Activity one

You are planning the audit of Flourish Co for the year ending 30 September 20X5. In January 20X5, Flourish Co purchased a company with an established brand name which Flourish Co has continued to use. The due diligence conducted prior to the acquisition valued the brand name at $700,000. The brand has been capitalised as an intangible asset and is valued at cost in the draft financial statements. No amortisation is being charged as management believe the brand has an indefinite life.

Required:

Design the principal audit procedures to be used in the audit of the valuation of the brand name.

Activity Two

You are planning the audit of Bherl Co for the year ending 31 December 20X5. During the period, Bherl Co entered into the following transactions: On 1 April 20X5 Bherl Co purchased 1 million shares in Concert Co for $5 per share. This amounts to a 6% holding of Concert Co's issued share capital, and is not sufficient to give significant influence or control. The shares of Concert Co are not listed. Bherl Co required additional finance and on 1 January 20X5, it issued 1 million $10 bonds at par. Interest is payable at a rate of 5% of the par value annually in arrears. The bonds will be redeemed at a premium on 31 December 20X7. The bonds are held in the financial statements at $10 million and the interest paid during the period has been charged to profit or loss.

Required:

Design the principal audit procedures to be used in the audit of:

a. The investment in the shares of Concert Co.

b. The bonds.

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Activity Three

You are a manager in the audit department of Gina & Co. You are responsible for the audit of Sam Co, which has a financial year ending 31 December 20X5. In April 20X5, Sam Co had all properties revalued by an independent expert. These valuations have been used in the financial statements as at 31 December 20X5.

Required:

a. Describe the factors Igneous & Co should consider when placing reliance on the work of the expert.
b. Design the principal audit procedures to be used in the audit of the revalued properties.

Activity Four

You are the Senior Manager recently engaged by Integrity Audit Consult responsible for Oliso Private Company Ltd's audit. You are performing the final review as required by ISA 520 Analytical procedures for the audit and have come across the following issues. Receivable balance due from Obey Company Ltd. Oliso Private Company Ltd has a material receivable balance due from a customer named Obey Company Ltd. During the year-end audit, your team reviewed the ageing of this balance and found that no payments had been received from Obey Company Ltd for over eight months. Oliso Private Company Ltd however would not allow this balance to be included in the list of balances to be circulated. Instead, management has assured your team that they will provide a written representation confirming that the balance is recoverable. Warranty provision The warranty provision included in the statement of financial position is material. The audit team has performed testing over the calculations and assumptions, which are consistent with prior years. The team has requested a written representation from management confirming the basis and amount of the provision. Management is yet to confirm acceptance of the need to issue this representation.

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Required:

a) Recommend THREE (3) audit procedures to validate the accounting estimates.

b) b) For each of the two issues above:

   i) Evaluate the appropriateness of written representations as a form of audit evidence.

   ii) Describe TWO (2) additional procedures the auditor should perform to conclude on the balances to be included in the financial statements.

c) c) The directors of Oliso Private Company Ltd have decided not to provide the audit firm with the written representation for the warranty provision as they feel it is unnecessary.

Required:

Explain the steps the auditor of Oliso Private Company Ltd should take to assess the impact of management's refusal to provide a written representation on the auditor's report.

Solution

Procedures the auditor should adopt in respect of auditing accounting estimates include:

- Inquire of management how the accounting estimate is made and the data on which it is based.
- Determine whether events occurring up to the date of the auditor's report (after the reporting period) provide audit evidence regarding the accounting estimate.
- Review the method of measurement used and assess the reasonableness of assumptions made. Test the operating effectiveness of the controls over how management made the accounting estimate.
- Develop an expectation of the possible estimate (point estimate) or a range of amounts to evaluate management's estimate.
- Review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias.
- Evaluate overall whether the accounting estimates in the financial statements are either reasonable or misstated.

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- Obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates and estimation uncertainty are reasonable.
- Obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

Receivables balance owing from Obey Company Ltd

1. The written representation proposed by management is intended to verify the valuation, existence and rights and obligations of a material receivables balance. However, as management has refused to allow the auditor to circularise the balance and there has been little activity on the account for the past eight months, then there is very little evidence that the auditor has obtained.

