

## PAYROLL : WAGES AND SALARIES

### *Salaries and wages*

#### Substantive tests of details

-Select payroll and other related debits from the general ledger and trace these to the total of the payroll.

-Select a sample of employees from the payroll and perform the following tests:

- Examine evidence for the work performed e.g.: time records, commission records etc.
- Check calculations of gross pay to time records and authorised rates of pay (including bonuses, overtime and subsistence allowances, leave pay and retrenchment pay).  
Reference should be made to rates in union agreements, employment contracts, authorised notifications of rate changes, authorisations for special payments including overtime pay, etc.
- Check the calculation of deductions including tax deductions, employees contribution to pension funds and medical aid schemes as well as other non-standard deductions (e.g.: advances holiday pay)
- Determine whether the selected individuals actually exist and are employed by the client.

-Where applicable, examine paid cheques or other evidence of receipt by employees, agreeing details such as names, dates and amounts.

-For selections used in sample above, calculate the average gross remuneration and overtime per hour. Use these averages as a basis for developing the expectations for purposes of the analytical procedures.

- Review the payroll for duplicate payments.
- Test the casts and calculations on the payroll.
- From a source independent of the wages department, select employees who left during the year. Obtain their details trace to wages and salaries records and ensure that the individuals have been timeously removed from the payroll.
- Reconcile the payroll to the appropriate general ledger accounts (salaries and wage expense and other payroll related accounts) for the month(s) selected. Investigate significant reconciling items.
- Ensure that all deductions have been paid over at year or are included in year-end accruals e.g.: PAYE, medical aid, pension, UIF, union levies etc.
- Consider attending a wage payout. (Note that wages are seldom paid out in cash any more)

#### **Substantive analytical procedures**

- Develop an expectation of recorded salaries/wages using independent information regarding the number of employees or total hours worked, salary/wage rate increases and any other changes that have occurred during the year.

Develop an expectation of gross remuneration per employee or per standard hour and overtime per employee or per overtime hour, with reference to the prior year, independent information relating to salary/wage increases, overtime pay scales and to the averages based on the tests of details set out below. Also develop an expectation of employer contributions as a percentage of gross remuneration and employee deductions (by significant category if necessary) as a percentage of gross remuneration.

- Compare the expectations to the recorded amounts. For any difference that is more than the expected difference, obtain and corroborate explanations for the difference (e.g.: by examining supporting documents)

#### **Audit programme for the audit of wages:**

- Ascertain whether there is a permanent file for each employee in the sample which contains the following information:

- Letter of appointment
  - Personal information (name, address and identity number)
  - Authorized vacation and sick leave
  - Authorized rates and any changes
  - Tax reference number
- Ascertain whether there is an authorised clock card for each employee in the sample on which the hours worked are shown. (occurrence/measurement)
  - Recalculate the number of hours worked on the clock card and check whether an accurate separations has been maintained between ordinary and overtime hours worked. (measurement)
  - Compare the number of hours worked on the clock card with the number of hours recorded on the payroll. (measurement)
  - Compare the rates used to calculate the wages on the payroll with the rates Contained in the permanent files. (occurrence/measurement)
  - Recalculate the gross wages payable per employee by checking the arithmetic accuracy of the payroll. (measurement)
  - Recalculate the net wages payable and confirm the validity of the deduction in the permanent files. (occurrence/measurement)
  - Ascertain whether the employees signed the payroll after receiving their wages during the wage payout. (occurrence)
  - Attend a wage payout and determine whether all the specific control requirements are complied with during the disbursement of wages and the handling of the unclaimed wages. (occurrence/measurement/completeness)
  - Recalculate the total of the net wages due according to the payroll and compare this total of the net wages due according to the payroll and compare this total with the cashed cheque for the withdrawal of the cash. (measurement/completeness)
  - Ascertain whether the responsible person's signature appears on the payroll as evidence that the information on the payroll and the calculations have been checked for accuracy. (occurrence/measurement/completeness)
  - Scrutinise the permanent records of the employees and check whether the permanent files contain authorised letters of appointment or dismissal or resignation.

- Ascertain whether there is written authorised for the changes in respect of salary increased or deductions.
- Check whether the monthly payroll has been signed by a senior person as evidence that the accuracy of the information and calculation was checked before the cheque for the net salaries were prepared.

### ***Sales representative commission (paid) for different products sold***

#### **Occurrence**

1. Inspect the commission agreement (or other similar document) for each of the workers & note:
  - 1.1 The commission percentage payable to the rep for each of the categories of product sold.
  - 1.2 Any conditions which relate to the commission e.g. what happens if the entity to which the sale was made does not pay and the debt goes bad.
  - 1.3 Whether the agreement was signed by both parties.
2. Confirm the "existence" of the reps by introduction or corroborating evidence – pay slips, confirmation from other staff.
3. For selected commission payments, inspect the salary records, bank transfers/bank statement for evidence that the commissions were actually paid.
4. Review the commissions account in the general ledger and follow up on any unusual amounts, particularly any credits on the account, e.g. a reversal of commission.
5. Perform analytical review:
  - 5.1 Comparison with prior year by representative by product.
  - 5.2 Comparison with total sales.

