

Predecessor auditor:

An auditor from a different firm who audited the financial statements for the prior period and has been replaced by the current auditor.

The auditor should obtain sufficient appropriate evidence that:

- the opening balances do not contain misstatements that materially affect the current period's financial statements;
- appropriate accounting policies are consistently applied or that changes therein are properly accounted for and adequately presented and disclosed in the financial statements.

The auditor should always agree the opening balances to the prior period's closing balances to ensure they are correctly brought in as opening balances in the current period.

However, if the prior periods AFS's were audited by a predecessor auditor:

Procedures that the new auditor should perform are:

- reviewing of the predecessor auditor's working papers to obtain sufficient appropriate audit evidence regarding opening balances. Whether it is appropriate to rely on the predecessor auditor's working papers will depend on the predecessor auditor's competence and independence. The incoming auditor will need to consider and assess the competence and independence of the predecessor auditor;
- if the prior period's audit report was modified, the auditor should pay attention in the current year to the matters that resulted in the modification and consider whether they remain relevant and material to the current period's financial statements;

If the prior periods AFS's were not audited or where no reliance can be placed on the predecessor auditor's work:

The auditor should perform audit procedures to verify the opening balances. These may entail:

- confirmation of opening balances with third parties (e.g.: bank certificates)
- examination of the records underlying the opening balances (e.g. fixed asset register, contracts, etc) and obtaining audit evidence regarding opening balances as part of the current year's audit (e.g. debtors' and creditors' accounts paid);

ISA 520-ANALYTICAL PROCEDURES

Analytical procedures mean evaluation of financial information through analysis of plausible relationships among both financial and non financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant info or that differ from expected values by a significant amount.

There are **three times** the auditor should carry out analytical procedures:

- 1) The auditor should apply analytical procedures during the planning of the audit (during the risk assessment phase of the audit per ISA 315 para 6b);
- 2) when obtaining audit evidence at the assertion level as part of the substantive procedures;
- 3) at the overall review phase of the audit.

This includes the consideration of the entity's financial information by means of:

-Comparisons:

- with comparable information from prior periods;
- with anticipated results; and
- with similar industry information.

-Consideration of relationships between:

- elements of the financial information expected to conform to a predictable pattern; and
- financial and non-financial information.

The auditor should investigate unusual items and fluctuations that may be identified by the analytical procedures by inquiry of management, followed up by corroboration of management's explanations (e.g. by using the auditor's knowledge of the business and other audit evidence obtained)

Different stages when analytical procedures are carried out:

1. In the **planning phase** of the audit as **risk assessment procedures** (at both the financial statement and assertion levels):
 - to understand the client's business and environment;
 - to identify potential risks of material misstatements; and
 - to identify high risk areas so that the nature, timing, and extent of further audit procedures can be planned
 - to ascertain if the use of going concern assumption is appropriate
 - to reduce detailed audit procedures (if the analytical procedures show no deviations, the possibility of material error is thus slight and overall audit procedures can be reduced)
2. **During the course of the audit as substantive procedures** to limit the risk of material misstatement at the assertion levels (**substantive analytical review**).
3. **During the overall review phase at the end of the audit** (forming an overall conclusion):
 - as an overall test of reasonableness;

- to identify possible unrecognized risks of material misstatements requiring further audit procedures;
- to corroborate conclusions formed during the audit
- to provide an overview as to whether the financial statements as a whole are consistent with the auditor's knowledge of the business.

ISA 540-AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

Some financial statement numbers cannot be measured precisely, but can only be estimated.

These items are referred to as accounting estimates.

Accordingly, there is a high risk of material misstatement related to such items, as:

- they are made under conditions of uncertainty;
- involve the judgement; and are prone to management bias.

Examples of accounting estimates include items such as:

- estimates relating to the outcome of litigation;
- fair value accounting estimates for derivative financial instruments;
- allowance for credit losses, inventory obsolescence, depreciation methods, warranty provisions etc.

Additional examples of situations where fair value accounting estimates may be required include:

- complex financial instruments
- share based payments
- PPE held for disposal, Business combination calculations including goodwill etc.

The auditor shall obtain sufficient appropriate audit evidence that the estimates are:

- correctly recognized and disclosed in the financial statements; and
- that it is recognized or disclosed at appropriate amounts.

The auditor must, for all significant accounting estimates, respond to the risk and obtain sufficient and appropriate audit evidence to limit the auditor's risk.

Per paragraph 16, this will consist of:

1. Auditing events occurring up to date of the auditor's report (subsequent events)
2. Testing how management made the estimates and the data on which it is based, thus testing the method of measurement and assumptions used
3. Testing the operating effectiveness of the controls over how management makes the estimates together with appropriate substantive procedures

Require written repres

Testing ^{correctness} of accounting treatment ^{into applicable} _{acc framework.}

require written representation of management / have dialog with governance whether they believe significant or -

4. Developing a point estimate or range to evaluate managements point estimate (understand managements assumptions & methods and conclude if appropriate or not to use managements range). And if managements range cannot be used, further substantive procedures must be carried out

assumptions used in making ac estimates are reasonable

ISA 550 -RELATED PARTIES

The auditor carries out related party transaction procedures as part of the risk assessment process at the planning stage of the audit. The auditor should perform audit procedures that recognize fraud risk factors resulting from related party relationship and transactions.

