# Tutorial Letter 202/1/2012

## Introduction to the performing of the audit process

## AUE202M

## Semester 1

### Department of Auditing

This tutorial letter contains important information about your module.

Bar code

**Please note/important notes:**

**This Tutorial Letter contains the key to and comments on Assignment 02 and 03**

## ASSIGNMENT 02/2012

**Question 1** **50 Marks**

**1.1 Documents that are important for audit purposes in the credit sales cycle** **9 Marks**

**Reference:** Jackson & Stent (2012:10/6 – 10/7)

a) **Customer order:** the customer's instruction as to what goods are required. (1½)

b) **Internal sales order:** a document compiled by the company's own sales order clerk which records the goods ordered by the customer. It is used for sales authorisation and as a basis for creating the picking slip. (1½)

c) **Picking slip:** this document lists all the items which the customer has ordered. It is used to assist stores personnel to "pick" the goods needed to fill the order from the store so that they can be despatched to the customer. (1½)

d) **Delivery Note:** this document details the date, description and quantity of the goods despatched to the customer and is signed by the customer to acknowledge receipt of the goods. When the company delivers to its customers, details of the deliveries, e.g. address, delivery note number, will be entered on a delivery list which is used by the delivery staff to schedule and control deliveries. (1½)

e) **Sales Invoice:** the document which is sent to the customer to notify them of the quantity and price of the goods sold to them, the total amount of the sale, discounts and VAT. (1½)

f) **Statement:** a summary of all transactions for the period, usually a month, sent by the company to the customer. The statement reflects the opening balance, sales made, payments received, other adjustments such as credit notes, and the closing balance as well as a breakdown of the periods for which the total amount owed has been outstanding, e.g. 30 days, 90 days and over. (1½)

**1.2 Risks and Internal controls in the invoicing and recording of credit sales** **29 Marks**

**Reference:** Jackson & Stent (2012: 10/14 – 10/17)

1. **Risk:** There is a risk that goods supplied may not be invoiced. (1½)

**Internal Controls:**

a. A copy of the internal sales order should be held in numerical order in a temporary file in the "invoicing department". (1½)

**b.** As signed delivery notes are received they should be matched to their internal sales orders and filed sequentially by delivery note number. (1½)

**c.** On a frequent and regular basis internal sales orders remaining on the temporary file should be investigated. (1½)

**d.** The file of matched delivery notes should be sequenced tested and gaps in the sequence investigated. (1½)

**(max 4.5 marks)**

**2.** **Risk:** There is a risk that invoices may be inaccurately prepared and/or misstated (i.e. prices, quantities, descriptions, discounts, VAT). (1½)

**Internal Controls:**

**a.** The invoice clerk should: (1½)
- Compare details on the internal sales order and delivery notes.
- Check prices quoted to the customer, and entered on the internal sales order, against official price lists and discounts schedule.
- Prepare an invoice and cross reference it to the delivery note/customer order.
- Sign as proof of having performed the control. (1½)

**b.** A second employee (supervisor) to check and sign invoice after checking: (1½)
- Prices, extensions, casts
- Discount and VAT calculations
- Customer details

**(max 4.5 marks)**

**3.** **Risk:** There is a risk that invoices are omitted from the sales journal. (1½)

**Internal Controls:**

**a.** Invoices to be entered in the sales journal in numerical sequence and the sequence to be continued from period to period (1½)

**b.** Sales clerk to regularly check the sequence of journal entries and follow up on any missing invoices. (1½)

**c.** Sales manager to review the recorded sales invoices in the sales journal against the invoices as recorded by the sales clerk. (1½)

**(max 4.5 marks)**

**4.** **Risk:** There is a risk that invoices may be duplicated in the sales journal. (1½)

**Internal Controls:**

**a.** Prior to entry in the sales journal, invoices to be added to obtain a control total. This control total is then compared to the total in the sales journal after entry of individual invoices (i.e. batch control system). (1½)

