**MARKING GUIDE FOR AUDIT AND ASSURANCE TEST 2**

1. **Direct controls and tests of controls**

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| Direct controls | Tests of controls |
| The company carries out credit checks for all new customers before they are added in the receivables ledger file. This ensures sales are made on credit only to customers that exist and are credit worthy which minimalizes bad debts. | Select a sample of new customers opened in the period and confirm by reviewing the information in the system that a credit check was performed for each customer. |
| Credit limits are set up and frequently revised only by the finance manager based on payment history. This ensures that credit limits for customers that are credit worthy are increased to increase sales and for those who are not are reduced or credit is even suspended | For a sample of customer accounts, inspect evidence for authorisation and revision of credit limits like the signature or password of the finance manager. Attempt to process an order that makes a customer balance exceed the credit limit to determine whether the order is rejected. |
| When orders from customers are received by the sales department, the system automatically checks the availability of inventory before generating sales orders. This ensures that orders are only accepted if goods are available to be despatched to customers | Select a sample of orders received by the sales staff and establish whether goods were in the warehouse when the orders were received and if not, establish if the sales staff informed customers of the waiting time. |
| Goods despatch notes (GDNs) are signed by customers on delivery of goods. This ensures that goods are despatched to the right customers and payment of invoices is not disputed subsequently. | Inspect a sample of GDNs for evidence of the customer’s signature. |
| GDNs are sent to customer, finance and sales departments daily. This ensures sales invoices are raised on a timely basis and sales staff can identify pending orders for follow up. | Compare dates on a sample of GDNs and sales invoices to confirm prompt delivery of GDNs. |
| The finance department prepare sales invoices daily using GDNs. This ensures that all goods despatched are invoiced. | Match a sample of GDNs with the corresponding invoices. |
| The revenue accountant reconciles the receivables ledger control account and the receivables ledger balances monthly and this is reviewed by the finance manager. This ensures errors are detected and corrected promptly. | Inspect the monthly reconciliation statements of the ledgers and get evidence of the review by confirming signature of the finance manager. |
| A list of those invoices exceeding 30 days is sent to the credit controller who contacts customers for payment. This minimizes bad debts. | Inspect the lists sent to the credit controller monthly and correspondence with customers. |

*(A mark for any properly described direct control and a mark for each test of control, up to four, total, 8 marks)*

1. **Deficiencies and recommendations**

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| Deficiencies | Recommendations |
| Employees swipe their cards at the beginning and end of the shift. This process is not supervised. This could result in a number of employees being swiped in as present when they are not. This will result in a substantially increased payroll cost for Smart Industries Ltd. | The clocking in and out process should be supervised by a responsible official to prevent one individual clocking in multiple employees. A supervisor should undertake a random check of employees by reviewing who has logged in with a swipe card and confirming visually that the employee is present. |
| Appointments of temporary staff are made by factory production supervisors. The supervisor could appoint unsuitable employees and may not carry out all the required procedures for new joiners. This could result in these temporary employees not receiving the correct pay and relevant statutory deductions causing  dissatisfaction of employees. | All appointment of staff, whether temporary or permanent, should only be made by the human resources department. |
| Overtime reports are sent out quarterly by the payroll department to production supervisors for review. These reports are reviewed after the payments have been made. This could result in unauthorised overtime or amounts being paid incorrectly and payroll cost increasing. | All overtime should be authorised by a responsible official prior to the payment being processed by the payroll department. This authorisation should be evidenced in writing. |
| The payroll manager reviews the bank transfer listing prior to authorizing the payments and also amends the payroll records for any changes required. There is a lack of segregation of duties as it is the payroll team which processes the amounts and the payroll manager who authorises payments. The manager could fraudulently increase the amounts to be paid to  certain employees, process this payment as well as amend the records causing loss for the company. | The payroll manager should not be able to process changes to the payroll system as well as authorise payments. The authorisation of the bank transfer listing should be undertaken by an individual outside the payroll department, such as the finance director. |
| A payroll clerk distributes cash pay packets to employees without requesting proof of identity. Even if most employees are known to the clerk, there is a risk that without identity checks wages could be paid to incorrect employees. This could result in increased payroll costs or dissatisfied employees if incorrect amounts are received. | The payroll clerks should be informed that all cash  wages can only be paid upon sight of the employee’s clock card and identity card. |

*(A mark for any properly described deficiency and recommendation, up to four, total, 8 marks)*