The auditor is then to ensure further that the entities related party relationship and transactions have been appropriately identified, accounted for and disclosed in the financial statements.

Related party relationships and transactions poses a high risk to the auditors, and accordingly the auditor should plan and perform the audit with professional scepticism.

Related parties and related party transactions are defined in the applicable financial reporting framework, but are essentially those between a person and an entity that has control or significant influence over another, or transactions between the entity and their directors or key management.

The procedures to search for related parties & transaction will include the following

- Review prior years' working papers for names of related parties.
- Review share registers/records for names of major shareholders.
- Review minutes of board and shareholders' meetings.
- Review statutory registers, for example register of directors' interests in contracts.
- Enquire of other auditors about their knowledge of related parties.
- Review tax and other statutory returns.
- Review the accounting records for abnormal transactions.
- Review confirmation letters for indication of related party transactions, for example loans and bank confirmations for guarantor relationships, etc.
- Review the entity's procedures for identification of related parties.
- Enquire as to the affiliation of directors and officers with other entities
- Investigate investment transactions, for example equity interests acquired or sold.
- Consider the adequacy of the internal control procedures over the authorization and recording of related party transactions.
- Review information provided by management regarding related party transactions and be alert for other similar transactions.
- Obtain a management representation letter in respect of related party transaction

Enquire on related parties

ISA 580 -WRITTEN REPRESENTATIONS

Written representation:

A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

The auditor shall request written representations from management with appropriate responsibilities for the financial management and knowledge of the matters concerned.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. And the fact that management have provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of managements responsibilities or about specific assertions.

If management refuses to provide the auditor with written representations when requested to do so, the auditor must:

- discuss the matter with management or those charged with governance;
- re-evaluate the integrity of management;
- consider the effect thereof on the audit opinion.

If the auditor concludes that written representation by management are unreliable or management refuses to provide such representations:

- the auditor is unable to obtain sufficient appropriate audit evidence; and
- the auditor must qualify the audit opinion (disclaim opinion, as it affects all elements in the financial statements and is pervasive).

ISA 600 –SPECIAL CONSIDERATIONS – AUDIT OF GROUP FINANCIAL STATEMENTS

Component: An entity or business activity whose financial information is included in the group financial statements

Component auditor: The auditor who audits the components

Component materiality: The materiality level for the component as determined by the group engagement team

Group engagement partner: The partner responsible for the group engagement and its performance

Significant component: A component identified by the group engagement team that is: Of individual financial significance to the group; or is likely to include significant risk of material misstatement the group.

The auditor of the group financial statements should obtain sufficient appropriate audit evidence on which to base the audit opinion of the group.

The group engagement partner is to consider the professional competence and independence of component or other auditors and should consider factors such as:

- membership of professional organizations;
- membership or affiliation with the same firm of auditors; and
- professional bodies to which the other auditor belongs.

He should also advise the other auditor of the important aspects of the audit and perform procedures to obtain sufficient appropriate audit evidence that work of the other auditor is sufficient for the principal auditor's purposes and finally perform procedures on the findings of the auditor.

Accordingly, the group engagement auditor/ partner are responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and applicable legal and regulatory requirements and the group audit report.

The engagement partner should:

- consider whether to accept or continue as auditor of the group.
- understand the group, its components and their environment

The group engagement team must:

- establish an overall group audit strategy for the group audit as a whole
- establish materially for the group financial statements as whole
- identify and respond to the risk misstatement at group level
- identify and respond to the risk misstatement for significant components (non-significant components will be audited through analytical review)
- carry out consolidation process procedures & subsequent events review for the group
- evaluating audit evidence obtained (including the work of component auditors)
- communicate with those charged with governance (report to those charged with governance on review of the audit performed, findings, risks and other relevant aspects
- documentation must be made and maintained for all the different aspects of the audit
- the principal auditor should not refer to the other auditor in an unqualified audit report. If the group auditor cannot rely on the other auditor's work and cannot rectify the situation by implementing additional audit procedures, and it has a material effect on the financial statements, he must qualify the opinion.

ISA 620 –USING THE WORK OF AN AUDIT EXPERT

An auditors expert:

A person or firm possessing special skills, knowledge and experience in a particular field other than auditing or accounting, where work is used to assist the auditor to obtain sufficient appropriate audit evidence.

The auditor is an expert in the field of accounting and auditing and general business matters, but it is not expected to the auditor to be an expert of other professions or occupations such as, for example, IT. It may thus be necessary for the auditor to rely on the work of an expert in relation to aspects that might affect the financial statements on which he/she has to express an audit opinion.

Where the auditor is to rely on the work of an expert, the auditor should obtain sufficient appropriate audit evidence that such reliance is justified.

The auditor should consider the following in relation to the expert:

- whether reliance is justified, considering the expert's competence, capabilities and objectivity;
- the scope of the expert's work; and
- adequacy of the expert's work

Note that when an auditor appoints a expert, the auditor will still need to apply procedures on his/her work and findings and has the sole responsibility for the audit opinion expressed and that responsibility is not reduced by the auditors use of the work of an expert.