**b.** Invoices recorded in the sales journal to be marked "cancelled". (1½)

**(max 4.5 marks)**

**5.** **Risk:** There is a risk that invoices may be inaccurately entered in the sales journal e.g. R4325.50 may be entered as R432.55 instead of R4325.50, omitting the "zero" at the end. (1½)

**Internal Controls:**

**a.** An independent staff member should: (1½)
- Compare customer name and amount entered in sales journal to the invoice for accuracy.
- Check postings from the sales journal to individual debtors account in the debtors' ledger and follow the total to the general ledger. (1½)

**b.** The above should be done after the supervisor has checked and signed the invoice after checking: (1½)
- Prices, extensions, casts
- Discount and VAT calculations
- Customer details

**(max 4.5 marks)**

**6.** Risk: There is a risk that invoices may be entered in the debtor's ledger against an incorrect debtor. (1½)

**Internal Controls:**

**a.** An independent employee should check postings from the sales journal to individual debtors account in the debtors' ledger and follow the total to the general ledger. (1½)

**b.** On a regular basis an independent employee should perform reconciliations of the debtor's ledger to debtor's control account in the general ledger. (1½)

**c.** The employee must sign the reconciliation to acknowledge the control procedure was performed. (1½)

**d.** The supervisor to review and sign all reconciliations. (1½)

**(max 4.5 marks)**
**(1½ marks for each appropriate control risk with a maximum of 9 marks)**
**(1½ marks for each appropriate control measure with a maximum of 18 marks)**
**(2 marks for presentation of answer in required format)**
**Total 29 marks**

**1.3 Substantive procedures to audit the credit sales figure** **12 marks**

**References:**
- Jackson & Stent (2012:10/61 – 10/63)
- Study Guide (2007:98 – 100)

**1.** Select a sample of sales invoices and compare each sales invoice with the corresponding purchase order and delivery note in respect of the name of the client, the description and the quantity of goods dispatched. (Occurrence) (1½)

**2.** Inspect the selected purchase orders for approval of the sales transaction by a responsible person. (Occurrence) (1½)

**3.** Select a test sample of documented inventory issues according to the continuous inventory records, in the case where it has been kept, and compare the issues with the corresponding delivery notes and sales invoices. (Accuracy) (1½)

**4.** Trace a test sample of sales invoices to the sales journal and confirm that the amount and date agree and that the transaction was accurately and completely recorded and classified as a sales transaction. (Accuracy, classification, completeness) (1½)

**5.** Recalculate the totals of the sales journal for selected periods and compare to amounts posted to the general ledger sales account to ensure that the postings are accurate. (Accuracy) (1½)

**6.** Inspect the postings of total sales to the credit side of the sales account in the general ledger and individual sales transactions to the debit side of the accounts receivable (trade debtors) account in the case of credit sales transactions. (Classification) (1½)

**7.** Select a number of sales invoices before and after year end and follow them through to the correct period in the sales journal to ensure the correct cut-off. (Cut-off) (1½)

**8.** Perform analytical procedures:
- Compare the current year sales amount to the prior year
- Calculate the gross profit percentage and compare it with prior periods (Accuracy). (1½)

**9.** Inspect the number sequence of the delivery notes and sales invoices for missing and duplicate numbers. (Completeness) (1½)

**10.** Compare the amount of the turnover in the financial statements with the total of the trial balance and the general ledger. (Accuracy) (1½)

**11.** Inspect the accuracy of turnover related adjustments in the general ledger, for example discount, sales returns and Value Added Tax (VAT). (Accuracy) (1½)

**12.** Inspect the accuracy of the disclosure of turnover in the financial statements. (Presentation and disclosure) (1½)

**13.** Obtain a management representation letter with regards to credit sales. (All assertions) (1½)

**(1.5 marks for each valid substantive procedure with a maximum of 12 marks)**

## ASSIGNMENT 03/2012

**QUESTION 1** **16 marks**

**1.1 FALSE** (½)
**(J&S 2012: 1/19)**

- The audit objective associated with the completeness assertion is "to obtain satisfaction that all transactions or events, which should have been recorded, have been recorded.
- "To obtain satisfaction that a transaction or event which has been recorded, took place and pertains to the entity" is the audit objective for the occurrence assertion. (1½)

