

Audit Planning Case Study

Audit planning

1 When gaining an understanding of the client, the auditor will identify the geographic location of the client because:

- (a) more spread-out clients are harder to control.
- (b) the auditor will need to visit the various locations to assess processes and procedures at each site.
- (c) the auditor will plan to use staff from affiliated offices to visit overseas locations.
- (d) all of the above.

2 When gaining an understanding of the client's sources of financing, the auditor:

- (a) is not interested in debt covenants because all debt contracts are the same.
- (b) will assess if the client is meeting interest payments when they are due.
- (c) will ignore the relative reliance on debt versus equity funding because that is a management decision not an audit issue.
- (d) none of the above.

3 When gaining an understanding of the client at the industry level the auditor:

- (a) will not ignore information about the client's industry.
- (b) will not consider the level of demand for the goods and services provided by other companies in the client's industry.
- (c) will not consider government taxes on the industry because they are out of the client's control.
- (d) will not listen to bad news reports about the client firm because the client's reputation in the press is not important.

4 An example of an incentive or pressure that increases the risk of fraud is:

- (a) the client operates in a highly competitive industry.
- (b) the client has a history of making losses.
- (c) a significant percentage of management remuneration is tied to earnings.
- (d) all of the above.

5 The auditor must consider whether it is appropriate to assume that the client will remain as a going concern:

- (a) because this means that assets are valued on the basis that they will continue to be used for the purposes of conducting a business.
- (b) only if the client is facing bankruptcy, and long-term debt is likely to be withdrawn.
- (c) only if the client is listed on a stock exchange.
- (d) because mitigating circumstances are not important.

6 The planning stage of an audit does not include:

- (a) gaining an understanding of the client.
- (b) identifying factors that may affect the risk of a material misstatement in the financial statements.
- (c) developing an audit strategy and a risk and materiality assessment.
- (d) executing and reporting on an audit.

1. Cloud 9

"Great news!" announces Sharon Gallagher at the weekly team meeting. "We have just had word that the audit engagement letter for Cloud 9 Ltd. (Cloud 9) has been signed. We are now officially their financial statement auditors and the planning phase starts now!"

Later, at the first planning meeting, Sharon and Josh Thomas focus on assigning the tasks for gaining an understanding of Cloud 9. Ian Harper, a first-year graduate, is not happy.

He grumbles to another new member of the team, Suzie Pickering, as he leaves the room, "This is such a waste of time. Why did we sign an engagement letter if we don't understand the client? Why don't we just get on with the audit? What else is there to know?"

"Oh boy, are you missing the point!" Suzie says. "If you don't spend time planning, where are you going to start 'getting on with it'?"

"The same place you always start," replies Ian. Suzie realizes that she has a big job explaining to Ian and invites him for a coffee so that they can talk. Although Suzie is new to the team, she has audit experience with other clothing and footwear clients, and will be helping Sharon and Josh manage the Cloud 9 audit.

What do you think could go wrong with the Cloud 9 audit?

2. Scooter Ltd

Ivy Bishnoi is preparing a report for the engagement partner of an existing client, Scooter Ltd., an importer of scooters and other low-powered motorcycles. Ivy has been investigating certain aspects of Scooter Ltd.'s business given the change in economic conditions over the past 12 months. She has found that Scooter Ltd.'s business, which experienced rapid growth over its first five years in operation, has slowed significantly during the last year. Initially, sales of scooters were boosted by good economic conditions and solid employment growth, coupled with rising gas prices. Consumers needed transport to get to work and the high gas prices made the relatively cheap running costs of scooters seem very attractive. In addition, the low purchase price of a small motorcycle or scooter, at between \$3,000 and \$8,000, meant that almost anyone who had a job could obtain a loan to buy one.

However, Ivy has found that the sales of small motorcycles and scooters have slowed significantly and that all importers of these products, not just Scooter Ltd., are being adversely affected. The onset of an economic recession has restricted employment growth, and those people who still have jobs are less certain of continued employment. In addition, the slowdown in the world economy has caused oil prices to fall, further reducing demand for this type of economical transport. Ivy has also discovered that, due to the global financial crisis, the finance company used by Scooter Ltd.'s customers to finance the purchase of scooters and motorcycles has announced that it will not be continuing to provide loans for any type of vehicle with a purchase price of less than \$10,000.

Required

- (a) Identify the issues that potentially have an impact on the audit of Scooter Ltd.
- (b) Explain how each issue affects the audit plan by identifying the risks and the financial statement accounts that require closer examination

3. Countrywide Capers

Michael has drafted an audit plan for a new client. The client is Countrywide Capers, a party rental business. Countrywide Capers earns 80 percent of its revenue from renting out tents, tables, dishes, cutlery, napkins, and tablecloths. Michael's plan shows that audit time is divided to reflect this revenue pattern (that is, 80 percent of the audit time is spent on the rental business and 20 percent of the time is spent on the retail business). Michael believes that the significance of the revenue activities should be the only driver of the audit plan because the client has no related parties and has a simple, effective corporate governance structure.

Required

What questions would you have for Michael before accepting his audit plan?