Examples of circumstances where reliance will be placed on the work of an expert:

These include aspects such as valuation of assets, financial instruments, PPE, jewelry antiques , intangible assets , actuarial gains / losses, unusual tax compliance issues, valuation of environmental liabilities and site clean-up costs, and legal opinions / issues.

When determining the need to use the work of an expert, consider:

-the need for an expert to assist the auditor in understanding the entity and its controls and in -identifying & assessing the risks of material misstatement at overall financial statement and assertion level

-evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements

The steps that an auditor should take and matters that you should consider when appointing an expert for example an independent sworn appraiser/ valuer of property:

1. Obtain the client's permission for the appointment of the valuer.
2. Should the client refuse this consent, this would constitute a scope limitation on the audit.
3. Consider the valuer's qualifications and suitability, including;
 - 3.1 his/her membership of a recognised professional body and other evidence of his competence,

- 3.2 his/her reputation and experience in commercial property,
 - 3.3 His/her independence in relation to the client.
4. Consult with the expert prior to his appointment, specifically regarding;
- 4.1 The objective of the valuation,
 - 4.2 The basis of valuation to be used - open market value,
 - 4.3 The method or assumptions to be used.
 - 4.4 His/her understanding of the purpose for which the valuation is required,
 - 4.5 The form and content of the report or certificate

THE AUDIT OF TRANSACTIONS AND BALANCES

The Revenue / Receipts cycle

Income statement / Statement of comprehensive income transactions & events

- Revenue (credit & cash sales)
- Services rendered
- Credit losses
- Settlement discount granted
- Interest received on arrear accounts

Balance sheet / Statement of financial position balances

- Trade receivables
- Allowance for credit losses (provision for bad debts)

Substantive audit procedures to obtain evidence that *credit sales* have been fully accounted for in the accounting records and the financial statements.

The primary risk is understatement of sales.

Sales: Completeness, accuracy and cut-off

- Draw a sample of delivery notes and compare it with the corresponding invoices in respect of the name of the client, the description and quantity of goods dispatched.
- Select documented inventory issues in case where reliable, continuous inventory records have been kept, and follow them up by examining the corresponding delivery notes and sales invoices.
- Follow up the sales invoices that you have checked by referring to the sales records (sales journal)
- Recalculate the totals of the sales records for selected periods to make certain that the postings totals are accurate.
- Check the postings of total sales to the credit side of the sales account and the debit side of the receivable account.
- Observe whether an authorised person has signed as evidence that the numerical accounting for sales invoices and delivery notes has been checked.

Develop an expectation of recorded sales based on:

Historical and current year trends in sales, factors considered by the client in developing budgets, industry statistics, changes in the current year affecting pricing or sales mix and other known information (e.g.: expanding/declining markets, level of competition, new or discontinued product lines, major customers gained or lost, dates and percentages of price increases).

Expected gross profit and the cost of goods sold. The components of this computation should either be obtained from reliable independent sources or be subjected to audit. (If necessary the expected gross profit percentage could be calculated monthly by major product type. This analysis may reveal unexpectedly low margins, indicating unrecorded sales).

Quantities delivered/hours of service where this information is independent of sales and considered to be reliable) and expected average prices.

- Determine the threshold needed to identify a significant difference between the expected and recorded sales amounts.
- Compare the expectation(s) to the recorded amount(s). For any difference that is more than the threshold, obtain and corroborate explanations for the difference (e.g. by examining supporting documents)

Sales returns (debits to sales):

Substantive tests of details

- Select from credit notes issued and journal entries passed (as recorded in the sales analysis and/or the general ledger during the period) and verify their validity by examining supporting documentation e.g.: agree to signed goods returned voucher (or to approved claim form) and to the related sales invoice. Check casts and extensions.

For credit notes issued after year end:

- Examine significant credit notes issued after financial year end and determine their impact on the current period's sales.
- Examine source documents for credit notes not yet issued and ensure that the impact on the current period's sales is accounted for.
- Consider the possibility of raising a provision for credit notes based on the above or adjusting the existing provision

Substantive analytical procedures

- Compare monthly sales deductions such as discounts and credit notes, as a percentage of sales for the current periods. Corroborate explanations for significant changes. It would generally also be necessary to select say, one month's debits to sales and examine supporting documentation for the debits.

Audit of debtors

The primary risk is overstatement of debtors. The focus is on validity, accuracy, existence, ownership, late cut-off and valuation. Understatement of debtors is addressed through the audit of sales.

- Agree final balances on the debtors listing with the debtors control account in the general ledger at year end
- Verify significant reconciling items.
- Cast the debtors listing and the debtors control account in the general ledger at year-end.
- Identify intercompany balances and file a copy of client-obtained confirmations. Otherwise confirm these balances with the auditors of the respective companies.
- Select a sample of accounts for verification from the debtors listing including large unusual and old balances as well as a selection of smaller balances. Obtain positive confirmation of the balance from the debtor as follows:
 - Prepare, or have the client prepare, confirmation requests for the balances or invoices selected. Dispatch the requests under our control.
 - Send second requests for non-replies
 - Compare replies to requests and investigate differences. Take careful note of comments indicating that the debtor has paid as this may indicate rolling of cash. Trace reconciling items to supporting documents.
 - For non-replies, trace subsequent cash receipts to bank stamped deposit slips. For unpaid amounts, examine source documentation supporting the sale such as signed proof of delivery orders etc.

