

Impact of substantive procedures performed during the interim audit on the final audit

- If substantive procedures are performed at an interim date, the auditor must cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls for the intervening period.
- Conclusions will have been reached on the testing carried out at the interim audit and the auditor essentially has to carry out any procedures necessary to provide a reasonable basis for extending the audit conclusions from the interim date to the period end.
- One approach an auditor who has carried out an interim audit can take is to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date. Essentially, because the interim balance has been audited, the auditor can focus on auditing the movements in the balance between the interim date and the year end.
- A point to note is that when misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor may need to modify the planned nature, timing or extent of substantive procedures covering the remaining period. This may result in repeating the procedures in full that were performed at the interim date. Therefore part of the expected benefit of carrying out the interim audit will have been lost.

1.8 Audit documentation

Objective

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained and conclusions reached. There also called working papers or work papers.

ISA 230 *Audit Documentation* requires the auditor to prepare documentation on a timely basis as it:

- Provides evidence on the achievement of the overall objectives of the auditor.
- Provides evidence that the audit was planned and performed in accordance with ISAs and applicable laws.
- Assists the engagement team in planning and performing the audit.
- Assists the engagement team supervisors in directing, supervising reviewing audit work.
- Enables the engagement team to be accountable for its work.
- Is a record of matters of continuing significance to future audits.
- Enables the conduct of quality control reviews and inspections both internal and external.

Content and form

The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand audit procedures performed, audit evidence obtained, significant matters arising during the audit and conclusions reached together with judgments made.

A typical working paper

Client: NMS

Year end: 30 June 2025

Ref: A 1.1

Prepared by: **Date:**

Reviewed by: **Date:**

Subject: Year-end inventory count

Audit objective: To test the accuracy of year-end inventory

Work done:

- Sample selection
- Work done
- Source of information
- Key to any audit risks
- Appropriate cross-referencing

Results:

Weaknesses in internal controls or misstatements detected

Conclusions:

Whether the audit area would make financial statements show a true and fair view.

Audit files

Working papers may be divided into permanent audit files and current audit files.

a) A **permanent audit file** contains information of continuing importance the audit and includes:

- i) Client acceptance questionnaire
- ii) Engagement letters
- iii) Memorandum and articles of association of the company
- iv) Legal documents like loan and lease agreements
- v) Entity business history and industry information
- vi) Previous years' signed financial statements and reports to management
- vii) Accounting systems notes and internal control questionnaires

b) A **current audit file** contains information relevant to the current year's audit and includes:

- i) Financial statements
- ii) Accounts checklists
- iii) Summary of unadjusted errors
- iv) Report to partner including details of significant events and errors
- v) Review notes
- vi) Audit strategy and planning memorandum
- vii) Accounting systems notes and internal control questionnaires
- viii) Time budgets and summaries
- ix) Written representations
- x) Management letter
- xi) Notes of board minutes
- xii) A lead schedule for each balance in the financial statements and a list of audit procedures performed together with the results and conclusions of the testing.

✓ The final audit file should be completed within 60 days from the date of the audit report.

Safe custody and retention of working papers

Working papers are the property of the auditors and must be **kept safely and confidential**.

Information in working papers should not be made available to third parties without the permission of the entity.

Working papers must be kept for a period of not less than **five years** from the date of the auditor's report.

1.9 Audit evidence and financial statement assertions

Definition of audit evidence

Audit evidence is information used by the auditor in arriving at conclusions on which the opinion is based.

Sufficient appropriate audit evidence

ISA 500 *Audit evidence* requires the auditor to obtain **sufficient appropriate** audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

Sufficient is the quantity of audit evidence to support the audit opinion. Factors to consider are:

- a) Risk assessment
- b) Nature of accounting and internal control systems
- c) Materiality of the item
- d) Experience gained during the previous audits
- e) Results of audit procedures
- f) Source and reliability of information available

Appropriate means relevant and reliable evidence.

- Evidence must be relevant to financial statement assertions.
- **Reliability** of evidence varies:
 - Evidence from **external sources** is more reliable than that from internal sources.
 - **Auditor generated** evidence is better than client generated.
 - Internal evidence is more reliable when **controls are effective**.
 - **Written/documentary** evidence is better than oral evidence.
 - **Original** documents are more reliable than photocopies of faxes which can easily be altered.