- This representation would constitute entity generated evidence, and this is less reliable than auditor generated evidence or evidence from an external source. However, if related control systems operate effectively, then this evidence becomes more reliable. In addition, if the representation is written as opposed to oral, this will increase the reliability as an evidence source.
- Overall this representation is a weak form of evidence, as there were more reliable evidence options available, such as the circularisation, but this was not undertaken.

2. **To reach a conclusion on the balance, the following procedures should be performed:**
    - Discuss with management the reasons as to why a circularisation request was refused.
    - Review the post year-end period to identify whether any cash has now been received from Obey Company Ltd
    - Review correspondence with Obey Company Ltd to assess reasons for the continued non-payment.

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- Review board minutes and legal correspondence to assess whether any legal action is being taken to recover the amounts due.
- Discuss with management whether a provision or write down is now required.
- Consider the impact on audit opinion if balance is considered to be materially misstated.

Warranty provision

1. In this case, the auditor has performed some testing of the provision to obtain auditor-generated evidence. The team has tested the calculations and assumptions. None of this is evidence from an external source.

   The very nature of this provision means that it is difficult for the auditor to obtain a significant amount of reliable evidence as to the level of future warranty claims.

   Hence the written representation, whilst being an entity generated source of evidence, would still be useful as there are few other alternatives.

   To reach a conclusion on the balance, the following procedures should be performed: Review the post year-end period to compare the level of claims actually made against the amounts provided. Review the level of prior year provisions with the amounts claimed to assess the reasonableness of management's forecasting. Review board minutes to assess whether any changes are required to the level of the provision as a result of an increased or decreased level of claims by customers.

c. **Steps to take if written representation on warranty provision is not provided**

- ISA 580 Written Representations guides the auditor when written representations are requested from management, but they refuse to provide.
- If management does not provide the requested written representation on the warranty provision, the auditor of Oliso Private Company Limited should discuss the matter with management to understand why they are refusing.

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- In addition, the auditor should re-evaluate the integrity of Oliso Private Company Limited' management and consider the effect that this may have on the reliability of other representations (oral or written) and audit evidence in general.
- The auditor should then take appropriate actions, including determining the possible effect on the audit opinion.

Impact on the audit report

- As the auditor cannot obtain sufficient appropriate evidence to conclude that the warranty provision is free from material misstatement, a modified audit opinion will be required.
- The warranty provision is material but not pervasive, and therefore a qualified opinion would be appropriate.
- The opinion paragraph will be amended to state 'except for' for the lack of evidence on the warranty provision, the financial statements show true and fair view.
- The audit report will require an additional paragraph known as the basis for the qualification paragraph after the opinion paragraph, which will describe the reason for the modification, namely that management refusal to provide a written representation in relation to the warranty provision and hence the reason for the except for opinion.
- The materiality of the warranty provision will be stated in the basis for the opinion paragraph.

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Activity Five

Your audit client, Asuoyeboa Ltd, has recently hired an Internal Auditor to deal with increased regulatory requirements. Afrakoma, the CEO of Asuoyeboa Ltd, has indicated that she believes the presence of the Internal Auditor will dramatically reduce the work that your audit firm will have to perform. She anticipates that this will have an impact on the audit fee. Required: Draft a report indicating factors that will influence the extent to which the external auditors will rely on the Internal Auditors' work as per the requirements imposed by ISA 610: Using the Work of Internal Auditors.

Answers

Factors that may affect the external auditor's determination of whether the work of the internal auditors is likely to be adequate for the audit include:

Objectivity

- The status of the internal audit function within the entity and the effect such status has on the ability of the internal auditors to be objective.
- Whether the internal audit function reports to those charged with governance or an officer with appropriate authority, and whether the internal auditors have direct access to those charged with governance.
- Whether the internal auditors are free of any conflicting responsibilities. Whether those charged with governance oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- Whether and to what extent management acts on the recommendations of the internal audit function, and how such action is evidenced.