#### **Accuracy**

1. Obtain a schedule of payments made to each sales rep for each month.
2. Select a sample from this schedule which includes payments to each of the rep.
3. Trace the payments to the supporting sales invoices and
  - 3.1 confirm by inspection that it is an invoice in the companies name & dated during the year under audit and for goods sold by the company
  - 3.2 inspect the invoice to determine which representative made the sale.
  - 3.3 re-perform the amount of commission which should be paid on the invoice ensuring that • the commission percentage used was correct in terms of the rep who made the sale and the product(s) sold per the invoice, and • confirm that the commission was allocated to the correct representative.

4. Cast and cross cast the schedule and general ledgers accounts and agree the total to the trial balance/detailed statement of comprehensive income.

**Completeness**

1. Extract a small random sample of sales invoices for the year and reperform the commission payable.
2. Trace the invoice/amount to the schedule of commissions to confirm that the invoice/amount has been included.
3. Confirm by inquiry and inspection of the commissions schedule and ledger accounts that the commission payable on sales made at the end of the current year have been accrued.  
3.1 Select a small sample of sales in the final month of the financial year, recalculate the commission and trace to the supporting documentation, for the journal entry accruing the commission.
4. Inspect the invoices for any material sales entered in the new financial year and by reference to the dates on the supporting documentation e.g. delivery note, confirm that the sale took place after year end.

**Classification**

1. Trace the posting of the commissions paid (via the salary payments) to the general ledger to confirm that the postings have been made to the correct accounts e.g. commissions, PAYE.

## Inventory Cycle

**Substantive audit procedures, which the auditor normally carries out to ensure that the *inventory is shown at a reasonable value* in the financial statements.**

- Determine whether the valuation method (FIFO) used is consistent with that of previous years.
- Recalculate the totals and calculations on the inventory list.
- Reconcile the inventory list with the inventory account in the ledger and follow up all reconciling items.
- Select a sample of a number of inventory items and carry out the following tests:
  - Check that the correct cost price has been used for the valuation of the items by referring to the most recent purchase invoices applicable to the items.
  - Determine the net realizable value of the items by referring to the selling

price of the items.

- Ensure that the items have been accounted for on the inventory list at either the cost price or the net realizable value, whichever is the lowest.
- Check whether obsolete, slow – moving and damaged inventory have been valued at the lower of cost and net realizable value.
- Compare the value of the main categories of inventory with value for previous years, investigate any material differences and obtain explanations for them.
- Calculate the gross profit percentage and the inventory turnover rate and compare them with the budgets for previous years, the industrial average, etcetera. Obtain explanations and investigation and material deviation.
- Obtain a certificate from management showing the value of inventory, the basis of valuation, the main categories of inventory, the encumbrance of inventory, etc.

### **Substantive procedures to completely verify the company's *inventory at year-end***

- Attend the year-end inventory count and
  - satisfy yourself regarding the efficiency of the inventory count plan.
  - satisfy yourself that all the control measures were effectively applied in carrying out the inventory count.
  - make copies of all count sheets.
  - compare the quantity counted with the perpetual inventory records and follow up any differences.
- Compare the total value of inventory with the total of inventory according to the perpetual inventory records and investigate material differences.
- Compare the prices on the perpetual inventory records with relevant invoices towards the close of the financial year.
- Test check the calculation of the value of a number of representative inventory items as these appear on the inventory sheets.
- Examine the basis used for the calculation of the inventory (FIFO) and ensure that it is consistently applied in relation to previous years.
- Inspect that obsolete, slow-moving and damaged inventory is valued at the lower of cost or net realisable value.
- Enquire from management and test a representative sample of items for the valuation of inventory at the lower of cost price or net realisable value.
- Compare the value of the main categories of inventory with the previous year and investigate and obtain explanations for material differences.
- Compare goods received and issued with the purchases and sales invoices prior to and after the year-end to ensure the correct cut-off procedures.
- Calculate the gross profit percentage and inventory turnover rate and compare these with the previous year's budgets, industrial averages, etc.  
Obtain explanations and examine material deviations:
- Obtain a certificate from management regarding the value of inventory, basis of valuation, main categories of inventory, encumbrance of inventory, etc.
- Compare the value of inventory according to the inventory count and the perpetual inventory records with the value of inventory in the financial statements,



taking into consideration possible alterations.

- Examine the disclosure of inventory in the financial statements:
  - Classification of inventory according to the main categories of inventory.
  - Disclosure of the accounting policy concerning:
    - the basis of valuation according to the lower of cost price or the net realisable value,
    - the method of the inventory valuation (FIFO),
    - its consistency with the previous year

### **Substantive procedures for the auditing of the *existence and ownership of inventory***

- Procedures **before** the inventory count is performed

-Evaluate the auditee's inventory count plan prior to the date of the actual count.