Financial statement assertions

Assertions are representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework.

Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement.

Evidence must be relevant to the particular financial statement assertion the auditor is to test.

ISA 315 (Revised) lists two types of assertions.

a) Assertions about classes of transactions and events and related disclosures (OCCCAP)

- i) **Occurrence** – transactions and events that have been recorded or disclosed have occurred and pertain to the entity.
- ii) **Completeness** – all transactions and events that should have been recorded have been recorded and all related disclosures that should have been included in the financial statements have been included.
- iii) **Cut-off** – transactions and events have been recorded in the correct accounting period.
- iv) **Classification** – transactions and events have been recorded in the proper accounts.
- v) **Accuracy** – amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- vi) **Presentation** – transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

b) Assertions about account balances and related disclosures at the period end (COVECP)

- i) **Completeness** – all assets, liabilities and equity interests that should have been recorded have been recorded and all related disclosures that should have been included in the financial statements have been included.
- ii) **Obligations and rights** – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- iii) **Valuation, accuracy and allocation** – assets, liabilities and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded and related disclosures are appropriately measured and described.
- iv) **Existence** – assets, liabilities and equity interests exist.
- v) **Classification** – assets, liabilities and equity interests have been recorded in the proper accounts.
- vi) **Presentation** – assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Procedures for obtaining audit evidence

Sufficient appropriate evidence is collected using tests of controls and substantive procedures.

- a) **Tests of controls** are audit procedures designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Tests of controls are only performed:

- When control risk has initially been assessed as low i.e. controls are expected to operate effectively
- When substantive procedures alone do not provide sufficient appropriate evidence for example, when an entity conducts its business using IT systems which do not produce documentation of transactions

- b) **Substantive procedures** are audit procedures designed to detect material misstatements at the assertion level.

Substantive procedures comprise:

- i) Tests of details of classes of transactions, account balances and disclosures.
- ii) Substantive analytical procedures.

Substantive procedures must always be carried out on material classes of transactions, account balances and disclosures.

Auditors obtain evidence by performing one or more of the following audit procedures (AEIOU).

Audit procedure	Description, examples and comments	Type of procedure
Analytical procedures	<p>The evaluation of financial information by comparing financial and non-financial data and the investigation of significant differences and relationships which are inconsistent with other information.</p> <ul style="list-style-type: none"> ➤ Compare gross profit to revenue in 2025 and 2024 ➤ Compare payroll costs to number of employees 	Substantive procedure
Enquiry & confirmation	<p>Enquiry is seeking information from knowledgeable persons within or outside the entity. Inquiry of:</p> <ul style="list-style-type: none"> ➤ Management about incentive plans like bonuses. ➤ Lawyers about cases in court. <ul style="list-style-type: none"> • Strength of evidence depends on the knowledge and integrity of source of information. • Enquiry alone does not provide sufficient audit evidence to detect a material misstatement at assertion level, nor is it sufficient to test the operating effectiveness of controls. <p>Confirmation is obtaining representations directly from a third party.</p> <ul style="list-style-type: none"> ➤ Confirmation of trade receivables from debtors ➤ Confirmation of bank balances from banks <ul style="list-style-type: none"> • External confirmation may provide highly reliable evidence as it from sources independent of the client. 	<ul style="list-style-type: none"> • Both a test of controls & a substantive procedure • Substantive procedure
Inspection	<p>Examining records and tangible assets</p> <ul style="list-style-type: none"> ➤ Inspection of assets recorded in the asset register ➤ Inspection of inventories during the counting <ul style="list-style-type: none"> • Inspection of records provides evidence that is readily available and widely used at a relatively low cost. • The reliability of evidence from inspection of records depends on the effectiveness of internal control and whether they are from internal or external sources. • Inspection of tangible assets that are recorded in the accounting records confirms existence, but does not necessarily confirm rights and obligations or valuation. • Confirmation that assets seen are recorded in accounting records gives evidence of completeness. 	Both
Observation	<p>Looking at a process or procedure being performed by others.</p> <ul style="list-style-type: none"> ➤ Observe whether the entity's personnel follow instructions when counting inventory ➤ Observe the dispatch of goods 	Test of controls

