AUE303R

Key to MAY 2013 exam

QUESTION 1

Substantive procedures to audit the value of finished goods

Reference: Principles and Practice of Auditing 12/24
Costing

1. Discuss the blueprints with Evans to obtain a general **understanding** of the diagram and the costing. (1½)

2. Observe the manufacturing process and establish the **reasonableness** of the components, measurements and quantities as reflected the blueprints. (1½)

3. Compare the blueprints (components, quantities & measurements) with previous years' working papers to establish **consistency** in the costing and obtain explanations for any variances. (1½)

4. On a sample basis **agree the number of the units on the final stock** count sheets to the number of units on the stock count sheets obtained during the inventory count at year end. (1½)

5. Scrutinise the final stock count sheets for **any unusual items not reflected on the count sheets** obtained during the inventory count. (1½)

6. On the blueprints perform the following tests to cost the trailers:

   6.1 **Raw material component**:
   - Agree the component codes and unit cost price used in the blueprints with those reflected in the ***stock count sheets*** for the respective raw materials. (1½)
   - Trace the unit prices of components to the **relevant supplier's invoices** to establish whether the correct prices have been **used in terms of the FIFO cost formula**. (3)

   6.2 **Labour component**
   - Examine the **labour hours** used to manufacture a trailer model and compare the number of hours with the **previous years' costing**. (1½)
   - Agree the **hourly rate used** in the blue print with the hourly wage rate in the **wage records**. (1½)

   6.3 **Overheads**
   - Enquire from the cost accountant and Evans regarding the **basis of allocation** of overheads and the **reasonableness** thereof. (1½)
   - **Recalculate the allocated manufacturing overheads** with reference to the approved allocation basis and the use of accurate information pertaining to normal operating capacity. (1½)

7. **Cast the costing** in the blueprints and agree the total of the unit price of a trailer model with **unit price reflected in the *stock count sheets***. (3)

8. **Cast (adding) and cross cast the *stock count sheets*** for finished goods (Quantity x unit price). (1½)

9. Trace the value of finished goods per the stock count sheets and agree it to the inventory control account in the **general ledger balance and trial balance**. (1½)

10. Agree the amount in the trail balance to the amount of finished goods disclosed in the notes to the financial statements. (1½)

11. Perform **analytical tests** (inventory turnover; gross profit percentages etc) and trend analysis of component costing. Compare with corresponding figures of prior years. Obtain acceptable explanations for deviations identified. (1½)

12. Compare the selling price on the approved **price list/invoices** around year end with cost price on the inventory list to ensure that it is higher than the cost price. (1½)

13. Determine through enquiries from management and the sales staff, as well as by inspection of the minutes and correspondence files, whether any of the inventory items are subject to **special sales conditions/offers**. (1½)

14. Where **selling prices are lower than cost prices**, request management to make the required adjustment to net realisable value. (1½)

15. Inspect the *stock count sheets* for finished goods identified during the count as **damaged and/or obsolete**. Discuss with management and write off where appropriate and trace the journal entries to the general ledger. (3)

16. Inspect the financial statements for the accounting policy with regard to inventory and ensure that it is **appropriate and applied consistently**. (1½)

17. Inspect financial statement **presentation and disclosure** that it is consistent with the evidence collected and that the information is appropriately disclosed. (1½)

18. Obtain a **management representation letter** with regards to the inventory value as at year end. (1½)

(26 x 1½ =39)
Maximum 30 marks

QUESTION 2
Considering the reliability work of the management's expert

Reference: ISA 500.A36

1. Inventory composition is not too complex and by observing the production process with the blue prints should not be a complex exercise. (1½)

2. The audit plan indicated no unusual risk of misstating inventory at assertion level is expected. (1½)

3. However as per the auditing reporting schedule there is an uncertainty regarding the company's ability to **continue as a going concern**. This would result in an increased risk for the **overstatement of inventory** (assets) effecting the **existence and valuation and allocation assertions**. (3)

4. Alternative sources of audit evidence can be used like last years' working papers and analytical review procedures to substantiate the engineer's (Evans) findings. (1½)

5. The nature, scope and objectives of Evan's work is relatively easy to understand and can be verified through observing the production process. (1½)

6. Hold discussions with Evan's to familiarise yourself with the nature, scope and extent of his work. (1½)

7. Consider situations or events that may threaten Evans' objectivity eg familiarity with management; intimidation threats etc. (1½)

8. Evans is employed by the entity on a contractual basis allowing scope for independence compared to a permanent employee. (1½)

9. On the other hand management can exercise control or influence over the work of Evan so this could be a threat that should be kept in mind. (1½)