On the date of the stock count, evaluate the effectiveness of the client's stock count procedures. In particular, note whether:

- The stock is arranged in an orderly manner to facilitate an accurate count
- Defective, obsolete or unsalable items are separately identified
- Stock held but not owned as well as stock at or near the shipping and receiving areas is appropriately treated
- Adequate procedures are performed to prevent double-counting or not counting any stock and to resolve any count discrepancies
- Adequate procedures to ensure accurate cut-off are in place
- Used and unused count documents are effectively controlled
  
- Recommend improvements where necessary.
- Determine the dates and venues of the actual count.
- Identify the audit team needed during the count, make the necessary arrangements with them.
- Inform the audit team properly about the procedures.
- Determine the location of the significant inventories held by the entity and discuss the timing and method of inventory verification with relevant client staff. If there are multiple locations, determine which locations the audit firm will attend stock counts.

- Procedures **during** the performance of the inventory count

- During our attendance at the stock count perform both overstatement and understatement and understatement tests for high value stock items as follows:
  - From client's final count sheets trace to physical quantities (overstatement testing)

- From physical quantities, trace to final count sheets (understatement testing)
- Consider photocopying the final stock sheets as a control to ensure that no subsequent alteration, omission or addition of count sheets occurs. This is necessary as you as auditor have only done a sample count of items. If the client wishes at a later date to include other stock items onto the count sheets, the only way that this fraud can be detected is if you have a copy of the final stock sheets.
- Perform the following procedures on the client's final period stock sheets and work in progress schedules:
  - Ensure all stock count sheets have been accounted for
  - Check the accuracy of final schedules/perpetual stock records, including a review of stock listings for obvious amendments, errors, irregularities or duplications
  - Trace our test count quantities (and others, if necessary) to final priced schedules/perpetual stock records
  - Compare the final physical stock value to the theoretical stock value and note the amount of the stock adjustment. Where material, obtain and verify explanations for adjustment.
- Where stock consists of registerable goods ensure that, for selected items, the client has certificates of ownership.
- Consider the need to appoint a specialist  
(If a specialist is required, then the solution should be complete as to all audit procedures re: the appointment, use and reliance on a specialists work per ISA 620).
- **Perform the following tests for raw materials and other purchased stock:**
  - Verify the prices of selected items and ensure that these have been appropriately determined based on the client's accounting policy i.e. FIFO, weighted average, etc.
  - Consider the effect of purchase rebates, discounts, freight and duty costs
  - If these above costs are included, trace the costs to the relevant supporting documentation
  - If the goods were imported and no forward exchange contract was taken out, determine that the stock is valued at the spot rate ruling on the date that the risks and rewards of ownership passed.
  - If the goods were imported and the goods were covered forward, determine that the stock was valued at the forward rate, or spot rate if applicable.
  - Test the valuation of imported stock and ensure the method of foreign currency translation is in accordance with GAAP using either the spot or forward rate where applicable.

- Ensure the basis of valuation is in accordance with the accounting policy and consistent with the prior year.

**Perform the following tests for *work in progress and manufactured goods*:**

- Consider the need for a specialist. (If a specialist is required, all audit procedures in this regard will be included in the solution).
- Test the allocations of labour, raw material and overhead costs
- For overheads, vouch production overheads to the supporting documentation for each expense item
- For overheads, evaluate whether the basis of allocation for production overheads to individual units is acceptable
- Ensure that these allocations are not materially overstated, e.g.: valuation includes costs only up to the observed stage of completion, abnormal scrap and idle plant costs excluded. Also, determine that all completed jobs have been closed out and that no costs remain in work in progress for such jobs.
- Ensure that the basis of valuation is consistent with the prior year and in accordance with the accounting policy and GAAP by comparing the current years policy to:
  - Stock certificates
  - Audit working papers and
  - Annual financial statements
  - Ensure stocks are valued at the lower of cost or market value on a consistent basis:
  - Examine sales prices of large finished goods subsequent to year end to ensure they have not fallen below cost (including costs still to be incurred in completing and selling the items)
  - For work in progress, estimate the total costs after completion and compare them with net selling or contract prices
  - For significant balances, consider contacting suppliers to determine the NRV of goods

**Cut-off testing:**

- Last document numbers for stock receipts and deliveries must be obtained at the audited stock count by inspection of the actual relevant documents.
- Cut-off tests are performed on sales, purchases and returns in the revenue and expenditure cycles. Debtors and creditors should be verified at the finished goods and raw materials stock count dates respectively, so that the cut-off procedures in these cycles address stock cut-off. If stock is counted at an early verification date and a roll forward is performed, cut-off must be tested at the early verification date. Cut-off must also be tested at the year-end if a specific risk of incorrect cut-off has been identified.

- Stock cut-off must be separately addressed where internal stock movements between raw materials, work in progress and finished goods take place. Cut off numbers must be obtained and verified at the stock count and all internal movements over the stock count period should be tested to ensure that stock on hand is not counted twice or omitted.
- Test goods in transit by selecting from the client's records, agreeing values with supporting documentation and examining dates of arrival/delivery of goods. If material, consider a subsequent visit to inspect the goods or request direct confirmation of ownership.