	<ul style="list-style-type: none"> • The reliability of the evidence is limited to the point in time at which the observation takes place and by the fact that the presence of the auditor may influence the way the procedures are carried out. • Evidence from observation should later be corroborated with evidence from other procedures. 	
Recalculation & Re-performance	<p>Recalculation is verifying the mathematical accuracy of documents or records.</p> <ul style="list-style-type: none"> ➤ Recalculate the depreciation expense for buildings ➤ Recalculate the finance cost for a bank loan. <ul style="list-style-type: none"> • Recalculation gives reliable information on the accuracy of figures as the evidence is obtained directly by the auditor. <p>Re-performance is the auditor's independent execution of procedures and re-performance of controls.</p> <ul style="list-style-type: none"> ➤ Re-perform the year-end bank reconciliation ➤ Recount inventory to check the accuracy of the count <p>Re-performance is however only limited to controls present in the system.</p>	<ul style="list-style-type: none"> • Substantive procedure • Test of controls

Using analytical procedures as substantive procedures

The auditor can use three types of analytical procedures.

- Variance analysis** e.g. compare the current year financial information to prior period or budget information.
- Ratio analysis** – calculation of ratios and analysis and investigation of significant differences.
- Proof in total** – use of financial and non-financial data to estimate an expected value in the financial statements and investigation of significant differences.

Destiny Ltd received a loan of Shs 200 million on 1 January 2025 to finance the construction of a road. The loan carries a fixed interest of 2% per month payable at the end of each month. The company repaid Shs 50 million of the loan on 1 May 2025. Finance cost in the statement of profit or loss for the year ended 31 December 2025 is Shs 48 million. You are required to verify the finance cost for the year using a proof in total.

Solution

Finance cost: 1.1.2025 to 30.4.2025 = $(200\text{m} \times 2\% \times 4 \text{ months})$ = 16m.

Finance cost: 1.5.2025 to 31.12.2025 = $(200\text{m} - 50\text{m}) \times 2\% \times 8 \text{ months}$ = 24m.

Total 40m

Finance cost is Shs 40m and profit is understated by Shs 8m.

Factors to consider when using analytical procedures

- The **suitability** of analytical procedures to a particular assertion.
- The **reliability of data** from which the expected amounts or ratios are developed.
- Whether the expectation is sufficiently precise to identify a **material** misstatement.
- The amount of any **difference that is acceptable** without further investigation being required.

Tests of details

They are substantive procedures that involved details of classes of transactions, account balances and disclosures by inspection of accounting records and assets. Examples include:

- Inspection of invoices to verify the accuracy of the amounts recorded in financial statements.
- Physical inspection of non-current assets and inventory to verify their existence.
- Review of after date money received per cash book in order to verify the valuation of receivables.

Tests of controls versus substantive procedures

Collecting evidence using tests of controls differs from using substantive procedures. Below is an example on bank reconciliation.

Tests of controls	Substantive procedures
The focus is on: <ul style="list-style-type: none">• Understanding of the control being in place• Testing that it has operated effectively throughout the audit	The focus is on the auditor performing detailed procedures on figures in the financial statements
Include: <ul style="list-style-type: none">• Observing the control taking place• Re-performing the control• Inspecting evidence that the control has taken place	Include: <ul style="list-style-type: none">• Analytical procedures• Enquiry• Confirmation• Inspection• Recalculation
Tests include: <ul style="list-style-type: none">• Re-perform the bank reconciliation to ensure it has been accurately done• Review the bank reconciliation for evidence of the supervisor/manager review being done	Tests include: <ul style="list-style-type: none">• Obtain bank confirmation letters from banks of the client• Verify the accuracy of bank reconciliation

Directional testing

Substantive tests are performed to detect:

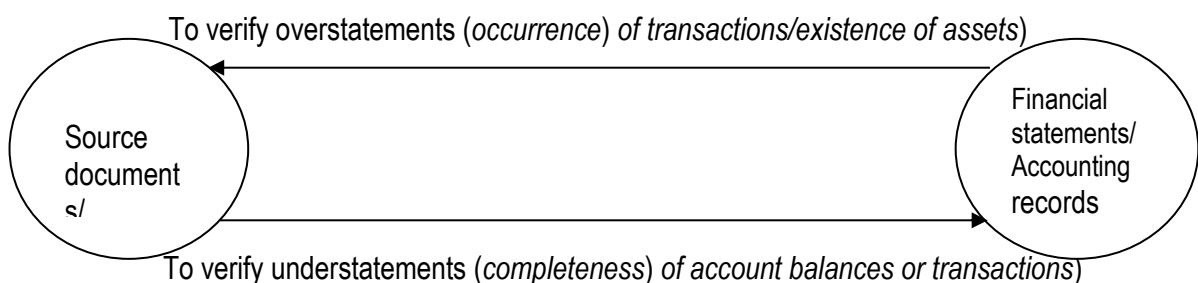
- **Errors** resulting in understatements and overstatements
- **Omissions** resulting in understatements

Tests designed to discover errors start with the accounting records in which the transactions are recorded to supporting documents or other evidence.

- Such tests detect any overstatement and also any understatement through causes other than omission.
- To test whether sales are priced correctly, select invoices from the sales ledger and check prices to the official price list.

Tests designed to discover omissions start from outside the accounting records and then traced to those records.

- Understatements due to omission will never be revealed by starting with the account itself as there is no chance of selecting items that have been omitted from the account.
- To detect whether all raw material purchases have been properly processed, select goods received notes and agree them to the inventory records or payables ledger.



Auditors design tests to detect both errors and omissions.

The type of test and the direction of the test should be recognized before selecting the sample.

The concept of directional testing is based on the principle of **double-entry bookkeeping** where for every debit there should be a corresponding credit.

- Any misstatement of a debit entry will result in either a corresponding misstatement of a credit entry or a misstatement in the opposite direction, of another debit entry.
- By designing audit tests carefully, auditors make conclusions not only about the debit or credit entries that they have directly tested, but also about the corresponding credit or debit entries that are necessary to balance the books.

Tests are therefore designed in the following way:

Test item	Example
Test debit items (expenditure or assets) for overstatement by selecting debit entries recorded in the nominal ledger and checking value, existence and ownership.	If a non-current asset entry in the nominal ledger of Shs 10 million is selected, it would be overstated if: <ul style="list-style-type: none"> • It was recorded at anything less than Shs 10 million or • If the company did not own it or • If it did not exist (e.g. it had been sold or the amount of Shs10 million represented a revenue expense.
Test credit items (income or liabilities) for understatement by selecting items from appropriate sources independent of the nominal ledger and ensuring that they result in the correct nominal ledger entry	Select a goods despatched note and agree that the recorded sale has been recorded in the nominal ledger sales account. Sales would be understated if: <ul style="list-style-type: none"> • The nominal ledger did not reflect the transaction at all (completeness) or • Reflected it at less than full value (say, if goods valued at Shs 10 million were recorded in the sales account at Shs 9 million, there would be an understatement of Shs 1 million.

- ✓ A test for the overstatement of an asset simultaneously gives comfort on understatement of other assets, overstatement of liabilities, overstatement of income and understatement of expenses.
- ✓ So by performing the primary tests, the auditors obtain audit assurance in other audit areas. Successful completion of the primary tests will therefore result in them having tested all account areas for both overstatement and understatement.

1.10 Revision questions

- 1) ISA 315 *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment (Revised)* requires an auditor to assess the risks of material misstatement.

Required:

- a) Describe a risk-based audit.
 - b) Define audit risk and the components of audit risk.
 - c) Identify **SIX** key areas that should be examined by an auditor when understanding an entity and its environment and assessing the risks of material misstatement.
 - d) Describe **FOUR** risk assessment procedures used by the auditor in understanding an entity and its environment and for each procedure give one example showing how the procedure is used.
- 2) ISA 320 *Materiality in planning and performing an audit* provides guidance on the concept of materiality in planning and performing an audit.