**1.2 TRUE** (½)
**(J&S 2012: 1/19)**

- The classification assertion refers to the correct recording of transactions and events in the proper accounts. (1½)

**1.3 TRUE** (½)
**(J&S 2012: 5/15)**

- The people involved in the control system must be fully aware of their responsibilities and must be accountable for their performance. (1½)
- Employees must acknowledge in writing that they have performed a task. This is usually done by signing. (1½)

**(max 2)**

**1.4 FALSE** (½)
**(Study guide 2007: 148)**

- The responsibility for carrying out an inventory count rests with the management of the enterprise, since it is the responsibility of management to ensure that the inventory figures in the financial statements are complete, accurate and valid. (1½)

**(max 2)**

**1.5 FALSE** (½)
**(J&S 2012:8/17)**

- Changes to the live computerised information system should only be made once the changes have been tested and accepted as stable and ready to be implemented. (1½)
- Changes should first be signed off on a management level before final implementation. (1½)

**(max 2)**

**1.6 TRUE** (½)
**(J&S 2012:12/22)**

- "Mistakes in establishing the *quantity* and *value* of inventory can have a material effect on the financial statements".
- Existence and valuation are the assertions most at risk when auditing inventory when taking into account factors such as damaged and obsolete inventory included in perpetual records; undetected theft of inventory included in perpetual records. (1½)

- Inventory count: Observation – existence
  Test counts – existence
  Observe damaged, obsolete stock - valuation (1½)

**(max 2)**

**1.7 TRUE** (½)
**(J&S 2012:14/12)**

- This cycle poses directors with many opportunities for fraudulent reporting. By omitting long term loans from the statement of financial position, the financial position of the company is improved. (1½)
- The profit/income will also be improved as income will be overstated. (1½)
- The assertion at risk is completeness which is a main assertion of interest to the auditor during the audit of long term liabilities. (1½)

**(max 2)**

**1.8 FALSE** (½)
**(J&S 2012:12/6)**

- Surveillance cameras recording movement at the entry and exit points of the inventory warehouse is a control procedure to mitigate the risk of stolen inventory. (1½)
- Frequent inventory counts and comparison between physical and theoretical perpetual inventory numbers are control measures to mitigate the risk of damaged or obsolete stock being included in the theoretical perpetual inventory figure. (1½)

**(max 2)**

## QUESTION 2 — 20 marks

### 2.1 A positive confirmation request

**Reference:** Jackson & Stent (2012:10/64)

A positive confirmation requests that the debtor confirms with the auditor (1½) whether the balance on the statement is correct or not. (1½)

In other words, all trade debtors are expected to respond to the confirmation. (1½)

**(max 3)**

### 2.2 Assertions mainly substantiated during a positive debtor's confirmation

**Reference:** Jackson & Stent (2012:10/64)

**Existence:** (½)
As all the debtors are requested to respond to the auditor on whether the balance on their statements are correct or not, the auditor gets assurance that all the debtors actually exist. (1½)

**Valuation:** (½)
As all the debtors confirm whether they agree with the balance on their statements, the auditor gets assurance about whether or not the value that the debtors owe are correct. (1½)

**(4)**

## 2.3 Confirmations to be returned directly to the auditor

**Reference:** Jackson & Stent (2012:10/64)

Confirmations should be returned directly to the auditor to prevent the company employees from manipulating the results (1½) to cover up fraud or misstatement. There should be no opportunity for an employee of the auditee to remove any statements and substitute others. (1½)

**(3)**

## 2.4 Further procedures to be performed to follow up on no-replies

**Reference:** Jackson & Stent (2012:10/64)

1. Discuss with management the reasons for the low response from debtors and send out second debtors confirmations to debtors from whom responses were not received. (1½)

2. Follow up on trade debtors statements returned by the post office as undelivered (addressee unknown). Obtain the proper addresses and repost them. (1½)

