sell its current inventory of personal computers.  
• The financial position of the major competitor and its ability to sustain the price war.  
• The current level of inventories and any purchase commitments for further deliveries of the affected products.  |
| 2.1 Loss of statutory records | • The existence and viability of a plan to rectify the problem before year end.  
• The possibility that the loss of records was motivated by a need to conceal a director’s interest in a contract.  
• The company may need to rationalise the business in order to decrease overheads and restore profitability.  
• The financial statements may be materially misstated due to inappropriate valuation of inventory.  
• The company may not be in compliance with the Companies Act.  
• Controls over retention of other statutory records may be inadequate.  
• Other outsourcing arrangements may not be adequately managed.  |
Part (a)
Potential risk/significance to the business of matters addressed in the Audit Risk Control Committee papers

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>2.2 Warranty repairs</td>
<td>• The extent to which maintenance contract income is subsidising warranty costs.</td>
</tr>
<tr>
<td>• Maintenance contracts may be overpriced due to the historical records of non-warranty repair costs being overstated.</td>
<td></td>
</tr>
<tr>
<td>• Overpricing may discourage customers from entering into maintenance contracts.</td>
<td></td>
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<tr>
<td>• The manufacturing problems which cause defects may not be identified as warranty cases are not being recorded.</td>
<td></td>
</tr>
<tr>
<td>• Reputational issues arising from manufacturing defects may not be appropriately identified or addressed.</td>
<td></td>
</tr>
<tr>
<td>• The financial statements may be materially misstated due to inappropriate provision for warranty costs and related aggressive revenue recognition.</td>
<td></td>
</tr>
<tr>
<td>2.3 Business continuity planning</td>
<td>• The significance of the profit contribution from the business units not addressed by the disaster recovery planning.</td>
</tr>
<tr>
<td>• Inadequate disaster planning may result in the loss of data and/or a business interruption and/or financial loss.</td>
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</tr>
<tr>
<td>• The ability of those other business units to implement workaround solutions in the event of a disaster.</td>
<td></td>
</tr>
<tr>
<td>• Whether those other business units make regular backups of programs and data.</td>
<td></td>
</tr>
<tr>
<td>• The adequacy of loss of profits insurance.</td>
<td></td>
</tr>
<tr>
<td>2.4 Cheque signing procedures</td>
<td>• The level at which authority levels are set.</td>
</tr>
<tr>
<td>• Any further frauds may not be detected.</td>
<td>• The extent of rigour applied to authorisation of payment requisitions.</td>
</tr>
<tr>
<td>• Unauthorised payments may be made due to inefficiencies in segregation of duties and/or authority limits.</td>
<td>• The effectiveness of controls over standing data changes relating to suppliers and their settlement details.</td>
</tr>
<tr>
<td>2.5 IT environmental controls</td>
<td>• The extent of independence of the business on its IT systems and equipment.</td>
</tr>
<tr>
<td>• There is a possibility of business interruption and/or financial loss due to inadequate precaution against the physical destruction of IT equipment.</td>
<td>• The extent to which timely replacement of IT equipment is currently addressed by the business continuity plan.</td>
</tr>
<tr>
<td>• The adequacy of equipment insurance.</td>
<td></td>
</tr>
<tr>
<td>• Steps taken to implement the control recommendations arising from the prior year audit.</td>
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</tbody>
</table>
Part (a)
Potential risk/significance to the business of matters addressed in the Audit Risk Control Committee papers

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<tbody>
<tr>
<td>3.1 Accounts payable reconciliations</td>
<td>• The extent of purchases and/or returns which may not be recognised.</td>
</tr>
<tr>
<td>• The management accounts may be misstated due to incomplete recording of purchases.</td>
<td></td>
</tr>
<tr>
<td>• Business relationships with suppliers may be impaired by the non-payment and/or late payment of supplier invoices.</td>
<td>• The extent of unprocessed invoices and/or late payments.</td>
</tr>
</tbody>
</table>