Required:

- a) Define materiality and performance materiality.
 - b) Explain factors used by the auditor in determining materiality.
 - c) You are carrying the audit of NSSF with PBT of Shs 100 billion and total assets of Shs 2 trillion. You have discovered fraud of Shs 20 million by the managing director. Explain whether this matter affects the users of the financial statements of NSSF.
- 3) ISA 240 *The auditor's responsibility relating to fraud in an audit of financial statements* gives guidance on fraud. Explain the external auditor's responsibilities in relation to the prevention and detection of fraud and error.
- 4) ISA 330 *The auditor's responses to assessed risks* requires the auditor to respond to the assessed risks of material misstatement. Explain how the assessed risk determines the audit approach.
- 5) ISA 300 *Planning an audit of financial statements* requires an auditor to plan every audit.
- a) Explain the benefits of audit planning.
 - b) Distinguish between an audit strategy and an audit plan.
 - c) Identify **THREE** main matters other than the characteristics of the audit that should be included in the audit strategy document for a client and for each area provide an example relevant to the audit.
 - d) Distinguish between internal audit and external audit and for each type of audit describe **THREE** audit procedures that may be undertaken in each audit.
- 6) ISA 230 *Audit Documentation* requires the auditor to prepare documentation. State **FOUR** benefits of documenting audit work.
- 7) ISA 500 *Audit evidence* requires auditors to obtain sufficient and appropriate audit evidence. Identify and explain **THREE** factors that influence the reliability of audit evidence.
- 8) You are an audit supervisor of Newman & Co and are planning the audit of Kampala Paint Ltd for the year ending 31 December 2025. The company develops and manufactures paint products and has been a client of your firm for several years. The audit manager has attended a planning meeting with the finance director and has provided you with the following notes of the meeting and financial statement extracts. You have

been asked by the audit manager to undertake preliminary analytical procedures using the financial statement extracts.

Planning meeting notes

During the year Kampala Paint Ltd has spent Shs 90m, which is included within intangible assets, on the development of new product lines, some of which are in the early stages of their development cycle. Additionally, as the company is looking to expand production, during the year it purchased and installed a new manufacturing line. All costs, incurred in the purchase and installation of that asset, have been included within property, plant and equipment. These capitalized costs include the purchase price of Shs 220m, installation costs of Shs 40m and a five-year servicing and maintenance plan costing Shs 50m. In order to finance the development projects and the new manufacturing line, the company borrowed Shs 400m from Stanbic bank that is to be repaid in instalments over eight years at an interest rate of 18%. Developing new products and expanding production is important as the company intends to undertake a stock exchange listing in the next 12 months.

The company started a number of initiatives during the year in order to boost revenue. It offered extended credit terms to its customers on the condition that their sales order quantities were increased. In addition, Kampala Paint Ltd announced in January 2021 of its 'price promise' that it would match the prices of any competitor for similar products purchased. Customers who are able to prove that they could purchase the products cheaper elsewhere are asked to claim the difference from, within one month of the date of purchase of goods, via its website.

The company intends to include a refund liability of Shs 25m, which is based on the monthly level of claims to date, in the draft financial statements.

The finance director informed the audit manager that a problem arose in September 2025 in relation to the mixing of materials within the production process for one particular product line. A number of these faulty paint products had already been sold and the issue was identified following a number of complaints from customers about the paint consistency being incorrect. As a precaution, further sales have been stopped and a product recall has been initiated for any of these specific paint products sold since June. Management is investigating whether the paint consistency of the faulty products can be rectified and subsequently sold.

Financial statement extracts for year ending 31 December

	Forecast 2025 Shs 000	Actual 2024 Shs 000
Revenue	1,985,000	1,699,000
Cost of sales	<u>(1,244,000)</u>	<u>(1,080,000)</u>
Gross profit	<u>741,000</u>	<u>619,000</u>
Inventory	185,000	133,000
Trade receivables	275,000	178,000
Bank	(81,000)	56,000
Trade payables	197,000	119,000

Required:

- Calculate THREE ratios, for BOTH years, to assist you in planning the audit of Kampala Paint Ltd.
- Using the information provided and the ratios calculated, describe EIGHT audit risks and explain the auditor's response to each risk in planning the audit of Kampala Paint Ltd. Note: Prepare your answer using two columns headed Audit risk and Auditor's response respectively.