Perform cut-off tests at early verification date, if applicable, and again at the year-end if a specific risk of incorrect cut-off has been identified.

- Examine cash receipts shortly before verification date to ensure that they have been credited to the debtors control account and specific debtor's accounts prior to verification date.

- Examine cash receipts shortly after verification date and ensure that they are credited to debtors after verification date.
- Select receipts credited to the debtors control account before year-end and ensure that the cash was received and deposited before year-end.
- Select receipts credited to the debtors control account after year-end and ensure that the cash was received and deposited after year-end. If the control account entries have not yet been processed after year-end, select from the daily receipts listing or equivalent record.
- Consider the results of related cut-off procedures for sales invoices and credit notes performed under the sales audit.

- Perform the following roll forward procedures
- Examine the reconciliation of the debtors listing to the general ledger at both verification and balance sheet dates
- Compare the balance of the debtors control account at verification date and balance sheet date and vouch material movements as follows:
 - Review sales (debits to receivables), receipts and credit note postings (credits to debtors) and any other movements during the roll forward period by agreeing the amounts to books of prime entry and comparing them to entries in preceding months and to the amounts recorded in prior periods.
 - Verify any large/unusual adjustments to the control account
 - Where variations or fluctuations cannot adequately be explained, perform tests of details by selecting individual transactions and examining the supporting documentation.

Debtors: valuation

- Test the accuracy of the ageing of the debtors' records. This may be done by:
 - Selecting sales invoices and other debtors' transactions, noting their date and ensuring that they have been correctly reflected in the age analysis; and
 - Ensuring that cash receipts are allocated against specific invoices and not simply allocated against the longest outstanding balances.

- Analyse the debtor's age analysis by age category as a percentage of total debtors, and compare with prior periods to identify any deterioration in collections.
- Scrutinise the debtor's age analysis for significant overdue amounts and determine their recoverability. Review files of disputed amounts and queries.

- Consider the recoverability of unpaid, disputed or overdue amounts identified during the tests of details in above.
- Review debtor's write-offs during the year in relation to prior year write-offs and the allowance for credit losses. Consider the reasonableness of the current allowance for credit losses in relation to the write-offs. Review minutes of management meetings for discussion of debtors considered to be doubtful.
- Review records of credit losses (bad debts) recovered and debits to the allowance account.
- Evaluate the reasonableness and consistency of the methods and assumptions used by management to determine the allowance for credit losses. Where applicable ensure that the stated policy in relation to doubtful debts has been complied with.
- If management's methods and assumptions are not considered to be reasonable, develop an independent range of estimates of the allowance for credit losses and determine whether management's estimate falls within the range. Summarise your overall findings and use these to assess the adequacy of the allowance.

Debtors: presentation

- Trade debtors: disclose net of allowances for credit losses & other IFRS 7 disclosure requirements are met
- Determine that the following balances are properly classified:
 - credit balances in debtors
 - long term debtors
 - intercompany balances
- Ensure that any encumbrances over debtors are disclosed.

Substantive audit procedures for a *trade receivables circularization*

- Re-perform calculations to check the additions of the list of trade receivables' accounts in the trade receivables' ledger and trade receivables' control account in the general ledger.
- Agree the total of the trade receivables' list with the amount in the trade receivables' control account.
- Compare the information that appears on the statements of account with the information in the trade receivables' ledger and the list of trade receivables e.g.name and amount.

- Examine some of the trade receivables' information e.g. name and a cc address to recent correspondence from the customer or, alternatively, to the information in a telephone directory.
- Inspect the monthly statements for every trade receivable balance by comparing the statements with the list of trade receivables.
- Reach an agreement with management concerning those trade receivables that should not be circularised, e.g. trade receivables handed over to attorneys for collection.
- Use CAAT'S to select the sample required for positive confirmation or negative confirmation and agree the customer's details, including the name and address appearing on the monthly statement with the customer master file details.
- Attach the audit stickers which bear the request to contact the auditor directly, to the statements.
- Place all the statements in envelopes that have the auditor's name and address on the reverse side of the envelope, to ensure the return of all undelivered mail to the auditor's office, as well as a stamped envelope in the case of positive circularization
- The auditor's office must actually mail the envelopes, so that there is no opportunity for an employee of the auditee to remove any statements and substitute others.
- Prepare a working paper detailing all the trade receivables' names and extend the amount into the relevant column signifying the type of circularisation. Leave space in sufficient columns in which to subsequently record agreements, complaints, further audit procedures and conclusions.
- Follow up all queries and complaints raised by customers in relating to their monthly statements, and ensure that all the necessary steps have been taken to rectify any errors revealed in this way.
- Follow up trade receivables' statements returned by the post office as undelivered. Obtain the proper addresses and repost them. If no other address is known, report the matter to management and ascertain whether provision should possibly be made for such debts as irrecoverable. Consider the possibility of a fictitious account.
- In the case of a positive circularisation, where no reply has been received re-circularise and, should there still be no reply, examine the relevant trade receivables account. If it has been subsequently paid vouch the receipt, and if it is still unpaid ascertain whether the debt was in fact correctly recorded by examining the relevant order forms, delivery notes and invoices.