**Disclosure requirements:**

- Disclosure requirements of IAS 2 and Companies Act should be complied with. Stock should be split between components. An accounting policy for stock valuation should be disclosed. Cost of sale should be disclosed. The write-down and subsequent write up of stock should be disclosed with the tax and outside shareholders interests where applicable

***Consignment inventory:***

There are two types of consignment stock:

- Consignment inventory owned by the company are **not included** in stock
  - Check by inquiry and inspection that stock items are not included on stock sheets of the consignee or if so, are clearly identified.
  - Observe whether consignment stocks are kept separately and if not ascertain how they were identified.
  - Satisfy yourself that the breakdown of the stock figure does not include an amount or consignment stocks.
- Consignment inventory are **included** in stock
  - Attend stock take of the consignment stock and perform test counts. Alternatively have other auditors attend the stock take and obtain a certificate in this regard. At the count determine whether the consignment stock is damaged.
  - Check reconciliation of physical stock with theoretical quantity derived from the system.
  - Obtain certificate of stock balance direct from the consignee and reconcile to evidence gathered.
  - Compare current year figure to prior year for reasonableness.

- The obsolescence of consignment stock should be considered using the appropriate procedures.

**Roll forward:**

- If physical stock counts are performed at an early verification date from the following roll forward procedures.

- Compare the stock balances at count date to those at balance sheet date and vouch the movement as follows:

*For debits to stock:*

- Examine supporting documentation for all known purchases
- Ensure that goods delivered on a consignment basis are included in stock and not debtors
- Review goods returned records for goods returned during the intervening period and examine supporting documentation

*For credits to stock:*

- Compare with debits to cost of sales and review by comparing to recorded sales and expected gross margins;
- Verify all significant adjustments and unusual entries
- Agree or reconcile the stock sheets to the general ledger at verification date
- Agree to reconcile the stock report to the general ledger at balance sheet date
- Agree the final balance per the general ledger to the balance sheet

***Substantive procedures for identifying obsolete inventory at year end***

1. Obtain sufficient understanding of the clients business to help you recognize inventory that is no longer useful to the client and review procedures that management has established in this regard
2. Review the perpetual records for slow moving items
3. Discuss the quality of the inventory with management (minutes of management meetings)
4. Ask the technical product manager questions during physical inventory observation about the extent of use or non-use of inventory items
5. During the physical inventory count, look out for any signs of rust, damaged inventory, inventory in unusual locations and unusual amounts of dust on the inventory (see sell by dates)
6. Identify inventory that is tagged obsolete, spoilt or damaged, or set aside because it is obsolete or damaged

## THE FINANCING CYCLE – SOURCES OF FINANCE

### A) SHARE CAPITAL & RESERVES

#### *Share capital and reserves*

The auditor will have to:

- Review the reconciliation of share capital and equity movements.
- Obtain a confirmation of changes in capital and year end share capital details from the share registrars.
- Verify all movements in share capital and reserves to supporting documents.
- Ensure compliance with the Companies Act in respect of all share transactions.
- Review statutory registers.
- Obtain management representations

Identification of the required documents, registers, accounting records and accounting entries that must be updated when there is an additional issue of shares

Documentation of the special resolution taken at a general meeting of the company authorizing the share issue.

#### **Substantive audit procedure for a *share issue***

- Examine the previous year's audit working paper and agree the opening balances of the authorised and issued shares for the current year.
- Examine the minutes for possible special resolutions taken regarding the amendment of the authorised issued capital and classes and rights of shares that may be issued.
- Inspect the minutes of the shareholders meeting at which the issue of new shares to existing shareholders was authorised.

- Compare the accounting entries in the cash receipts journal at the relevant month end with the particulars in the minuted resolution.
- Confirm that funds that have been paid in by referring to the relevant bank deposit slips.
- Compare the particulars of the deposit with the list of shareholders to make certain that all shareholders did pay in the required amount.
- Trace the payment of the deposit to the companies' bank statement and note the date on which the money was paid in.
- Trace the postings from the cashbook to the capital account in the general ledger. Agree the total of the capital account in the general ledger to the issued share capital.
- Check the particulars of the individual shareholders in the share register and agree the notes with regards to the new share issue with the minuted resolution.
- Agree the total of the individual shareholders account in shares register with the total issued share capital.
- Enquire from management and refer to the share certificate counterfoils to see whether the share certificate were issued within the prescribed period of 3 months.

