a. Trade and Other Receivables and Sales: You have assessed the risk of management distortion, and overstatement of Sales to be high this year because senior management is trying to obtain an extended loan from their financial institution. You have also noticed that the client has a high level of lay-buy sales which extend over several months. However, controls in this system are relatively strong, and the only weakness revealed in the testing of controls is a lack of review of adjusting journal entries.

>Most important assertion: existence, valuation and allocation - because managers have failed to review journal adjustments to ensure they are presented fairly we need to ensure that receivable journals in the report exist and have not been paid/written-off and that the values recorded reflect the amount owed to the entity.

>Existence is commonly tested using positive confirmation from the client's customers. A response to the confirmation which is requested from the customer is required by the auditor before concluding that the client's trade receivable exists.

<u>testing methods:</u>

-substantive test asserts that trade receivable is not overstated by providing evidence of the completeness assertion for transaction which has negative impact on the balance of receivables.

-positive confirmation letter confirms amount owed to entity.

>valuation and allocation is commonly tested using subsequent receipts (trade receivables at year-end is vouched to the subsequent receipt of cash from the customer) supplemented by analytical procedures (e.g compare previous periods trade receivable, industry expectation, historical number of days to convert trade receivables to cash).

<u>testing methods:</u>

-Compare historical sales returns and sales discounts as percentages of sales. Investigate significant or unexpected discrepancy.

-Compare historical allowance for doubtful debts and bad debts as a percentage of receivables and sales. Investigate significant or unexpected discrepancy.

-Review the listing of accounts receivable to ensure all balances are related to the account.

-Compare historical number and amounts of sales credit notes issued. Investigate significant or unexpected discrepancy.

b. Inventory: A perpetual stock system is in place and a stock count is performed every six months by off-shift employees after the business closes. The employees complete stock forms (not pre-numbered) each with the following headings: Stock Item #, Stock count. When they're done, they sign off the form and leave.

>Most important assertions: existence, valuation and allocation - the process for stock reviews are weak due to lack of pre numbering and misstatements may be undetected for this reason to assert that inventory is fairly disclosed we must determine that it exist and has been evaluated at the correct amount.

>Existence is commonly tested using stocktake, auditors test for existence by physically sighting the stock to determine if items exist in the quantities recorded.

<u>testing methods:</u>

-trace cut-off information obtained during physical inspection to records.

-inspect creditors reports/documents to verify account balances.

-inspect shipping , receiving and transfer documents and the related inventory items to gather information needed to verify cut-off in the accounting records.

-test clients count (from the floor to recorded counts and from recorded counts to the floor), ensure that sufficient information is recorded for inventory compilation at a later date.

>valuation and allocation is commonly tested using stocktake, auditors test for valuation and allocation by observation of the condition of inventory. This provides insights into whether there appear to be any items that may be slow-moving, damaged, obsolete, impaired or excess to the client's needs that are over valued in the reports.

Another common method to test is to observe the inventory life cycle: valuation focus on the initial cost recorded (vouching to supporting invoices), the value recovered for any sales (vouching to sales invoices), and any provision for impairment calculations for excess, slow-moving or obsolete stock on hand at year-end.

<u>testing methods:</u>

-review reconciliation of inventory against ledgers and account balances. Investigate significant or unexpected discrepancy.
-compare quantities and business purpose of item to industry expectation to determine reasonableness
-Recalculate invoice to test mathematical accuracy.
-Compare purchase order/invoice to supplier catalogues to verify.

c. **Fixed asset Subsystem: Overall controls relating to the fixed assets subsystem are generally strong, however, you discovered that management is not transparent about how they assess the value of some of the Intangible assets and derivative financial instruments. Kathmandu's accounting policy relating to property, plant, and equipment (PP&E) states that the company review and adjust (if appropriate) assets' residual value and useful lives at each balance sheet, However, you have noticed that this year, no review was carried out for PP&E's residual value and useful lives by the management.**

>Most important assertion: Valuation and allocation, Existence - because managers have failed to review the PP&E we need to assert what assets still exist or need to be disposed of and if they have been evaluated fairly.
>valuation and allocation is commonly tested by vouching disclosed PP&E at years end against valuation review results and supplemented by analytical procedures (e.g compare previous periods PP&E valuation, market valuation of assets, domain/industry expert valuation).
<u>testing methods:</u>
-review depreciation/valuation of PP&E against historical trends. Investigate significant or unexpected discrepancy.
-compare valuation and business purpose of item to industry/market expectation to determine reasonableness
-Recalculate valuation of PP&E to test mathematical accuracy.
-Compare purchase order/invoice to supplier catalogues to verify acquisition cost of assets (initial value of PP&E).
>Existence is commonly tested using inspection of physical assets, auditors test for existence by physically sighting the assets to determine that they exist, their condition and trace records.
<u>testing methods:</u>
-vouching acquisition documents against physical assets reported in entity's PP&E.
-positive confirmation letter confirms assets owned by entity.

d. **Payroll: Payroll includes both hourly wage earners and 'managers' who are paid a set monthly wage. Any changes to managers and conditions are negotiated by the union. Previously it was observed that there is usually a delay between when a negotiation is complete and when it is incorporated into the system. Net wages are made by auto-deposit to the employee's bank account. No comparisons are made between employee records and this payment system. Also, assume that average staff turnover is very high in recent years and processes to close personnel files when someone leaves are weak.**

>Most important assertions: accuracy, completeness and cut-off - the controls in payroll are weak and susceptible to misstatement as accounts are not being closed in appropriate periods and documents are not being vouched to ensure accuracy.
>Completeness: All costs related to the current period's revenues and all expenses of the current period are included in the income statement. Commonly tested by vouching recorded amounts to supporting documentation.
<u>testing methods:</u>
-Inspect the postings of totals in the payroll transaction file and trace them to the general ledger.
-Verify the record of hours charged, for example, timecards or job tickets to the payroll transaction file/payroll software used to record and calculate payroll.
-Examine payments of accrued payroll liabilities and/or payroll disbursements after the end of the period.
>Accuracy: Costs and expenses are stated in income statement at the appropriate amounts. Commonly tested by vouching recorded amounts to supporting documentation.
<u>testing methods:</u>

-Compare the payroll at the beginning and end of the period to identify changes in employees and in pay rates.
-Compare hours paid with the record of hours worked, for example timecards.
-Investigate if former employees were removed from the payroll on a timely basis using outside sources.
-Reconcile the accrued payroll balance to the amount in the payroll transaction file for the corresponding balance.
-Recalculate the extensions of wage rates times the hours worked.
>Cut-off: Costs and expenses are stated in income statement in the appropriate period.
Commonly tested by vouching recorded amounts to supporting documentation.
testing methods:
-Verify the record of hours charged, for example, timecards or job tickets to the payroll transaction file/payroll software used to record and calculate payroll.
-Examine payments of accrued payroll liabilities and/or payroll disbursements after the end of the period.
-Examine historical cost of labour. Investigate discrepancy.
-Examine invoice against operational labour budget. Investigate discrepancy.