Solution

a) Ratios to assist the audit supervisor in planning the audit:

	2025	2024
Gross margin	$741,000/1,985,000 = 37.3\%$	$619,000/1,699,000 = 36.4\%$
Inventory holding period	$(185,000/1,244,000) \times 365 = 54 \text{ days}$	$(133,000/1,080,000) \times 365 = 45 \text{ days}$
OR Inventory turnover	$1,244,000/185,000 = 6.7$	$1,080,000/133,000 = 8.1$
Receivables collection period	$(275,000/1,985,000) \times 365 = 51 \text{ days}$	$(178,000/1,699,000) \times 365 = 38 \text{ days}$
Payables payment period	$(197,000/1,244,000) \times 365 = 58 \text{ days}$	$(119,000/1,080,000) \times 365 = 40 \text{ days}$
Current ratio	$46,000/(197,000 + 81,000) = 1.65$	$367,000/119,000 = 3.08$
Quick ratio	$275,000/(197,000 + 81,000) = 0.99$	$(367,000 - 133,000)/119,000 = 1.97$

b) Audit risks and auditor's response

Audit risk	Auditor's response
<p>During the year, Kampala Paint Ltd (KPL) has spent Shs 90m on developing new product lines, some of which are in the early stages of their development cycle. This expenditure is classed as research and development under IAS 38 <i>Intangible Assets</i>. The standard requires research costs to be expensed to profit or loss and only development costs to be capitalised as an intangible asset.</p> <p>The company has included all of this expenditure as an intangible asset. If research costs have been incorrectly classified as development expenditure, there is a risk that intangible assets could be overstated and expenses understated.</p>	<p>Obtain a breakdown of the expenditure and verify that it relates to the development of the new products. Review expenditure documentation to determine whether the costs relate to the research or development stage. Discuss the accounting treatment with the finance director and ensure it is in accordance with IAS 38.</p>
<p>KPL purchased and installed a new manufacturing line. The costs include purchase price (Shs 220m), installation costs (Shs 40m) and a five-year servicing and maintenance plan (Shs 50m).</p> <p>As per IAS 16 <i>Property, Plant and Equipment</i>, the cost of an asset includes its purchase price and directly attributable costs only. IAS 16 does not allow servicing and maintenance costs to be capitalised as part of the cost of a non-current asset, as they are not directly related to the cost of bringing the asset to its working condition.</p> <p>The servicing costs relate to a five-year period and so should be charged to profit or loss over this time. The upfront payment represents a prepayment for five years; as the services are received, the relevant proportion of the cost should be charged to profit or loss. If the service for 2021 has been carried out, then Shs 10m (Shs 50m/5) should be charged to profit or</p>	<p>Review the purchase documentation for the new manufacturing line to confirm the exact cost of the servicing and that it does relate to a five-year period.</p> <p>Discuss the accounting treatment with the finance director and the level of any necessary adjustment to ensure treatment is in accordance with IAS 16.</p>