### ***Audit of reserves***

1. Perform a reconciliation of reserves:
  - opening balance: agree with the previous year's annual financial statements and working papers;
  - movement in reserves: audit in detail- in particular ensure statutory requirements are met;
  - Closing balance: agree with the trial balance and financial statements.
2. Audit movements in reserves as follows:
  - test the castings and calculations in the general ledger account;
  - examine the MOI i.r.o the provisions regarding the treatment of debits and credits and ensure requirements are met;
  - credits:
    - agree to the amount of the profit and loss account;
    - agree to supporting evidence, e.g. valuation certificate
  - calculations of revaluation (NDR);
  - debits
  - agree to supporting evidence such as invoices, cheques, etc.;
  - agree to the credit entry (bank or asset).

3. Inspect the MOI for any limitation on the utilization of reserves and ensure the provisions thereof are met.
4. Perform a reasonableness test of the trial balance amounts;
  - Equity (reserves) = Assets – Liabilities – Share capital.
 Agree the above amount of the reserves with the amount per trial balance.
5. Examine the presentation and disclosure in the financial statements and ensure it meets the requirements of the fourth schedule and IFRS.
6. Obtain a management representation letter.

## **B) NON-CURRENT LIABILITIES**

### **Substantive procedures for auditing a *mortgage loan***

- Determine the existence of borrowing powers with regards to the mortgage loan in terms of the MOI.
- Investigate the authorization of the transaction in the companies' minutes.
- Examine the mortgage deed and make certain that it is a legally valid document that bears the seal of the registrar of deed.
- Examine the mortgage deed to determine the particulars of the interest rate and the repayment conditions applicable to the mortgage loan.
- Ensure that the description of the encumbered property in the mortgage deed correspond with the description of the companies land and buildings in the general ledger.
- Ensure that mortgage has been registered in the deeds office and the registered mortgage appears has an endorsement on the deed of transfer.
- Obtain evidence from the seller that the total purchase price has been received and that no amounts is outstanding on the purchase price.
- Make enquiries from the bank or examine correspondence from the conveyancing attorneys to make certain that the full amount has been paid to the seller.
- Obtain a statement from the bank giving the particulars of the mortgage loan and make certain that the total amount appears as a disbursement on the correct date.



- Check the accuracy of the journal entry in which the mortgage loan is accounted for and agree the particulars with the ledger.

### ***Loans-Substantive procedures***

- Obtain a schedule of loans (including loans outstanding at the end of the prior years as well as any new loans) showing opening and closing balances and borrowings and repayments during the year and perform the following:
  - To obtain assurance about the completeness of the schedule:
    - Agree the opening balances to the prior year audit work papers
    - Obtain representations from management as to the completeness of loan obligations
    - Consider any evidence of additional loans through the examination of minutes of the board, significant contracts, confirmations of bank accounts, etc
    - Cast the schedule, agree opening balances to prior year's working papers and closing balances to the general ledger
    - Ensure that all movements on the schedule (advances, repayments) are in accordance with the terms of the loan agreement and that the client is in compliance with any loan covenants
    - Vouch loan receipts to deposit books
    - Vouch loan repayments to supporting documentation (e.g.: paid cheques, bank drafts)
    - Recompute the computation of the current portion of long term loans and the related interest
  - If there are new loans, inspect the loan agreement and record the following details:
    - Amount
    - Interest rate
    - Repayment terms
    - Purpose of loans
    - Security
    - Other salient conditions e.g.: penalties for late payment
- For new loans, inspect that the directors have authorised the loan in the minutes.
- For new loans, ensure that the loan is in accordance with the MOI.

- Where significant loans are held, prepare, or have the client prepare, for each lender with which the client had debt outstanding at the prior year-end or during the current year, a confirmation request for the amount(s) owed to the lender and perform the following:
  - Ascertain that the confirmation asks for all information likely to be relevant to our tests of debt and related interest balances (e.g.: applicable interest rates, due dates, the date to which interest has been paid, collateral and security interests).
  - Mail the requests under our control and send second requests for non-replies. Compare replies to the requests and to the loan schedule. Investigate and vouch any differences.
- Inspect that the terms of any loan covenants or restrictions in the memorandum of incorporation.
- Examine that there is sufficient information to comply with the disclosure requirements of the Companies Act consequently the loan amount split into current and long-term portion should be disclosed along with the amount of the monthly repayment, the effective interest rate, the date the loan will be paid off and any other relevant information. In addition, if the asset is encumbered, the appropriate disclosure is required.
- Obtain a management representation letter from management.

#### **Substantive analytical procedures**

-Compare balances for major loan categories (long term, short term, interest bearing, debentures, capitalised finance leases, etc) with the prior year and consider their reasonableness in view of other available information (e.g.: growth in operations, major capital expansion programs, cash flow requirement projections etc). Obtain explanations by significant or unusual changes.

#### **Debentures**

IAS 39 – Financial Instruments: Recognition and measurement, requires that debentures are held at amortised cost. An auditor should bear this in mind when, for example when auditing a debenture which is redeemable at a premium. IAS 39 requires the use of an effective interest rate in order to correctly reflect the value of the debenture at each reporting date and the finance cost associates with it.

In terms of IAS 39, the effective interest rate is the rate that "exactly discounts estimated future cash payments through the life of the financial instrument". Transaction costs may be included in this calculation. In effect the true finance cost (interest plus premium) is calculated and spread over the life of the debenture.