Part (b)
Effect on overall audit plan

The effects on the overall audit plan of the issues identified from the committee papers, including any increase in audit scope of which management would have to be advised, are as follows:

**Proposed upgrade of sales order processing software**
- Identify any changes in functionality which will affect the controls on which reliance was planned and consider the need to extend the scope of testing applied to those controls.
- Consider the timing of the software upgrade and the materiality of the transactions processed by the upgraded software in order to determine the audit significance of the upgrade.
- Obtain audit evidence regarding the data conversion process (accuracy and completeness assertions)
- Plan for use of computer auditors as appropriate, including consideration of the timing and staff grades/competencies.

**Increased competition**
- Obtain audit evidence regarding the effect of technological obsolescence on the valuation of inventory (valuation assertion)
- Increase the scope of revenue recognition testing to address the risk of a management incentive to overstate profit.
- Review the business plans developed in order to meet the competitive pressures and possible going concern risk.

**Loss of statutory records**
- The loss of the statutory records should have no effect as the records are expected to be replaced by year end. However, if the steps taken to replace the records are inappropriate, perform a company records search at the office of the Registrar of Companies to obtain the information required for the audit of the financial statements.

**Warranty repairs**
- Assess the potential understatment of warranty provision which arises from the warranty repair data being incomplete.
- Increase the scope of revenue recognition testing to ensure that the effect of loss-making maintenance contracts has been considered.
### Part (b)  
**Effect on overall audit plan**

**Business continuity planning**
- Consider the potential impact of inadequate business continuity planning on the going concern assumption.

**Cheque signing procedures**
- Extend the scope of testing in respect of purchases (occurrence assertion).
- Extend the scope of testing of supplier standing data and review the validity of new suppliers taken on.
- Review segregation of duties in respect of accounts payable and the related settlement processes.
- Consider the need to apply a lower materiality to address the risk of further unauthorised payments.

**IT environmental controls**
- The identified weaknesses in physical IT controls are not likely to affect the financial statements due to the minor nature of the matters raised.

**Accounts payable reconciliations**
- Extend the scope of testing regarding the reconciliation of accounts payable balances with supplier statements.

### Part (c)  
**Code of Conduct issues arising from request to attend the Audit Risk & Control Committee meetings**

The following are issues that should be considered in accepting the invitation to attend the Audit Risk and Control Committee meetings, and arising from the SAICA Code of Conduct:

- The audit partner should apply due professional care in ensuring his personal availability and in supervising the work done by the audit manager.
- When drawing on experience in providing input into the meeting, the audit partner should respect the confidentiality of information acquired during the course of performing professional services for other clients, unless such disclosure is specifically authorised.
- The audit partner would need to consider whether he is technically competent to provide input to the meeting, or whether he should involve specialists as required.
- The audit partner should maintain his independence through not exposing himself to a "self-review threat" by getting involved in management decisions.
- The fees charged for attendance at the meetings should be a fair reflection of the value of the professional services performed.
- The audit partner should consider whether the company is related to an SEC registrant and, if so, whether his attendance is in compliance with the requirements of the Sarbanes-Oxley legislation.
### Part (d)  
**Services to address King Code 2002 issues**

The following are ways in which the firm could assist the directors in fulfilling their responsibilities under the King Code 2002 as required to be reported on in the annual financial statements:

- Assist in documenting and/or assessing internal controls.
- Perform a specialist review of the management of financial risks.
- Perform a specialist review of the management of IT security risks.
- Perform a specialist review of the internal audit function.
- Facilitate simulated disaster scenarios to assist management in testing of business continuity planning.
- Make presentations to the Board on the implications of the King Code 2002.
- Facilitate risk identification and grading workshops to assist management to identify risks inherent in the business and determine their likelihood and financial impact.
- Provide accounting advice, for example in connection with Triple Bottom Line reporting.