**MATERIALITY AND RISK: DISCUSSION CASE**

As an auditor of the star manufacturing company, you have obtained a trial balance from the books of star one month before year end.

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| --- | --- | --- |
| ACCOUNT | RISK WEIGHT | DR (CR) |
|  |  | Ksh. 000 |
| Cash in Bank | 0.97 | 87,000 |
| Trade accounts receivables | 0.25 | 345,000 |
| Notes receivable | 0.21 | 125,000 |
| Inventories | 0.74 | 317,000 |
| Land | 0.11 | 66,000 |
| Buildings (net) | 0.17 | 350,000 |
| Furniture, fixtures and equipment, net | 0.23 | 325,000 |
| Trade accounts payable | 0.38 | (235,000) |
| Mortgage payable | 0.30 | (400,000) |
| Capital stock | 0.05 | (300,000) |
| Retained earnings | 0.85 | (510,000) |
| Sales | 0.43 | (3,130,000) |
| Cost of sales | 0.86 | 2,300,000 |
| General and administrative expenses | 0.91 | 622,000 |
| Legal and professional fees | 0.45 | 3,000 |
| Interest expense | 0.03 | 35,000 |
|  |  |  |

There are no inventories consigned either in or out.

All notes receivable are due from outsiders and held by star.

The risk weights have been deduced by the auditor from past experience. Risk weight gives the probability that the account in question may be materially misstated.

Required:

1. Which accounts should be confirmed with outside sources? Briefly describe from whom they should be confirmed. Organize your answer in the following way. (WE SHALL COVER THIS IN THE TOPIC ON AUDIT EVIDENCE).

|  |  |  |
| --- | --- | --- |
| Account | From whom confirmed | Information to be confirmed |
|  |  |  |

1. Compute the risk that each of the accounts may be materially misstated. Rank the accounts in the order of riskiness. Also, plot on a graph the risk map for the accounts.

**NB:** The easiest way to conceptualize risk is as a product of probability of misstatement and the impact.

Risk = Probability \* Impact

The impact here will be represented by the account in question. For example in the case of cash, the Ksh. 87,000,000 represents the impact.