3. Contact the debtors by telephone/fax/ email to obtain the required response from them. (1½)
   If there is still no reply: (1½)

4. Investigate receipts after year-end to confirm that the debtor does exist. (1½)

5. Ascertain whether the debt was in fact correctly recorded by examining the relevant order forms, delivery notes and invoices. (1½)

6. Investigate debtors collection procedures and correspondence from attorneys to determine the collectability of the debtors account. (1½)

7. Discuss with management the collectability of debtors and consider write-off. (1½)

**7x1.5 (max 7)**

## 2.5 Audit procedures to be performed to conduct subsequent receipts testing

**Reference:** Jackson & Stent (2012:10/64)

Select a sample of debtors on the debtors list at year end and:

**1.** Trace payments received after year-end to the cash receipts journal. (1½)

**2.** Match the debtors receipts after year-end to the invoices for the period under review on the individual debtors accounts in the debtors ledger and confirm that the delivery dates were prior to year end. (1½)

**(max 3)**
**(1½ marks for each valid answer with a maximum of 20 marks)**

**QUESTION 3** **25 marks**

**3.1 Processing controls (application controls) to ensure good controls over the recording of purchase transactions in a computerised environment** **10 marks**

**References:**
- Jackson & Stent (2012: 8/16)
- Jackson & Stent (2012: 11/5; 11/22 -11/24)
- Study Guide (2007:118 – 120)

**1.** The computer should print out a list of all outstanding goods received notes issued for which no matching invoice has been recorded. Accounts department should follow up on missing invoices. (1½)

**2.** The computer should automatically match purchase orders to the goods received notes and invoices, and purchases should only be processed if they match. An exception report of unmatched goods received notes, invoices and purchase orders or duplicated goods received notes, invoices and purchase orders should be produced. The accounts department should follow up on these exceptions. (1½)

**3.** The computer should match the date when purchases are recorded with the date on goods received notes and produce a printout when these dates are in different accounting periods. This should be followed up by the accounts department. (1½)

**4.** The computer should match unit prices on a supplier's invoice with those recorded on purchase orders and produce exception reports which should be reviewed and problems resolved. (1½)

**5.** The computer should match the assigned master file supplier account numbers on the purchase orders and the goods received notes with the supplier's name and referenced account number on the invoice, and match the particulars with the master file accounts payable details. (1½)

**6.** Accounts department employees should follow up on exception reports of mismatched suppliers' names and account numbers. (1½)

**7.** Automatic computerised run to run balancing reports should be performed and reviewed by appropriate accounting staff that will provide evidence that the monthly opening balances (totals) of the purchase account has been updated by the purchase transactions to result in correctly calculated month-end closing balances (totals). (1½)

**8.** The mathematical accuracy of invoices should be re-performed during the processing run: quantity times unit prices and invoice total, plus calculation of discounts receivable according to the entity's policy or agreement with supplier (which was uploaded onto the masterfile). (1½)

**9.** The computer should automatically follow the invoice through to the purchases account in the general ledger. (1½)

**10.** There should be weekly or monthly purchase transaction printouts of expense and asset allocations. Exception reports of unallocated expenses or assets should be followed up by the accounting department. (1½)

**(1½ marks for each appropriate control with a maximum of 10 marks)**

**3.2 Substantive procedures to audit credit purchases** **15 marks**

**Reference:** - Jackson & Stent (2012: 11/47 -11/49)
- Study Guide (2007:130 – 131)

**1.** Inspect whether there are orders for the selected credit purchase transactions by comparing the purchase orders with the appropriate invoices and goods received notes. (Occurrence) (1½)

**2.** Inspect the order to see whether it bears the signature of the purchases manager as evidence that the transaction has been authorised. (Occurrence) (1½)

**3.** Inspect a selected test sample of purchases from the purchases journal to make certain whether: (1½)
- The supplier's name appears on the list of approved suppliers, (Occurrence)
- The name of the AJH Motors Limited appears on the credit purchases invoice, (Occurrence)
- The goods purchased are in fact goods in which the enterprise trades, (Occurrence)
- A supplier delivery note exists for each purchase invoice and purchase order and that the details of goods delivered agrees to the purchase invoice and purchase order.