Substantive audit procedures for *cash register sales*

- Test check the tally rolls of cash register readings to the entries in the cash sales register.
- Test check castings of entries in the cash sales register.
- Test check the totals of the cash sales as recorded in the cash sales register to the corresponding entry in the cash receipts journal and on the bank deposit slip.
- Test check totals sales in the cash receipt journal to the deposits shown in the bank statement.
- Scrutinise the cash sale register for cash shortfalls and surpluses and discuss material amounts with management.
- Test check postings to the appropriate sales accounts in the general ledger.
- Compare the monthly cash sales with those of previous months and previous period and ask management for an explanation of any material fluctuations.
- Calculate the gross profit percentage on sales and compare with previous period. Ask management to explain any material deviations.

Substantive audit procedures for *allowance for credit losses (provision for doubtful debts)*

- Obtain a list of debtors per age analysis and:
 - test the castings and calculations on the list
 - agree the total of the list with the debtors control account in the general ledger, trial balance and financial statements.
- Select long outstanding debtors on the list and test the collectability thereof:
 - compare with the subsequent payment received after year end
 - attorney letters in respect of debtors handed over
 - guarantees/securities held by client (ensure legal and adequate)
 - discuss with credit manager
 - compare with response to debtors circulation
- Recalculate & inspect the client's provision calculation:
 - obtain/ascertain the clients policy with regards to provisions
 - compare the calculation with previous years working papers

- compare it with minutes of board meetings
- determine the acceptability of the policy with reference to industry norms, level of credit ----
- losses in previous years against the provision etc.
- recalculate the provision according to client's policy-compare it with the amounts provided per the trial balance and the financial statements
- Perform analytical procedures:
 - compare with previous years debtors, provision and days outstanding etc.
 - compare the ratio of credit losses: sales in the current year with the % of the provision
 - compare with the budgets and previous years amounts. Follow up on reasons for deviations and fluctuations.
- Obtain management representation letter with regards to the completeness and accuracy of the provision
- Test the disclosure in the financial statements and ensure it complies with GAAP/IFRS

Substantive procedures for the audit of *credit losses / bad debts*

- Obtain an aged list of trade receivables that divides the balances on a monthly basis, and use computer assisted auditing techniques (CAATS) to cast and crosses cast the schedule and agree the total to the general ledger control account for trade receivables
- Obtain Examine the journal information for doubtful debts written off and note the authorisation and compliance with the policy
- Follow the long outstanding trade receivables through to the list of bad debts written off.
- Examine the attorneys' file regarding collections, reminders and claims correspondence with trade receivables and other sources of information, as well as official notifications of insolvencies
- Discuss with management the adequacy of the bad debts written off & the provision for doubtful debts. Review management's calculation of the provision for the current year for consistency
- Perform ratio analysis to ensure the overall reasonableness of the doubtful debts written off.

Substantive audit procedures for other income

Interest income:

- Compare the schedule of investments with the schedule of investment income.

- Where investments held during the year have not generated any income, ensure by examining appropriate evidential matter that income did not accrue in respect of the investments concerned.
- Ensure that ex div and cum div earnings are correctly calculated
- Refer to work papers on investments and ensure that all investment income can be related to specific investments held during the period.
- Obtain details of investment income credited to income during the period and:
 - Agree balances to the general ledger
 - Trace interest income and dividend receipts to a bank/call account statement
 - Where possible, verify income received by reference to appropriate evidential matter (e.g. dividend and interest income for listed investments can be checked to stock exchange bulletins)
 - Ensure compliance with the disclosure requirements of Companies Act. This includes disclosure of income from investments, distinguishing between listed and unlisted investments and between interest, dividends and other specified income.
 - Investment income is usually audited as part of investments. For all investments audited, the
 - auditor should ensure all the related income has been taken into account :
- Confirmation from 3rd parties (investees) of balances of investments, interest received
- Analytical procedures:
 - return on investment calculated as a average % for the year and the average rand value of the investment income- compare with market returns
 - interest earned compared to prior periods

Rental income:

Audit of rental income should be done with reference to lease contracts, agreements etc.

-Recalculation of all amounts calculated as rental income for the period based on the contracts

- Compare the monthly rental received in the receipts journal in the bank statement and rental agreement.

- Examine the particulars on the rental agreement and make certain that the deed is in the companies name and the correct monthly rental has been correctly received.

- Check the postings from the cash receipts journal to the general ledger account to determine whether there are correct.

-Analytical procedures:

- year on year
- market/industry norms

Profit (or loss) on sale of assets

Audited as part of fixed assets.

Refer to:

- selling price per contract/sales invoice;
- purchase price per:

- # fixed assets register;
- # purchase invoices /contracts;
- # previous year's working papers.

- * Authorization and conditions of sale: inspect minutes of management/ board of directors /shareholders' meetings (Companies Act).
- * Book value: Recalculation of the accumulated depreciation to the date of sale.
- * Profit: recalculate.