10. Evan is a qualified engineer and possibly belongs to a professional society that has ethical standards and therefore a certain amount of professionalism can be expected from his work. (1½)

11. As a registered production engineer Evans is likely to have the skills and competence to carry out the task. (1½)

12 The cost accountant performs the costing and discussions can be held with him to determine if anything on the blue print bothers him. (1½)

13. The auditor has previous experience with this client and therefore with the expert and would know if there are any risks. (1½)

(14 x 1½ =21)
Maximum 15

QUESTION 3
Audit of the credit note journal entry

1. Review policy documents and discuss with management the reasoning behind the provision. (1½)

2. Discuss the provision of the credit note with the sales manager and credit controller to determine whether or not it is sufficient. (1½)

3. Compare the acceptability of the provision with the trend of provisions for the previous months. (1½)

4. Analyse credit notes passed during the year and correlate the figures with the adequacy of the provision and perform detailed analytical procedures on the provision, by comparing it with: (1½)
   - ratio of credit notes to sales per month (1½)
   - budgeted provision and the previous years' provisions (1½)

5. Review client correspondence to indicate customer dissatisfaction or order discrepancies. (1½)

6. Recalculate the provision at 2% of credit sales and agree with the client's provision.
   (1½)

7. Agree the February total in the sales journal with the figure used in the journal and recast the sales journal. (1½)

8. Obtain a management representation that refers to the provision, its appropriateness and that nothing has come to management's attention to provide otherwise. (1½)

9. Trace the posting of the journal entry to the sales and provision for credit notes accounts in the general ledger. (1½)

10. Trace the previous year's journal to the general ledger to ascertain that it has been reversed. (1½)

(12 x 1½)
Total 18

QUESTION 4

The two types of subsequent events

Reference ISA 560

1. Those that provide **evidence of conditions that existed at the date of the financial statements**. These will be subsequent events requiring ***adjustment*** in the financial statements. (2)

2. Those that provide evidence of conditions **that arose *after* the date of the** financial statements. These will be subsequent **events requiring *disclosure*** in the annual financial statements. i.e. for events which **do not relate to conditions existing at balance** sheet date but **are of such importance that non-disclosure would affect the ability of the user** of the financial statements to make proper evaluations and discussions. (4)

Total 6

QUESTION 5
Procedures to identify subsequent events

Reference: ISA 560 and Auditing Notes page 17/12

1. Review the procedures performed by management to identify events after the balance sheet date. (1½)

2. Inspect minutes of the shareholders, board of directors, audit committee and board committee meetings, for the period after year-end, and enquire on relevant matters where the minutes are not available. (1½)

3. Review the latest interim financial statements, budgets, cash flow forecast, management reports etc (scrutinising books after year end). (1½)

4. Enquire from legal advisors on pending litigations/claims. (1½)

5. Consider relevant information which came to the auditor's attention from sources outside of the entity after year end. (1½)

6. Scrutinise prior year working papers to identify types of events which have occurred previously. (1½)

7. Enquire from management whether subsequent events had occurred which could affect the financial statements. (1½)
   - New commitments, borrowings commitments. (1½)
   - Sales or acquisitions of assets have occurred /planned. (1½)
   - Any developments regarding contingencies. (1½)
   - Unusual accounting adjustments made or contemplated. (1½)
   - Appropriateness of accounting policies used in the AFSs. (1½)
   - Events occurred that are relevant to the measurement of estimates or provisions. (1½)
8. Obtain a management representation letter referring to the appropriate treatment of subsequent events. (1½)

(14 x 1½)
Maximum 18

QUESTION 6

Completing the audit reporting schedule

Format of answer: Presentation (½)

6.1

6.2 etc. (Schedule included for marker reference only)

Issue	Conclusion in audit file	Reason for possible modification	Extent to which AFS. Are affected	Effect on report/ Type of opinion
1	The provision in respect of the credit note policy was understated by a material amount.	**6.1 Material misstatement: disagreement with management**	**6.2 Material but not pervasive**	**6.3 Qualified - Except for**
2	The ability of Tiger Trailers to continue as a going concern in the foreseeable future depends on negotiations to be finalised after the annual financial statements (AFSs) are issued. Disclosure of this fact has been made in the AFSs.	**6.4 Adequately disclosed**	**6.5 Fundamental to the users understanding**	**6.6 Emphasis of matter**
3	Various transactions took place during the year between the audit client and a party related to the client. These transactions took place well below the market price. No disclosure of the related party transactions has been made in the AFSs and this has a major affect on the AFSs which on the whole are misleading.	**6.7 Material misstatement: Disagreement with management**	**6.8 Material and pervasive**	**6.9 Adverse opinion**

(Marks 9 x 1½ + ½ presentation = 14)