(any of the examples (1½))
**(max 3)**

**4.** Inspect the date on the goods received note to determine whether it has been recorded at the correct date. (Cut-off) (1½)

**5.** Determine the number of the last goods received note at the cut-off date and compare the information and the date thereof with the matching purchase invoice. (Cut-off) (1½)

**6.** Inspect a selected test sample goods received notes that they have been numbered sequentially and all included in the purchases journal, without missing numbers to ensure that they have all been accounted for. (Completeness) (1½)

**7.** Examine the file with the 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. These should be followed up with management and invoices captured to ensure completeness of purchases. (Completeness) (1½)

**8.** Compare the information on a selected test sample of goods received notes with the information on the matching invoices and compare this information with the information recorded in the purchases journal and the general ledger accounts . (Accuracy, classification) (1½)

**9.** Compare the purchased inventory indicated on the selected test sample of goods received notes with the information recorded in the inventory records. (Accuracy) (1½)

**10.** Inspect monthly accounts payable reconciliations drawn up and compare it to the monthly supplier statements to ensure that all purchases of goods transactions have been fully accounted for. (Completeness, accuracy) (1½)

**(1½ marks for each appropriate substantive procedure with a maximum of 15 marks)**

**QUESTION 4** **19 marks**

**4.1 Weaknesses in the wages system, control risks and internal control measures:**

**Reference:** Jackson & Stent (2012: 13/9 -13/13)

**1.** Mr Ntobela is not properly trained to administer the wages of the company as he usually works in the marketing section of the company. (1½)

Control risk: Errors and mistakes can be made by Mr Ntobela in the calculation and recording of wages, as he is not properly trained to administer the wages of the company. (1½)

Control: Competent and trustworthy personnel should be appointed to positions in the wage administration department. Mr Ntobela should be properly trained to the functions of wage administration. (1½)

**2.** Mr Ntobela is responsible to calculate wages (wage summaries), record the hours on the wages programme, maintain hard copies of employee files, have access to the employee masterfile and receives the filled wage packages from the security company. (lack of segregation of duties) (1½)

Control risk: Mr Ntombela can create fictitious employees and pay wages to the fictitious employees as he calculates the wages, records it on the wages programme and the loaded pay packets comes back to him. (1½)

Control: Segregation of duties should be implemented between the calculation of wages, the recording thereof, the employee records and the payment of wages (segregation of duties). (1½)

**3.** There is no one who checks and authorises Mr Ntombela's calculation of the hours worked per the clock cards before the hours is recorded on the wages programme. (1½)

Control risk: Errors in the calculation of hours worked and fictitious hours can be recorded on the wages programme with a resulting financial loss to the company. (1½)

Control: A manager in the accounting section should check and approve the calculation of the hours worked per employee, before the hours is captured on the wages programme (isolation of responsibility). (1½)

**4.** There could be unauthorised access and changes to the wages information as the general accounting section password provides access to the wage records. (1½)

Control risk: Fictitious or incorrect hours can be entered or altered by any of the employees in the accounting section with a resulting financial loss to the company. (1½)

Control: Multi-level passwords should be used and access should be restricted to employee's areas of responsibility. Only the director should have access to all application modules (Physical control). (1½)

**5.** There could be unauthorised changes to the employee master file as all employees in the accounting section have access to the master file amendment. (1½)

Control risk: Fictitious or incorrect tariffs and particulars can be entered or altered on the employee masterfile with a resulting financial loss to the company. (1½)

Control: Only the appointed manager in the accounting section should be able to gain access and effect changes to the employee masterfile (password protection and isolation of responsibilities). (1½)

**(1½ marks for each appropriate weakness with a maximum of 6 marks)**
**(1½ marks for each appropriate control risk with a maximum of 6 marks)**
**(1½ marks for each appropriate control measure with a maximum of 6 marks)**
**(1 mark for presentation of answer in required format)**
**Total 19 marks**

