

***EXTRACT**

❖ **TESTS OF DETAIL**

- The most basic (but inefficient) type of audit test is the test of detail.
- Tests of detail involve:
 - Selecting a sample of items.
 - Testing the items in the sample (and comparing to evidence).
 - Noting the errors.
 - Based on these errors, making an estimate of the overall error in the acct.

Inventory Eg

- ABC's fin statements contain a figure of \$3m for inventory.
 - This consists of 3k computers at \$1k ea.
 - Gather evidence about whether this is true or not.
 - Inventory is a B/S acct so we need to test:
 - a) existence,
 - b) rights and obligations
 - c) completeness,
 - d) accuracy, valuation and allocation,
 - e) classification, &
 - f) presentation
 - Inventory is recorded in the inventory sub-ledger. If this ledger is correct, then the figure on the b/s is correct.
- 1) To test **existence**, perform a stocktake – Take a sample of inventory items from the inventory sub-ledger and compare the quantities (recorded in the sub-ledger), to those from the physical stocktake.
 - *Is there anything in the ledger that doesn't exist in reality?
 - 2) To test **rights and obligations**
 - Take a sample of inventory items and examine the purchase docs, e.g. invoice for those items, to check that they are not being sold on consignment.
 - On consignment – don't own the items. Eg) real estate agents selling houses that are not theirs
 - *Is there existing inventory that is not yours?
 - Take a sample of sales invoices and find the matching dispatch dockets. If these cannot be found, then check that the sold items are not included in the inventory sub-ledger.
 - *Have you sold something that is already owned by a customer? This happens bc an item gets sold but not yet delivered.
 - 3) To test **completeness**, perform a stocktake – Take a sample of inventory items from the warehouse, count them and compare the count to the quantities recorded in the inventory sub-ledger.
 - *Is everything in the warehouse actually in the ledger?
 - **Note:** this is the opposite way round to the stocktake for existence
 - Existence – sample from the sub-ledger and compare to the physical stock
 - Completeness – sample from the physical stock and compare to sub-ledger
 - 4) To test **accuracy, valuation and allocation**
 - Take a sample of inventory items from the inventory sub-ledger and compare the recorded cost to:
 - a) The last sales price of the item,
 - b) The advertised price of the item.
 - Never answer qn by comparing to "market price".
 - Take a sample of inventory items from the inventory sub-ledger and physically examine the items, to see if they are damaged or obsolete.
 - *Does inventory need to be written down?
 - 5) To test **classification**, take a sample of computers from the sub-ledger and check that all of them are available for sale (i.e. real inventory) by enquiring of staff and checking serial numbers.
 - Check that none of the computers in the ledger are actually PPE that are used in the business and are not for sale.

- Check that none of the computers are actually other items that have been incorrectly entered into the system as computer inventory.

*Are all computers for sale and therefore inventory?

6) To test **presentation**, check the b/s –

- Is the B/S figure the same as that on the trial balance?
- Are the prior yr figures correct?
 - Compare to last yr's annual report
- Is the split between current and non-current inventory correct?
 - Enquire and use judgement
- Is the note reference correct?
 - Read the inventory note and check details against sub-ledger and inventory schedules to ensure that the note no. actually refers to the correct note in the notes.

Accounts Payable Eg

- ABC's fin Statements contain a figure of \$5m for accts payable.
- This consists of 250 individual creditors accts with balances of between \$2,780 and \$340k.

• Accounts Payable is a balance sheet acct so we need to test:

- existence,
- rights and obligations,
- completeness,
- accuracy, valuation and allocation,
- classification, &
- presentation.

• Accounts Payable is recorded in the accts payable sub-ledger.

1) To test accts payable for **existence**, take a sample of accts payable from the accts payable sub ledger and:

- Look for supplier statements.
- Look for subsequent cash payments on the bank statement.
- Look for purchase invoices from that supplier.

*Are the creditors real?

2) To test for **rights and obligations**

- Confirm with suppliers to check that the company actually owes the money and that it is not going to be paid by a 3rd party.
- Examine supplier statements for special contract terms that mean that a 3rd party will be liable for the debt.

*Is the debt owed by somebody else, even if it is real?

3) To test accts payable for **completeness**, take a sample of:

- Purchase invoices,
- Supplier statements,
- Cash payments from the bank statement,

And check that there is a creditor in the accts payable sub ledger for each one.

- A common type of fraud is to omit creditors.

*Is there a business relationship?

4) To test accts payable for **accuracy, valuation and allocation**

- Confirm the balance with the supplier.
- Perform a reconciliation of the supplier statements.
 - A supplier statement is a bill but it also acts as a record of your transaction with them from their POV.

5) To test accts payable for **classification**, take a sample of creditors' accts from the accts payable sub-ledger and check that they are really accts payable and not other types of debt by examining contracts. Items that are not A/P:

- Interest bearing debt where there has been no exchange of goods/services – they are just borrowings.
- Provisions – No contractual requirement to pay anyone.
- Tax payable – Did not receive anything in exchange.

*Are there liabilities that aren't accts payable?

- 6) To test accts payable for **presentation**, check the b/s (same as inventory) –
- Is the B/S figure the same as that on the trial balance?
 - Are the prior year figures correct?
 - Compare to last year's annual report
 - Is the note reference correct
 - Read the accts payable note and check details against sub-ledger and accounts payable schedules