

PM 1.2

AUDIT PLANNING MEMORANDUM

ABC WHOLESALE & RETAIL

31 December 20X1

Issues	Reviewers Initials and comments
<p><u>Type of engagement</u></p> <p>The audit was requested by the client. The audit will be conducted in accordance with ISAs. The accounts have been prepared in accordance with IFRS. The IFRS for SMEs has not been taken advantage of.</p>	
<p><u>Timing and nature of reporting</u></p> <p>The accounts have to be filed with the Registrar of Companies by 31 January 200X along with the annual return.</p> <p>The company's tax information must be submitted by 31 March 20xx to the tax authorities. The deadline for any tax payable is 1 August following the year of assessment.</p>	
<p><u>Reliance on internal control</u></p> <p>We have considered the design and implementation of the internal controls as required by ISA 315. We have not placed any reliance though on internal controls and feel that a fully substantive based approach is both the most effective and efficient approach in the circumstances.</p>	
<p><u>Results of previous audits</u></p> <p>The audit has always been relatively clean and few problems have been encountered. The client has always been receptive to our work which is reflected in their decision to have an audit carried out.</p>	

<p><u>Key areas identified:</u></p> <p><i>Areas identified:</i></p> <ol style="list-style-type: none">1. Completeness of income.2. Valuation and existence of inventory.3. Completeness of payables. <p><i>Why they are a key area:</i></p> <ol style="list-style-type: none">1. Completeness of income – this is a key area because income is primarily cash and therefore potentially susceptible to an	
--	--

<p>increased risk of fraud and error.</p> <ol style="list-style-type: none"> 2. Existence and valuation of inventory – the amount is material There is also a theft risk due to the nature of the inventory held. 3. Completeness of payables – this is important to ensure there is no potential understatement of liabilities <p>Impact on audit approach:</p> <ol style="list-style-type: none"> 1. Completeness of income – essential to carry out detailed analytical review and comprehensive till roll reconciliations. 2. Existence and valuation of inventory – the requirements of ISA 500 on audit evidence will need to be considered carefully in this area. This will include the observation of an inventory count. Valuation of inventory will be tested by review of purchase invoices and a review for old obsolete inventory. 3. Completeness of payables – examine the subsequent payments and invoices <p><u>Immaterial areas</u></p> <p>Areas identified as low risk:</p> <p>Capital Payroll Prepayments</p> <p>Suggested audit approach:</p> <p><i>Reduced level of substantive testing and smaller sample sizes in these areas. Testing will focus on key assertions only.</i></p>	
---	--

Issues	Reviewers initials and comments
<p><u>Initial assessment of going concern</u></p> <p>The company is funded by \$1.1m of share capital and a long term loan. It has maintained a fairly consistent level of profitability over the last three years despite continued pressure on sales. However it does not have particularly good liquidity. At the balance sheet date it has a net current liability. An payment from one of its large debtors is expected to remedy this situation.</p>	

Nature, timing and extent of staff and principal involvement

Budget is shown on [B10](#). The work will be performed by appropriately trained staff i.e. a qualified manager and a part qualified experienced senior. Appropriate time has been allocated for partner control and review.

Summary audit approach					
Section	Assertions	Risk per B5 (H/M/L)	Tests of operational effectiveness? (Y/N)*	Detailed Analytical Review? (Y/N)*	Standard or tailored programme required?
Inventory	See IA1	<i>Med</i>	<i>No</i>	<i>Yes</i>	<i>Standard</i>
Payables and accruals	See L1	<i>Med</i>	<i>No</i>	<i>No</i>	<i>Standard</i>
Income	See QA1	<i>Med</i>	<i>Yes</i>	<i>Yes</i>	<i>Standard</i>

Briefing meeting

Date: 11 Jan 20XX

Personnel on audit

Name	Role	Initials	Briefing attended Y/N
John Brown	Audit Engagement Partner	JB	Y
Peter Mark	Manager	PM	Y
Matthew Scott	Audit Senior	MS	Y

Briefing meeting notes:

The briefing meeting was held on 11 Jan 20XX. The engagement partner, audit manager and audit senior were all present.

The following matters were discussed:

1. Key areas of the job and audit approach.
2. Fraud and error.
3. Sample sizes.

Discussion of significant risks and audit approach**Significant risks identified (see PAF 13):**

- Misappropriation of income
- Pilgrage of inventory
- Unrecorded liabilities
- Theft of cash

Key controls in place to mitigate risks:

- Daily reconciliation of cash sales
- Good culture in company
- Security of inventory (limited access)
- Accounting is outsourced

Audit impact:

- No test of internal controls will be tested
- Increased sample sizes will be used for work on completeness of income and completeness of payables
- Observation of inventory
- Review of procedures over cash till

Discussion of key audit areas and audit approach

The key areas referred to earlier in this memo were discussed and the approach to each area clarified.

Fraud and error

There are two types of fraud relevant to our work as auditors namely fraudulent reporting and misappropriation of assets.

In order to address these we will maintain an attitude of professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, despite our past experience and our lack of concern about the honesty and integrity of the directors.

Although the culture is good within the company and internal controls are appropriate we must remain alert to potential management over-ride of controls.

Fraud - income

There are a large number of small cash transactions therefore if errors arise they should be small.

Major risks are pilgrage of inventory and misappropriation of cash income.

Controls appear adequate and our own analytical review work should help identify any significant variations.

It was agreed that we would ensure we were vigilant for fraud and error throughout our audit testing

and that we would exercise our professional scepticism throughout the audit.

Fraud and error – other

It was noted that the other areas susceptible to fraud and error were

- Journal entries, particularly manual ones and their potential use in manipulating the figures;
- Validity of expenditure including directors personal transactions being made through the company;
- Theft of inventory

Audit approach to fraud and error

We will approach this area with rigour and scepticism and the audit approach will cover

- Completeness of income will be addressed in our work on sales completeness;
- Ensure appropriateness of accounting estimates;
- Ensure appropriate procedures are applied in relation to the inventory count;
- Review invoicing for directors expenses;
- Remain alert throughout the audit for mis-accounting and inappropriate journals; and

Materiality

Based on ISA 320 considerations, we have determined materiality based on profitability. We have considered the factors that may affect identification of an appropriate benchmark:

- Elements of financial statements
- Focus of users of financial statements
- Nature of entity – business, life cycle etc
- Ownership structure
- Volatility of benchmark

We concluded that the appropriate benchmark is profitability as the entity is in operations to make profit and although in the early stages of its life, the business is simple and profit has been more or less consistent over the years. We have adjusted the profit before tax for owner remuneration of \$600K to reflect the true profit of the entity.

We have set performance materiality at half of materiality. We believe this will reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.

Profit for year	619,250
Profit before tax	604,250
Owner salary	600,000
Revised PBT	1,204,250

Materiality - 5% of PBT	60,213
Performance materiality	30,106

Planning conclusion and approval:

In my view the staff have been appropriately briefed and all the areas required by the various ISAs to be covered have been covered.

Prepared by: Matthew Scott

Date: x Jan 20XX

Approved by: John Brown

Date: XX Jan 20XX

(Audit Engagement Partner)

Note – This example does not consider ALL significant accounts and is only a basic outline of what might be included on an audit file.

SAMPLE