It is 1 July 20X5. You are an audit supervisor of Orange & Co planning the audit of a new client, Scarlet Co, for the year ended 31 May 20X5. Scarlet Co manufactures chemicals for use in domestic and commercial cleaning products.

The company's financial accountant was taken ill suddenly in May 20X5 and is unable to undertake the preparation of the year-end draft financial statements.

As a result, the company recruited a temporary financial accountant in early June 20X5 who will prepare the draft financial statements.

The year-end financial statements need to be finalised quickly as the company is looking to raise finance through a bank loan to replace three machines in the production facility.

The bank has asked for a copy of the audited year-end financial statements by the end of September 20X5 before they will agree to the loan and the directors are keen to report strong results in order to obtain this financing.

In the year, the company also purchased a specialised machine to develop a new range of chemicals for a major customer.

Only trained staff are allowed to operate this machine and staff members had to undertake two days of training, followed by an assessment at the end of the training period.

The training costs of $15,000 have been capitalised as part of the cost of the asset.

The company sources many of its raw materials to be used in the chemical manufacturing process from an international supplier and goods can be in transit for up to three weeks.

The agreement with the international supplier contains a clause which states that Scarlet Co is responsible for the goods as soon as they leave the supplier's warehouse.

You have carried out a preliminary analytical review which indicates that the receivables collection period has increased from 38 days to 52 days.

The credit controller has confirmed that some customers are currently taking longer to pay than in previous years as they are awaiting payment from their customers.

On 29 May 20X5, the directors announced that one of its brands was being discontinued due to a fall in demand for the product. This resulted in four staff members being made redundant.

The payroll department has calculated the levels of termination costs associated with the redundancy and they will be paid in the July 20X5 payroll run.

The directors each received a significant bonus in the year which has been included in the payroll charge for the year in the statement of profit or loss.

Local legislation requires separate disclosure of directors' bonuses in the financial statements.

During the year the company sold a batch of chemicals to a customer for $120,000. At the beginning of May 20X5, the customer returned these chemicals because the chemical mix was not in line with the customer's specifications.

A credit note is yet to be issued to the customer and the chemicals have been written down to their scrap value within inventory.

The company usually pays its suppliers by the end of each month. However, due to the financial accountant's illness, the payment run for May 20X5 was not performed until 1 June 20X5.

The finance director has informed you that in order to show consistent results with the prior year, this payment run is shown as an unpresented item on the year-end bank reconciliation.

ISA 210 Agreeing the Terms of Audit Engagements requires auditors to issue an engagement letter.

(c) Describe EIGHT audit risks, and explain the auditors response to each risk, in planning the audit of Scarlet Co. (16 marks)