**c)(i) Substantive procedures for revenue**

1. Compare the **total revenue** against prior years and budget for the year and investigate any significant fluctuations to verify completeness of revenue.
2. Obtain a **schedule of sales** for the year broken down on a month by month basis or into main product categories and compare to those for the previous year and discuss any unusual movements with management to verify completeness.
3. Calculate the **gross profit margin** for the entity and compare this to the prior year and investigate any significant fluctuations to verify completeness of revenue.
4. Select a sample of sales invoices from the sales journal and inspect the **relevant GDNs** and sales orders to verify the occurrence of revenue (consider exceptions for consignment and bill and hold arrangements).
5. Carry out a **sequence check** on GDNs.
6. Select a **sample of** **cash sales** in the cashbook and agree to receipts, daily sales reports/till roll, deposit slips and bank statements to verify occurrence of cash sales.
7. Select a sample of sales invoices from the sales journal and agree the **prices and terms** to the price list to confirm the accuracy of invoices.
8. For a sample of invoices, **recalculate** invoice totals including any discounts and VAT to verify the accuracy of invoices and trace each to the receivables ledger and general ledger accounts.
9. Select a sample of **credit notes** raised, inspect the related invoice and goods received notes and ensure the invoice has been correctly removed from revenue.
10. Select a **sample of** **GDNs** and agree these to sales invoices in the sales journal, revenue accounts in the general ledger and customer accounts in the receivables ledger to confirm completeness of revenue.
11. Select a sample of **GDNs before and after the year end,** inspect the dates on the corresponding sales invoices and the dates they were recorded in the receivables and general ledgers to ensure they are recorded in the correct accounting period to verify cut-off of sales.

*(Half a mark for any properly described substantive procedure, up to ten, total, 5 marks)*

**ii) Substantive procedures for payroll expenses**

1. **Agree the** wages and salaries expense per payroll to general ledger accounts and financial statements and investigate anydifferences to verify completeness and accuracy.
2. Compare the **total payroll expense** to the prior year and budget and investigate any significant differences.
3. Review **monthly payroll charges**, compare this to the prior year and budgets and discuss with management for any significant variances.
4. Perform a **proof in total** of total wages and salaries, incorporating joiners and leavers and the annual pay increase to verify accuracy of the payroll expenses.
5. Select a **sample of employees’ wages and salaries** from the payroll and agree each to human resourcerecords, records of hours worked, production records to verify occurrence and accuracy of remuneration.
6. Trace a sample of time sheets/clock cards/production records and **overtime sheets** to the payrolls to verify completeness of the payrolls.
7. Select a sample of **joiners and leavers**, agree their start/leaving date to supporting documentation, recalculate that their first/last pay was accurately calculated and recorded.
8. **Re-perform calculations** on a sample of employees’ gross pay and net pay on payrolls to verify the accuracy of the payroll expense.
9. Verify the validity and accuracy of **deductions** by inspecting supporting documentation.
10. Verify the **existence** of employees on the payroll by performing a head count, attending a wages payout, inspecting human resource records, PAYE and NSSF returns and staff lists signed by managers.
11. Inspect payroll for **unusual items** and investigate them further by discussion with management.
12. Confirm **net pay** per payroll to cash book, cheques or bank transfer summary to confirm completeness and accuracy.
13. Agree **year-end liabilities** in the SOFP to payrolls and subsequent payment after the year-end in the cash book. Confirm that deductions were remitted on time by reviewing correspondence for any disputes.

*(Half a mark for any properly described substantive procedure, up to ten, total, 5 marks)*

**Substantive procedures for valuation of property**

1. Consider the **competence** of the valuer by assessing the qualification, membership of a professional body and experience in valuing these types of assets.
2. Review the assumptions and method adopted by the valuer in undertaking the revaluation to confirm the **reasonableness** and compliance with principles of IAS 16.
3. Agree all non-current assets in the **non-current assets register** to the valuation report to ensure their completeness and that all assets in the same category have been revalued in line with IAS 16.
4. **Recalculate** the revaluation increases and decreases and check that they are accounted for in accordance with IAS 16 & 36 *Impairment of assets:*

* A revaluation gain is credited to OCI and to revaluation surplus in equity or to profit or loss to the extent of a reversal of a previous revaluation loss on the same asset.
* A revaluation loss is debited to profit or loss or first deducted from the revaluation surplus on the same asset and the balance debited to profit or loss.

1. Recalculate the **depreciation charge** for the year and confirm that for non-current assets at the revaluation date, the depreciation was based on cost before the revaluation and based on the valuation after on a pro rata basis.
2. For a sample of non-current assets from the non-current assets register, physically verify to confirm **existence**.
3. For a sample of non-current assets trace back to the non-current assets register and general ledger to confirm **completeness**.
4. Confirm whether valuations of all revalued assets have been **updated regularly** by asking the finance director and inspecting the previous financial statements.
5. Review **insurance policies** and consider the adequacy of their insured values and check expiry dates.
6. Review the financial statements **disclosures** relating to land and buildings to ensure they comply with IAS 16.

*(Half a mark for any properly described substantive procedure, total, 5 marks)*