Question 1

The following are 11 audit procedures taken from an audit programme:

1. Select items from the inventory records and examine the items in the warehouse.
2. Perform test of reasonableness on depreciation expense of equipment items taking into account their remaining useful lives, additions and disposals during the year and compare against the amount calculated by the client.
3. Send confirmations to banks with which the client does business to confirm the cash balances, loan balances as well as the outstanding banking facility.
4. Use the calculator to cast the cash disbursement journal and trace totals to the general ledger
5. Examine evidence that the customer orders have been approved for credit by the credit manager.
6. Discuss with the client’s lawyers as to the probability of losing the court case as well as the likely compensation amount for the dispute.
7. Select samples of payroll records and compute the overtime payment.
8. Observe the listing of incoming cheques by the receptionist in opening the daily mail.
9. Conduct cash count for the petty cash kept in the office to verify the amount counted by the accountant.
10. Inquire of the sales manager and credit manager whether there is segregation of duties regarding the credit granting function and sales function.
11. Compute individual unit manufacturing costs by dividing total manufacturing costs by the number of units produced, and compare the results with those in previous years and note any unusual fluctuations.

Required:

1. For each of the audit procedures above, indicate whether each procedure is a test of control, substantive test of transactions, substantive analytical procedure or a test of details of balances. (11 marks)
2. Identify the type of evidence for each procedure. (17 marks)

(Hints: Inspection of records or documents, Inspection of tangible assets, Observation, Inquiry, External confirmation, Recalculation, Reperformance, Analytical procedures, Scanning)

Question 2

The following are misstatements that have occurred in Nancy Accessories Ltd., a trading company selling handbags and accessories:

1. The order clerk placed purchase orders for accessories items; however, it was discovered that only purchase orders above $3,000 required authorization. The order clerk regularly placed orders for goods for her personal use up to the value of $3,000.
2. When goods were received, the warehouse department verified the quantity to the supplier’s shipping documents and checked the quantity of the goods received. The warehouse department, however, did not check against the purchase order as no copy of the purchase order was ever sent to the warehouse department. It was discovered that three batches of handbags, which the company did not order, were received and subsequently paid for.
3. Purchase invoices were input daily by the purchase ledger clerk. No one checks the accuracy of the input and it was discovered that several mistakes were made during the input process and suppliers were paid incorrectly.
4. The finance director is only provided with total amount of payments to be made on the payment list for payment approval. It was then discovered that some of the payees were fictitious suppliers.
5. The sales ledger clerk was having a long holiday during Christmas time. Upon return in January, the clerk entered all the unrecorded sales during the annual leave as January sales for the sake of convenience.
6. When entering in sales orders, the sales clerk entered a discount manually into the invoice. As the sales clerk was a newly recruited member, it was noted that the employee either forgot to enter the discount or entered an incorrect amount of discount.

Required:

1. For each misstatement listed, identify the type of specific internal control activity that was absent (i.e. segregation of duties, authorization, adequate documents and records, physical control over assets and records, independent check on performance) (6 marks)
2. For each misstatement, identify the key management assertion which has not been met. (Occurrence, Completeness, Accuracy, Authorization, Cut-off, Classification) (6 marks)
3. For each internal control listed, design a control activity for management to implement to prevent or detect any future misstatement. (18 marks)