THE PROFESSIONALS' ACADEMY OF COMMERCE

Auditing

Referral 7 - Solution

Question no 1

a) Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. If the auditor is unable to obtain sufficient appropriate audit evidence regarding a matter which has, or may have, a material effect on the financial statements and such audit evidence is expected to be available, this will constitute a limitation in the scope of the audit, even if a representation from management has been received on the matter.
Hence in this case the non-availability of proper documentary evidence constitutes a limitation in the scope of the audit.
Alternate audit procedures from which evidence could be obtained include:
   - Inspecting a copy of the cheque received by Comp. Co.
   - Obtaining written confirmation from the buyer that Comp. Co. sold him the machine.

b) The planned merger is a management intention for which no other sufficient appropriate audit evidence is expected to be available, so written representation from the management on this matter will be considered as sufficient appropriate audit evidence. However, if the auditor is not satisfied, he can read minutes of Board meetings to ascertain whether any such merger has been discussed in the Board meeting.

Question no 2

The auditor should obtain written representations from management that:

- It has fulfilled its responsibility for the preparation of the financial statements in accordance with an applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement.
- It has provided the auditor with all relevant information and access as agreed in the terms of the audit.
- All transactions have been recorded and are reflected in the financial statements.
- It acknowledges its responsibility for the design and implementation of internal controls to prevent and detect fraud.
- It has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud
- It has disclosed to the auditor its knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, etc.

Question no 3

- Auditor must consider the effect of subsequent events on the:
  - The financial statements;
  - The auditor's report.
- Subsequent events are all events occurring after a period-end (i.e. reporting date), i.e.:
  - Events after the statement of financial position date; and
  - Events after the financial statements have been authorized for issue.

Events occurring up to the date of the auditor's report:

- The auditor is responsible for carrying out procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified.
- These procedures are in addition to those applied to specific transactions occurring after the period-end that provide audit evidence of period-end account balances (e.g. inventory cut-off and receipts from trade receivables)

  Such procedures should ordinarily include:
  - Reviewing minutes of Board/Audit Committee meetings;
  - Scrutinizing latest interim financial statements/budgets/cash-flows, etc.;
  - Making/extending inquiries to legal advisors on litigation matters;
  - Inquiring of management whether any subsequent events have occurred that might affect the financial statements (e.g. commitments entered into).
- When the auditor becomes aware of events that materially affect the financial statements, the auditor must consider whether they have been properly accounted for and adequately disclosed in the financial statements.

Facts discovered after the date of the auditor's report but before the financial statements are issued

- If the auditor becomes aware of such facts which may materially affect the financial statements, the auditor:
  - Considers whether the financial statements need amendment;
  - Discusses the matter with management; and
  - Take appropriate action (e.g. audit any amendments to the financial statements and issue a new auditor's report).
- If management does not amend the financial statements (where the auditor believes they need to be amended and the auditor's report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion (as appropriate).
- If the auditor's report has been released to the entity, the auditor must notify those charged with governance not to issue the financial statements (and the auditor's report thereon) to third parties.

Facts discovered after the financial statements have been issued

- The auditor has no obligation to make any inquiry regarding financial statements that have been issued.
- However, if the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor's report to be modified, the auditor should:
  - Consider whether the financial statements need revision;
  - Discuss the matter with management; and
  - Take appropriate action (e.g. issuing a new report on revised financial statements).

Question no 4

The tests of controls on the sales and purchases systems which I would suggest to the trainees are as follows:

Sales system:

a. They can carry out sequence test checks on invoices, credit notes, dispatch notes and orders and ensure that all items are included and that there are no omissions or duplications.
b. They can check the authorization for the; acceptance of the order (the creditworthiness check), dispatch of

goods, raising of the invoice or credit note, pricing and discounts, write-off of bad debts.

c. They can check the pricing for accuracy and credit limits to ensure that they have not been exceeded.
d. They can seek evidence of checking of the arithmetical accuracy of invoices, credit notes and sales tax.
e. They can check dispatch notes and goods returned notes to ensure that they are referenced to invoices and credit notes and vice versa.
f. They can check that control account reconciliations have been performed and reviewed. They can re-perform the control by checking the reconciliation to source documentation.
g. They can ensure that batch total controls have been applied by seeking signatures and tracing batches from input to output.

Purchases system:

a. Test for evidence of review of reconciliation of purchase ledger listing.
b. Test for evidence of authorization of adjustments to purchase ledger control account.
c. Test for evidence of matching credit notes to goods returned notes.
d. Test for evidence of a sequence check, evidence of approval, Adherence to authority limits
e. Test for evidence of matching purchase invoices with goods received notes and purchase orders.
f. Test for evidence of checking casts and extensions and correct treatment of purchase tax.

(The End)

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