### **Opening balance**

-inspect prior year work papers and prior year financial statements to confirm that opening balance agrees with the prior year closing balance.

### **Occurrence/existence**

- inspect the Memorandum of Incorporation to determine whether
  - the company is authorised to issue debentures
  - the issue has in anyway contravened the company's borrowing powers, e.g. authority requirements
  - inspect the minutes of the meeting of directors at which the decision to issue debentures was taken and note
    - to whom the issue was to be made
    - the number and amount of the debentures to be issued
    - the interest rate, date and manner of payment
    - any particular characteristics of the debenture e.g. repayable at a premium convertible to shares.
  
- inspect the register of debenture holders to confirm that the addition of new debenture holders and adjustments to the holdings of existing denture holders, have been made according to the authority granted for the issue.
  
- inspect the cash receipts journal, deposit slip/bank statements for evidence of the receipt of the correct amount.

### **Accuracy, cut-off, classification**

Initial recognition (on issue).

- \* reperform the calculations and casts to confirm that received from the issue of the debentures is in accordance with the debenture agreement e.g. 100 debentures of R1 000 = R100 000 received (accuracy)
- \* trace the receipt of cash from the cash receipts journal to the general ledger to confirm that it was posted to the debenture liability account (classification)
- \* inspect the dates on all documentation to confirm that they fall within the accounting period under audit (cut-off)

### Subsequent measurement

- \* recalculate the effective interest rate based on the terms of the debenture agreement and compare to the effective interest rate used by the client in the amortisation calculation.
- \* inspect the journal entry raising the finance cost and increasing the debenture liability account and agree the amounts to the amortisation calculation.

### Completeness

Confirm by inquiry of the directors and scrutiny of the minutes that no other debenture issues have taken place during the year.

### Presentation & disclosure

- \* The auditor must inspect the disclosures made and consider whether
  - they are complete in terms of generally accepted accounting practice, e.g.
    - details of any security which has been granted to debenture holders –e.g. a bond over fixed property
    - dates and conditions of any redemptions or conversion options
  - they are consistent with evidence gathered on the audit
  - amounts, facts, details etc are accurate and agree with the evidence obtained
  - any classification of the information disclosed is appropriate
  - the wording of disclosures is clear and understandable

### *Finance lease liability*

#### Occurrence/obligation and existence

- inspect the finance lease agreements for pertinent details:
  - name of lessor and lessee (i.e. client)
  - amount of minimum lease payments,
  - term of lease
  - other salient conditions e.g. penalties for late payment of lease rental

- inspect the minutes of directors' and steering committee's meetings authorising the lease agreement.
- inspect the Memorandum of Incorporation to confirm that they have been complied with in particular that the borrowing powers/conditions have not been breached.
- enquire of management and refer to prior working papers, to confirm that new finance will not breach contracts in respect of existing finance arrangements.
- determine whether the lease qualifies as a finance lease i.e. the risks and rewards of ownership have substantially transferred to the lessee (see important aspects).

### **Completeness**

- obtain specific representations from management that all finance leases have been included.
- review financial records, minutes of directors', audit committee and steering committee meetings and correspondence for evidence of unrecorded liabilities e.g. use of leases to provide off-balance sheet finance, when in fact they should be classified and treated as finance leases.
- enquire and confirm as to the source of funding for any major acquisitions identified during the audit of fixed assets.
- Obtain a schedule of all leased assets and by inspection and inquiry determine whether any leases that have been classified as operating should be finance leases.
- obtain a schedule of all lease payments, and match to lease agreements to confirm that all leases have been identified. Confirm by scrutiny of the agreements that all finance leases have been identified and capitalized.
- perform analytical review e.g. compare current year balances on finance lease accounts and lease payments paid to the prior year,

### **Accuracy, cut-off, classification**

#### **Initial recognition**

- obtain independent confirmation of the fair value of the asset which has been leased by inquiry of the supplier, inspection of trade journals etc. (the fair value is unlikely to appear in the lease agreement).
- if any direct lease costs have been capitalized confirm by inquiry and inspection of the supporting documentation that

the costs are valid lease costs applicable the leased asset and were incurred by the lessee.

#### Depreciation –leased asset

- by inquiry of management and evaluation of the terms of the terms of the lease agreement, determine whether the asset should be depreciated over its useful life or the term of the lease.
- determine by inquiry of the directors whether the residual value applicable to the leased asset is reasonable.
- determine by inquiry of the directors whether the "component" method of depreciation is applicable and if so, whether the allocation of costs of the components is appropriate (independent of the supplier may be required)
- enquire of the directors as to whether the depreciation method e.g. straight line, units produced , is appropriate, and confirm by reference to the minutes that the method has been reviewed by the directors (must be done annually)
  
- reperform the depreciation calculation
- enquire of production director as to whether any impairment of the asset is required.