The purchases / payments cycle

Income statement / Statement of comprehensive income transactions & events

- Purchases (credit & cash sales)
- Operating expenses
- Settlement discount received
- Interest paid on arrear accounts

Balance sheet / Statement of financial position balances

- Trade creditors
- Accruals

Audit procedures for *credit purchases*

Validity / Occurrence

- Check whether there are orders for the selected credit purchase transactions by comparing the orders with the appropriate invoices and goods received notes.
- Examine the order to see whether it bears the signature of the purchases manager as evidence that the transaction has been authorised.
- Examine the credit purchases invoices to make certain whether
 1. The date falls within the period of the current year.
 2. The supplier's name appears on the list of approved suppliers,
 3. The name of the customer appears on the credit purchases invoice.
 4. The goods purchased are in fact goods in which the enterprise trades.

5. The signature of the person responsible for checking the accuracy of the invoice appears on the invoice.
- Compare the information on the invoice with the information on the order and the goods received note.

Completeness

- Inspect the dates on the credit purchases invoice and goods received note to determine whether they have been recorded timeously.
- Determine the number of the last goods received note at the cut – off date and compare the information and date thereof with the purchase invoice. Make certain that the transaction has been accounted for in the correct period.
- Check the stationery register to see whether the pre-numbered goods received note books have been issued only to authorised persons and have been issued and recorded in numerical order.
- Examine the file for outstanding goods received notes which have not yet been linked to an invoice within a reasonable period of time.
- Examine the file with outstanding goods received notes where inventory has been received but cannot be compared with the invoices and can therefore not yet be accounted for in the accounting records.
- Examine a sample of goods received notes for the signature of the person who compared them with invoices.
- Compare the information on the goods received notes with the information on the invoices and compare this information with the information recorded in the purchases journal.
- Compare the inventory purchased per the goods received notes with the information recorded in the inventory records.
- Check whether monthly payables reconciliations are being drawn up to ensure that all the credit purchases transactions have been fully accounted for.

Substantive analytical procedures

- Develop an expectation of purchases based on the preceding period's amount and other known information (e.g.: increased costs of raw materials, labour overheads, changes in volume and product mix changes in overhead rates).
- Develop an expectation of gross profit (and gross profit percentages) based on the preceding period amount and other relevant information (e.g.: sales price increases).
- Compare the expectation(s) to the recorded amount(s). For any difference that is more than the threshold obtain and corroborate explanations for the difference e.g.: by examining supporting documents).

Audit procedures for *payments to creditors*

- Check to see whether the signature of the financial manager appears on the cheque requisition as evidence of the authorisation of payments to payables.
- Inspect the payments journal to see whether postings from this journal to the following are correct:
 - The general ledger creditors control account total
 - The bank account
 - The creditor's ledger & individual creditors account

Substantive audit procedures for *trade creditors* in the financial statements

The primary risk is understatement of creditors. Overstatement of creditors is addressed through the audit of purchases.

Substantive analytical procedures

- Compare the current year trends for purchases and creditors to previous years.
- Compare the current years creditors days outstanding to those of prior years.

Substantive tests of details

- Agree opening balances to the prior year work papers
- Obtain the creditors list
- Agree the total on the creditors list to the creditor's ledger

- Trace a sample of creditors on the creditors list to the creditor's ledger
 - Obtain a file of creditors statements and inspect that these creditors are on the creditors listing.
 - Obtain a sample of creditor's statements and trace through to invoices and inspect that all documents are addressed to the client.
 - Obtain a sample of creditors statements and trace through to invoices and inspect that all invoices are supported by valid GRN's that provide evidence that such goods/services were in fact received by the client.
 - Obtain a reconciliation of the creditors listing to the general ledger at year-end. Verify significant reconciling items and ensure that the control account balance is corrected where necessary.
 - Cast the creditors listing
 - Cast the creditors control account in the general ledger
 - Review the creditors control account for unusual debit entries.
 - Cast a sample of accounts in the creditor's ledger.
 - Identify any intercompany balances. Where the client obtains written confirmation of these intercompany balances from those companies, file a copy of each confirmation. Otherwise confirm these balances with the auditors of the respective companies.
 - Inspect the current and prior years listing and investigate why creditors with large balances in the prior year have small balances or nil balances in the current year.
 - Select a sample of accounts for verification. Ensure that the sample includes all material creditors from the prior year, all material creditors identified from our work on purchases, expenses and fixed asset additions as well as all other creditors which have a material statement balance.
 - Perform the following procedures for each creditor's balance in the sample:
Obtain the supplier's statement and examine the reconciliation between the supplier's statement and the trade creditors listing
- Cast the reconciliation
- Investigate and vouch material or unusual reconciling items
 - Investigate whether invoices outstanding have been or should be included in accruals

-Perform cut-off tests at early verification date/roll forward , if applicable, and at the year-end

- Trace a sample of purchase returns records before and after the year-end to supplier's credit notes ensuring claims against the suppliers were realised in the correct period.
- Trace a sample of payments before/after year-end and determine that they have been allocated to creditors in the correct period.