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Technical competence

- Whether the internal auditors are members of relevant professional bodies.
- Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- Whether there are established policies for hiring and training internal auditors.

Due professional care

- Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.
- The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

Communication

Communication between the external auditor and the internal auditors may be most effective when the internal auditors are free to communicate openly with the external auditors, and:

• Meetings are held at appropriate intervals throughout the period;

• The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal auditors when such issues may affect the work of the external auditor; and

• The external auditor informs the internal auditors of any significant matters that may affect the internal audit function.

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Activity Six

You have recently been promoted as a senior manager of your firm responsible for the audit of Tolon Ltd. The company's financial year ended on 31 December 2022. Your firm is at the completion stage of the audit and you are required to review the work completed on the material balances and transactions below.

Expenses related to payroll

The company has a payroll function which is outsourced to Pintoa Ltd, a service organisation which processes all of Tolon Ltd's salary expenses. The payroll expenses recognised in the financial statements have been traced back to year-end reports issued by Pintoa Ltd. The audit team has had no direct contact with Pintoa Ltd as the year-end reports were sent to Tolon Ltd's finance director who then passed them to the audit team. Tolon Ltd employs a few casual workers who are paid in cash at the end of each month and are not entered into the payroll system. The audit team has traced the cash payment back to the petty cash records and the amounts involved are considered immaterial.

Assets classified as held for sale

There was a planned disposal of one of Tolon Ltd's factory sites. The property and associated assets have been classified as held for sale in the financial statements. A manual journal has been posted by the Finance Director to reclassify the assets as current assets and to adjust the value of the assets for impairment and reversal of depreciation charged from the date at which the assets met the criteria to be classified as held for sale. The Finance Director asked the audit senior to check the journal before it was posted on the basis of there being no one with the relevant knowledge to do this at Tolon Ltd. The planned disposal was discussed with management. A brief note has been put into the audit working papers stating that in management's opinion the accounting treatment to classify the factory as held for sale is correct. The manual journal has been arithmetically checked by a different member of the audit team, and the amounts agreed back to the non-current asset register.

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Expenditure in relation to capital items

When auditing the company's capital expenditure, the audit team selected a material transaction to test and found that key internal controls over capital expenditure were not operating effectively. Authorisation had not been obtained for an order placed for several vehicles, and appropriate segregation of duties over initiating and processing the transaction was not maintained. The audit team noted details of the internal control deficiencies and updated the systems notes on the permanent audit file to reflect the deficiencies. The audit work completed on this order was to agree the purchase of the vehicles to purchase invoices and to the cash book and bank statement. The rest of the audit work on capital expenditure was completed in accordance with the audit programme.

Required:

Using the three issues above:

Comment on the sufficiency and appropriateness of the audit evidence obtained.

Recommend further audit procedures to be performed by the audit team.

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Activity Seven

GGC Co. Ltd (GGCL) specialises in manufacturing equipment which can help to reduce toxic emissions in the production of chemicals. The company has grown rapidly over the past eight years and this is partly due to the warranties that the company gives to its customers. It guarantees its products for five years and if problems arise during this period, it undertakes to fix them or provide a replacement. You are the manager responsible for the audit of GGCL and you are performing the final review stage of the audit and have come across the following issues.

Receivable balance owing from Nhyira Co. Ltd

GGCL has a material receivable balance owed by its customer, Nhyira Co. Ltd. During the year end audit, your team reviewed the ageing of this balance and found that no payments had been received from Nhyira Co. Ltd for over six months. GGCL would not allow this balance to be circularised. Instead management has assured your team that they will provide a written representation confirming that the balance is recoverable.

Warranty provision

The warranty provision included within the statement of financial position is material. The audit team has performed testing over the calculations and assumptions which are consistent with prior years. The team has requested a written representation from management confirming that the basis and amount of the provision are reasonable. Management is yet to confirm acceptance of this representation.

Required:

a) Describe the audit procedures required in respect of accounting estimates. b) For each of the two issues above:
   i) Discuss the appropriateness of written representations as a form of audit evidence; and
   ii) Describe additional procedures the auditor should now perform in order to reach a conclusion on the balance to be included in the financial statements.

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