<p>loss. Therefore property, plant and equipment (PPE) and profits are overstated and prepayments are understated.</p>	
<p>The company has borrowed an eight-year loan of Shs 400m from Stanbic bank. The loan should be split between current and non-current liabilities to ensure correct disclosure.</p>	<p>During the audit, the team need to confirm that Shs 400 million loan finance was received. In addition, the split between current and non-current liabilities and the disclosures for this loan should be reviewed in detail to ensure compliance with relevant accounting standards and local legislation. Details of security should be agreed to the bank confirmation letter.</p>
<p>As the level of debt has increased, there should be additional finance costs as the loan has an interest rate of 18%. There is a risk that this has been omitted from the statement of profit or loss leading to understated finance costs and overstated profit.</p>	<p>The finance costs should be recalculated and any increase agreed to the loan documentation for confirmation of the 18% interest rate. Interest payments should be agreed to the cash book and bank statements to confirm the amount was paid and is not therefore a year-end payable.</p>
<p>KPL intends to undertake a stock exchange listing in the next 12 months. In order to maximise the success of the potential listing, KPL will need to present financial statements that show the best possible position and performance. The directors therefore have an incentive to manipulate the financial statements, by overstating revenue, profits and assets.</p>	<p>Newman & Co should ensure that there is a suitably experienced audit team. Also, adequate time should be allocated for team members to obtain an understanding of the company and the significant risks of overstatement of revenue, profits and assets, including attendance at an audit team briefing.</p> <p>The team needs to maintain professional scepticism and be alert to the increased risk of manipulation. Significant estimates and judgements should be carefully reviewed in light of the misstatement risk.</p>
<p>The receivables collection period has increased from 38 to 51 days and management has extended the credit terms given to customers on the condition that sales order quantities were increased. The increase in receivable days could be solely due to these increased credit terms. However, it could also be due to an increased risk over recoverability of receivables as they may be overvalued and expenses understated.</p>	<p>Review and test the controls surrounding how KPL identifies receivables balances which may not be recoverable and procedures around credit control to ensure that they are operating effectively. Extended post year-end cash receipts testing and a review of the aged receivables ledger to be performed to assess valuation. Also consider the adequacy of any allowance for receivables.</p>
<p>This year the company made a 'price promise' to match the price of its competitors for similar products. Customers are able to claim the difference from the company for one month after the date of purchase of goods.</p> <p>The company should account for the price promise in accordance with IFRS 15 <i>Revenue from Contracts with Customers</i>. As the company may be required to provide a refund, the anticipated refund amount should not be initially recognised as revenue but</p>	<p>Discuss with management the basis of the refund liability of Shs 25m and obtain supporting documentation to confirm the reasonableness of the assumptions and calculations.</p>

<p>instead as a refund liability until the one-month price promise period has ended.</p> <p>This is a highly subjective area, with many judgements required with regards to the level of likely refund due. As this is a new liability, the directors may not have correctly accounted for this sum resulting in overstated revenue, under/overstated profits and liabilities.</p>	
<p>KPL has stopped further sales of one of its paint products and a product recall has been initiated for any goods sold since September. This product recall will result in KPL paying refunds to customers. The sales will need to be removed from the 2025 financial statements and a refund liability recognised. Also inventory will need to be reinstated, although at a possibly written down value. Failing to account for this correctly could result in overstated revenue, understated liabilities and misstated inventory.</p>	<p>Review the list of sales of the paint product made between September and the date of the recall, agree that the sales have been removed from revenue and the inventory included. If the refunds have not been paid before the year end, review the draft financial statements to confirm that it is included within current liabilities.</p>
<p>The company is holding a number of damaged paint products in inventory and overall the inventory holding period has increased from 45 days to 54 days.</p> <p>The quality of these products is questionable and management is investigating whether these products can be rectified. There is a risk that this inventory may be overvalued as its net realisable value may be below cost.</p>	<p>Discuss with the finance director whether any write down will be made to this product, and what, if any, modifications will be required to rectify the quality of the product.</p> <p>Testing should be undertaken to confirm cost and NRV of the affected paint products held in inventory and that on a line by line basis the goods are valued correctly.</p>
<p>Revenue has increased by 16.8% in the year; and the gross margin has increased slightly from 36.4% to 37.3%. This is a significant increase in revenue and, along with the increase in gross margin, may be related to the increased credit period and price promise promotion or could be due to an overstatement of revenue.</p>	<p>During the audit, a detailed breakdown of sales will be obtained, discussed with management and tested in order to understand the sales increase. Also increased cut-off testing should be undertaken to verify that revenue is recorded in the right period and is not overstated.</p>
<p>The payables payment period has increased from 40 to 58 days. The current ratio has decreased from 3.08 to 1.65. The quick ratio has also decreased from 1.97 to 0.99.</p> <p>In addition, the bank balance has moved from Shs 56m to an overdraft of Shs 81m. These are all indicators that the company could be experiencing a reduction in its cash flow which could result in going concern difficulties or uncertainties. These uncertainties may not be adequately disclosed in the financial statements.</p>	<p>Detailed going concern testing to be performed during the audit, including the review of cash flow forecasts and the underlying assumptions. These should be discussed with management to ensure that the going concern basis is reasonable.</p>