**QUESTION 5** **20 marks**

**5.1 Five details on the purchase contract of interest to the auditor** **5 marks**

**Reference:** Jackson & Stent (2012: 14/3; 14/19 - 14/25)

**1** Seller's name. (1)

**2** Purchaser's name. (Propco Limited) (1)

**3** Contract date. (1)

**4** Cost price. (1)

**5** Additional costs. (shipping charges, import duties, insurance) (if applicable) (1)

**6** Installation costs. (if applicable) (1)

**7** VAT amount. (if applicable) (1)

**8** Detail of the asset purchased. (1)

**9** Payment terms. (1)

**(1mark for each valid answer with a maximum of 5 marks)**

**5.2 Five other source documents involved in the purchase transaction of the new crane**

**Reference:** Jackson & Stent (2012: 14/3; 14/19 - 14/25) **5 marks**

**1** Paid cheque by Propco Limited. (1)

**2** Purchase invoice. (1)

**3** Receipt. (1)

**4** Loan agreement with ABC Bank. (1)

**5** Minutes of directors meetings approving the purchase transaction. (1)

**6** Insurance contract. (1)

**7** Licensing and registration documentation of the crane. (1)

**8** Propco Limited’s policies and procedures. (acquisition of non-current long term loans) (1)

**9** Bank statements from ABC Bank. (acquisition of non-current long term loans) (1)

**(1mark for each valid answer with a maximum of 5 marks)**

**5.3 Internal control measures to ensure good internal control over their building development equipment** **10 marks**

**References:**
- Study guide (2007: 182)
- Jackson & Stent (2012: 14/3)

**1** Company policy should dictate that authorisation should be obtained from management for the purchase of all new equipment (the crane) above a certain amount as well as the financing of the asset (from ABC Bank). (Control environment) (1½)

**2** Quotations should be obtained from approved suppliers for all capital expenditure above a certain amount (the purchase of the crane) and a choice should be exercised as to where the crane will be purchased from. This should be stipulated by company policies and procedures. (Control environment) (1½)

**3** Company policy should dictate that if right of ownership of assets (the crane) is subject to legal registration requirements, it should be registered in Propco Limited’s name and within a reasonable time. (Control environment, custody control) (1½)

**4** Once the new crane is received, the asset description (for example engine number and capacity, and crane year model) should be agreed to the information on the purchase contract. (Comparison and reconciliation) (1½)

**5** The employee performing the above comparison should sign on the purchase contract as proof of having done so and should be separate from the employee who executed the purchase transaction. (Isolation of responsibility, segregation of duties) (1½)

**6** Employees in the accounting department should be competent and adequately trained to perform their accounting duties, namely the recording of particulars of the new crane under the appropriate headings in the non-current asset register and the general ledger non-current assets account. (Control environment, competent and trustworthy personnel) (1½)

**7** Adequate insurance should be taken out on all building equipment in order to reduce the risk of damage and loss. This should be done in accordance with the company's policies and procedures regarding insurance over company assets. (Access and custody controls) (1½)

**8** Expenses for maintenance and repairs should, in accordance with company policies and procedures, be incurred in order to keep building equipment in good working order. Such expenditure should be approved. (Custody controls, control environment) (1½)

**9** The company's accounting policies should determine the annual depreciation rates applicable to building equipment to make provision for the decline in the value of the assets. These accounting policies should be approved and adhered to. (Control environment, comparison and reconciliation) (1½)

**10** Policy should dictate that regular physical inspections of building equipment should be undertaken by independent personnel or management not involved in the custodian of equipment, and the physical equipment compared with the non-current asset register. (Comparison and reconciliation, segregation of duties) (1½)

**11** The sale or write-off of building equipment above a certain amount should be authorised by management according to company policy. (Custody controls, Comparison and reconciliation, Control environment) (1½)

**(1½ marks for each valid answer a maximum of 10 marks)**