#### Lease payments

- reperform the implicit interest rate calculation.
- reperform the apportionment calculation of the leased payments and trace the posting of the amounts apportioned to the liability account (and finance cost account).
- reperform the "current portion of the lease liability calculation" and trace the reclassification to the general ledger/trial balance/financial statements.

#### General

- cast the finance lease liability account
- by scrutiny of dates on documentation confirm that the leases, repayments etc relate to the accounting period under audit .

#### Presentation and disclosure

- \* The auditor must inspect the disclosures made and consider whether
  - they are complete in terms of generally accepted accounting practice, e.g.
    - accounting policies
    - amounts and commitments
    - terms of leases

- encumbrances on any leased assets
- reconciliation between the total of future minimum lease payments at balance sheet date, and their present value
- they are consistent with evidence gained on the audit
- amounts , facts, date etc accurate and agree with the evidence gathered
- any classification of the information disclosed is appropriate
- the wording of disclosures is clear and understandable

### ***Contingent liabilities***

The auditor will have to:

- Enquire from management as to the existence of any contingent liabilities.
- Read minutes of meetings.
- Review contracts, loan agreements, leases and correspondence.
- Review tax returns and correspondence.
- Review bank confirmations.
- Inspect director's reports, and correspondence with related parties.
- Review events after reporting date.
- Review legal expenses and legal correspondence.
- Obtain an attorney's letter.
- Obtain management representations

### ***Taxation***

- The audit procedures in respect of normal tax are as follows:
- Examine the most recent tax returns and adjustments to the tax account for over or under provisions.
- Examine the correspondence with SARS, especially in connection with penalties or queries.
- Audit the tax computation.
- Agree amounts to audit work papers.
- Review tax schedules of income and expenditure compliance with the tax act.
- Consider obtaining expert tax opinion.
- Audit the tax liability.

- Agree the opening balance to prior year's financial statements.
- Vouch all movements to supporting documents, e.g. tax computation, receipts for tax paid, and tax assessment for adjustments.
- Test the castings.
- Agree the closing balance to the trial balance and the financial statements.
- Review disclosure in the financial statements, ensure compliance with GAAP / IFRS.
- Reperform the tax rate reconciliation.

### ***Deferred tax***

- Audit the deferred tax calculation
- Agree the carrying amount to the audit work papers or the trial balance and the tax values to tax computation.
- Test the castings.
- Recalculate the deferred tax.
- Agree to the trial balance and the financial statements.
- Enquire from management the extent of future profits to set off existing tax losses
- Review disclosure in the financial statements, ensure compliance with GAAP.

### ***VAT***

- The audit procedures in respect of vat are as follows:
- Review the client's procedures to account for VAT and prepare and submit VAT returns.
- Examine the VAT correspondence file for disputes, penalties and VAT audits.
- The internal controls in respect of VAT should be tested in conjunction with the purchases and sales cycles.
- Perform transaction tests of VAT entries in the input and output accounts
- Agree to purchases and sales journals, or to the cash book.
- Agree to supporting documents and ensure that VAT was correctly accounted for.
- Agree totals in the VAT accounts to the VAT return.
- Perform analytical procedures on the output VAT in the VAT returns by grossing up and comparing to the sales in the ledger.
- Perform similar analytical procedures on the input VAT and expenses, remember to include capital goods purchased.
- Audit VAT payable or receivable.
- Agree to the year-end VAT return.
- Agree to VAT paid or received after year end.
- Agree the balance to the trial balance and the financial statements.



## INVESTING AND CASH CYCLE: APPLICATIONS

### **Non-current assets (fixed assets)**

The assertions will most effectively and efficiently tested by substantive procedures. Generally, controls are not relied upon for audit assurance due to the relatively small number of material transactions impacting these accounts.

### **Substantive audit procedures for cash purchases of non – current assets**

- Inspect the purchase requisition for the purchase of the non – current asset and make certain that it was authorised by the responsible persons.
- Scrutinise the particulars on the invoice and cashed cheque and compare the information with that recorded in the cash payments journal.
- Check that the particular cheque payment for the purchase of the non – current asset appears on the bank statement.
- Compare the information shown on the invoice with the entry in the non – current asset register and make certain that it has been correctly recorded and classified and has been recorded on the correct date.
- Inspect the posting from the cash payments journal to the assets account in the ledger for accuracy.

## **Substantive audit procedure for property, plant and equipment.**

### ***Purchase of land and buildings***

- Examine the minutes of the directors/shareholdings meeting at which the purchase of the business premises was authorised.
- Obtain a certificate from the bank stating that the property has been registered in the name of the company or inspect the original deed of transfer.
- Carry out a deeds search at the deeds office and make certain that the property is registered in the name of the company. Compare the cost price of the property as shown on the deed of transfer with the accounting entries.
- Examine the municipal accounts received by the company and make certain that the accounts were in fact made out to the company and ascertain the municipal valuation of the property.
- Carry out a physical inspection of the land and the buildings to make certain that they do in fact exist and compare the particulars of the premises with the particulars shown on the deed of transfer.
- Check the posting of the journal entry and the payment of the transfer and registration costs to the fixed property account in the ledger.
- Ascertain whether the ledger account contains the correct description of the fixed property and whether the total cost price of the property is shown in the account.