-For creditors accounts that contain debit balances:

- Consider the causes of the debit balances and assess whether they have arisen as a result of a weakness or deficiency in the client's systems.
- Vouch selected items to supporting evidence (e.g.: overpayment in prior periods)
- Consider the recoverability of significant debit balances
- Transfer the balances to debtors if necessary

Perform the following procedures in relation to **accruals**:

- Obtain a list of accruals. Cast the list and agree amounts to the general ledger.
- Compare a current listings of accruals with those of the previous period and note any significant changes or potential under accruals (e.g. rent from year to year)
- Verify material accruals e.g.: rates by examining documentation and checking calculations that prove the amounts, or by direct confirmation with independent third parties.

- Subsequent to the financial year end, perform a search for **unrecorded liabilities** as follows:

- Examine goods received records dated prior to the year-end and establish that such goods have either been invoiced by the supplier and are included in creditors or are included in accruals.
- Examine the invoice log (if one is maintained) to ensure that all suppliers' invoices not processed at year-end have been accrued in instances where a GRN dated prior to the year-end exists.
- Examine files of uncleared or disputed invoices and establish the appropriateness of related accruals through matching invoices with GRN's. Note that for services received a GRN will not be available.
- Examine correspondence with selected creditors including major suppliers and suppliers with a history of accounting difficulties, to identify significant disputes.

- Review payments and creditors entries after the year-end to determine whether or not they apply to goods or services received prior to the year-end and if so, ensure that appropriate accruals were made.
 - Get the file of unmatched GRN's and determine whether these amounts have been or should be accrued for.
 - Look at large payments after year end determine whether these payments have been included in creditors if the goods/services were received prior to year end and were not included in creditors if they were received after year end.
- Inspect that the following are correctly disclosed:
- Material debit balances should be reclassified to debtors
 - Where a material payments to creditors will be made more than a year after the year end date, the related liabilities should be classified as long term
 - Intercompany balances should be properly classified.
- Obtain representations from management in the management rep letter that creditors are complete.

If roll forward procedures are to be carried out:

- Examine the reconciliation of the creditors listing to the general ledger at both verification and balance sheet dates.
- Compare the balance on the creditors control account at verification date and balance sheet date and vouch material movements as follows:
 - Review purchases (credits to creditors) payments and purchase returns (debits to creditors) and any other movements during the roll forward period by agreeing the amounts to books of prime entry and comparing them to entries in preceding months and to the amounts recorded in prior periods.
 - Verify any large/unusual adjustments to the control account
 - Where verifications or fluctuations cannot adequately be explained perform tests of details by selecting individual transactions and examining the supporting documentation.

Audit of cost of sales (COS)

- Calculations of COS

| | |
|--------------------------------|-----------|
| (1) Opening stock | xx |
| (2) Plus: Purchases/production | xx |
| (3) Less: Closing stock | <u>xx</u> |
| (4) COS | <u>xx</u> |

1. Agree with previous year's working papers and financial statements.
2. Purchases – audited see above.
3. Agree to the working papers i.r.o stock (audited there).
4. Agree with the amount in the financial statements.

- Manufacturer

COS is equal to the cost of manufactured goods sold – therefore finished goods.

- * COS: agree with the entries in the finished goods accounts in the general Ledger.
- * Audit the transfer from in progress to finished goods by selecting a number of transfers and auditing the production costs statement:

| | | |
|---|---------------------------|--|
| # | Opening balance WIP : | Previous year's working papers; |
| # | Current production costs: | |
| | * Materials : | Audit against the purchase account; |
| | * Labour : | Audit of salaries and wages; |
| | * Overhead : | Audit of expenses and allocation of overheads; |
| # | Closing WIP : | Audit as part of inventory. |
| # | Production : | Follow through to the general ledger account for finished goods. |

NOTE: For materials, labour and overheads the expenses must be audited, as well as their allocation to production.

Interest paid-long term loans

Occurrence

1. Obtain the loan agreement (or refer to the audit working papers) to determine the percentage, terms of payment and any related clauses for the loan.
2. Inspect a sample of new loan agreements, and note the following:
 - 2.1 The rate of interest.
 - 2.2 When it is payable e.g. monthly, annually, etc.

2.3 The date of the loan (from when interest occurs).

2.4 Any conditions relating to the interest e.g. fixed rate or linked to prime.

2.5 Whether the agreement is signed by authorised parties.

3. Inspect the cash payments journal/bank statements to confirm the interest charge in respect of the overdraft and by inquiry, and inspection of correspondence, determine whether there is an agreed overdraft rate between the bank and the company.

4. Inspect the cash payments journal for evidence of the payment of interest and interest on long-term loans (note this may not yet have been paid).

Accuracy, classification and cut-off

1. Re-perform the calculation of the interest on the loan and on using the rates obtained from the agreements and taking into account the portion of the year for which interest should be paid (accuracy and cut-off).

2. Trace the posting of interest on long-term loans from the cash payments journal and general journal (accruals) to the general ledger to confirm that the correct amounts were entered in the correct accounts (classification).

3. Agree the interest on overdraft to the cash payments journal, bank statement and trace the posting through to the general ledger.

4. Agree the totals on the schedule to the ledger accounts (for each category of interest) and the trial balance statement of comprehensive income.