### **Attorney's costs for the mortgage deed and the deed of transfer.**

- Examine the invoice or correspondence from the attorney in connection with the transfer and registration of the property and ascertain whether the particulars of the property correspond.
- Ascertain whether the transaction was authorised for payment by the designated person.
- Trace the payment of the attorney's costs in the cash payments journal and the corresponding entry on the company's bank statement.
- Examine the paid cheque and determine whether the particulars agree with the payments journal and whether the cheque was made out to the attorney in question.

- Trace the posting of the registration and transfer costs from the cash payments journal to the land and buildings account in the general ledger.

### **Substantive audit procedures for the *purchase of motor vehicles***

- Examine the minuted authorisation and make certain that the purchase of the vehicle has been properly authorised.
- Confirm the particulars in the non – current asset register by inspecting the supplier's invoices, trade in credits, comprehensive insurance, hire purchase contracts, registration certificates and current licensing certificates.
- Agree the accounting treatment of the transaction in the cash payments journal with particulars in the non – current asset register.
- Make certain that the vehicle were brought into account on the correct date.
- Examine the cashed cheque and make certain that the cheque was made out to the supplier in question and that the amount agrees with the amount in the cash payments journal.
- Trace the payment of the cheque to the company's bank statement.
- Inspect the registration certificates and make certain that the vehicles have been registered in the name of the company.
- Ensure about the depreciation policy of the company with regards to vehicle and make certain that it is consistent with the policy applied during the previous year.
- Recalculate the depreciation on the vehicles for the period in question and see whether the amount agrees with the depreciation write – off in the general ledger.
- Examine the postings of transactions to the relevant ledger accounts.

### ***Property, plant and equipment (PPE):***

#### **Substantive procedures**

- Obtain (or prepare) a schedule of fixed assets by category showing (for cost and accumulated depreciation) opening and closing balances and summarising transactions for the year.

- Cast and cross-cast the schedule, agree opening balances to prior year work papers and closing balances to the general ledger and to the fixed assets register.
  
- Cast the fixed asset register on a test basis and test check totals by category from the fixed asset register to the above schedule.
  
- Inspect original title deeds for land and buildings, noting any encumbrances, and ensure that they are in the name of the client and that the property descriptions agree to the client's records and financial statements. Alternatively, obtain confirmations from custodians in whose favour the encumbrances are registered if the title deed is not on hand.
  
- Select a sample of fixed asset additions and transfers in and perform the following:
  - Physically inspect the asset and determine that capitalisation is appropriate.
  - Examine evidence of ownership, e.g.: vehicle licenses and registration certificates
  - Vouch cost to suppliers' invoices/purchase contracts authorised by responsible company officials, board minutes, etc, and ensure recorded in the correct period.
  - If a finance lease or suspensive sale exists, ensure that the basis of determining the cost of the capitalised asset is accurate by reference to the agreement.
  - Review the client's capitalisation policy (including the policy with regard to finance leases) and ascertain that additions including all significant acquisition costs (e.g. legal fees, installation costs) are correctly recorded.
  - If applicable, check calculations of costs of assets constructed and consider the appropriateness of the treatment of borrowing costs capitalised, overhead allocations and internal profit eliminations etc.
  - Review transactions with related persons or entities and between group companies for unusual treatment.
  
- Search for unrecorded disposals as follows:
  - Review independent sources (e.g. board minutes, management reports) to identify details of any disposals.
  - Enquire of management whether there have been any significant disposals or any sale of leasebacks.

- Review our test of recorded additions and, for those representing replacements, enquire as to whether the old assets have been sold or scrapped.
  - Consider selecting material items from the opening balance of fixed assets and physically inspecting them to ensure that there are no unrecorded disposals/scrapings.
- For a selection of disposals and transfers out:
- Ensure that they have been appropriately authorised.
  - Examine documentation supporting the proceeds and ensure reasonable in relation to the nature and age of the assets sold.
  - Recalculate the profit or loss on disposal and ensure that it is correctly recorded and posted to the general ledger.
  - Ensure that the disposals have been properly excluded from the accumulated depreciation account balances
  - For leased assets sold, ensure ownership has been relinquished by the client and that the transaction has been correctly accounted for in the accounting records.
- Review repairs and maintenance expense accounts for the period to determine whether there are any material items, which should have been capitalised.
- Review any lease expense accounts for the period. Ensure correct classification and treatment of finance and operating leases and that the related assets have been capitalised where appropriate.
- Confirm intercompany transfers of fixed assets with the auditors of the respective group companies.

### **Valuation**

- Determine the basis of calculating depreciation and establish the depreciation rates for each category of fixed asset. Ensure consistency with the prior year.
- Consider the reasonableness of estimates of useful lives of assets in the light of the client's operations and industry trends.