5. Review the accounts in the general ledger for any unusual items.

Completeness

1. Confirm by inquiry of the accountant, inspection of the minutes of directors meetings, and inspection of the prior year audit working papers that there were no other loans, debentures etc. on which interest should be paid, including any loans repaid during the year.

2. Perform an unrecorded liability search for long-term liabilities.

Substantive audit procedures for *cheque payments - expenses*

- Check whether there is a cheque requisition and supporting documentation for each of the selected cheque payments.
- Check whether the cheque requisition has been approved for payments by the senior accountant by scrutinizing his signature on the cheque requisition.
- Compare the following information to the cheque requisition with the information on the supporting documentation for accuracy.
 - The beneficiary
 - The amount payable
 - The nature of the disbursement
- Check the calculations on the cheque requisition and supporting documents.
- Check whether the supporting documentation has been cancelled by means of a paid stamp or an indication of the corresponding cheque number.
- Compare the entry in the payments journal with the information on the cheque requisition and supporting documentation and make certain that the allocation is accurate, taking into account the nature of the transaction.
- Check whether the dates on the supporting documentation and the cashed cheque fall within the financial period under review.
- Check whether the signature of the responsible person appears in the payments journal as evidence that the accuracy and completeness of the cheque payments in the payments journal have been verified.
- Check the mathematical accuracy of the payments journal.
- Compare the information according to the payments journal and cheque requisition with the following information on the cashed cheque.
 - Beneficiary
 - Amount
 - Date
- Check whether the cashed cheques are crossed and note any endorsements on the cheque.
- Verify that the cheques have been cashed and that they bear a bank stamp.
- Verify that the cheque has been signed by two authorised signatories.
- Examine the postings from the payments journal to the general and creditor's ledger.

Other expenses (rental, admin costs, etc)

- Perform analytical procedures on sundry expenses and obtain explanations (supported by valid evidence) for unusual fluctuations.

- If the amounts for line items of expenses are not material (amount and nature) and the analytical procedures provide satisfactory evidence, the analytical procedures as substantive tests can be relied upon.

- Audit tests (if material).

- 1.1 Test the casting and calculations in the general ledger accounts.
- 1.2 Agree the totals of the general ledger accounts with the trial balance and financial statements.
- 1.3 Review the general ledger accounts for unusual items and investigate.

NB: Ensure during the procedures that expenses do not include improvements (which have to capitalised, and vice versa).

- 1.4 Select expense items from the general ledger accounts and verify it against the source documents (invoices, contracts, etc).
 - agree details such as supplier, date, amounts, etc
 - ensure correct treatment of VAT;
 - test accounting accuracy of source documents;
 - verify it against the paid cheque:
 - * agree amounts, dates, etc.
 - * examine signatures against authorised cheque signatories
 - * examine endorsements.

- 1.5 Select expenses from the cash book and follow it through to the entries in the general ledger account (understatement).

-Select expenses from the transaction files and follow it through to the invoices and entries in the general ledger accounts (understatement).

-Test cut-off by selecting expenses from the cashbook/purchases journal before and after year and follow it through to the general ledger accounts – ensure recorded in the correct period.

- Perform analytical procedures (specify), and verify material fluctuations against supporting documentation.
- Examine the financial statements and ensure amounts correctly:
 - disclosed; and
 - classified;
 In accordance with IFRS and the statutory requirements.
- Obtain a management representation letter.

Depreciation

Is normally audited as part of the audit of fixed assets (properly, plant and equipment)

It takes place through:

- * re-calculation of the depreciation amounts according to the accounting policy and depreciation rates;
- * determine /consider applicability of;
 - # the depreciation policy /method used.
 - # the useful life of the assets.
- * refer to (agree) the fixed assets register.

Dividends paid

Dividends paid are accounted for (in terms of IAS 1) when they are declared and not when they are proposed or paid. A dividend declared after the balance sheet date will be treated similar to a non-adjusting event after the balance sheet date and will only be disclosed in the previous year. This treatment does not go against the matching concept as a dividend is not an expense, but rather a profit distribution.

Dividends paid represent an utilisation of reserves and not an expense

- Ensure compliance with the statutory requirements (dividend rules):
 - * may not be declared from share capital (must be from reserves);
 - * must be paid from the current year's profits before taken into account:
 - # losses on fixed assets;

- # depreciation on fixed assets;
- # should however take depreciation and losses on current assets into account;
- * accumulated losses of previous years do not have to be taken into account;
- * preference dividends and preference dividends in arrears get preference;
- * ordinary dividends may not be paid as long as preference dividends are in arrears;
- * the financial position of the company as a whole should be taken into account, namely liquidity and solvability (Companies act);
- * may legally be declared from unrealised profits, provided:
 - # it is allowed by the MOI;
 - # the valuation is permanent and done in good faith;
 - # the entity will thereafter still be liquid and solvent.

- Documentation to be examined (against which to audit the declaration / amounts):
 - * minutes of meetings of board of directors and shareholders;
 - * dividend declarations and stock exchange reports;
 - * cash book;
 - * returned cheques
 - * correspondence with shareholders

NOTE: Where dividends can be taken up in the form of shares (scrip dividends):

- # it will be audited against the instructions/application form of shareholders;
- # against the entries in the share register and the general ledger accounts (in total).