ACCG305

Audit Planning

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April 13, 2017

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Introduction

It is essential for every company to be audited by an external auditor. It has been a key element of trust in corporate world. It provides assurance that company's management has presented a true and fair view of company's financial position. So that users could fully rely on the given information. In general, an audit consists of evaluation of a subject matter with a view to express an opinion thereon.

This report focuses on planning stage of audit to gain an understanding of company's structure, business environment and to identify inherent risk which could affect the financial report of the company. Identifying these risks will help determine the nature of audit procedures to be performed. An additional step is also considered in planning phase, which is the concept of Materiality as it applies to client.

Purpose of Audit Planning

It has been already discussed that which are the key market forces including general and industry specific economic trends and conditions, technology advancement, customers and suppliers' information, competitive environment, laws and regulations etc.

The main purpose of this research is to identify the inherent risk. It is the responsibility of the auditor to find out which financial report assertions may get affected by these inherent risks. Identifying these risks will help to determine the nature of audit procedures to be performed.

Auditor uses the assertions for account balances to form the basis for the assessment of risks of material misstatement. In other words assertions are used to find out the type of errors in account balance. It will support the auditor to identify, obtain sufficient evidence and pay more attention to important and risky areas of the audit. It assists the auditor to identify and resolve potential problems effectively and efficiently on a timely basis.

An additional step is also performed in planning phase that is concept of materiality as it applies to client. It is the auditor's duty to design the procedure in order to identify errors and irregularities that could affect the financial report of the company.

Materiality in the Context of an Audit

Materiality is used to determine the audit procedures, sample selection, identifying differences between audit results and clients records. It tells about the maximum amount of misstatements (individually or an aggregate) that can be accepted in financial report. Auditor has to use the key drivers for selecting the base figure for calculating materiality.

In this report one audit methodology is used that is one planning materiality (PM) amount is used for the whole financial statement. The basis is selected is determined to be the key driver of the business.

Calculation of Planning Materiality

Following are the approaches that can be used by the auditor for calculating the planning materiality (PM).

- Single Rules
- Variable or Size Rules
- Blended or Average Approach
- Formula Methods

But as per the requirement of this report, Planning materiality has been calculated only on one basis that is “Single Rule Method” which determined by keeping in mind the key drivers of business and using the Balance sheet as on 31 December 2011 which has been annualized by using the interim figures of trial balance as on 30 September 2011.

The auditor would select one of the four following materiality amounts:

Single Rule	Computation	Materiality Amount
5% of Profit Before Tax	$1,906,420*5%	$95,321
5% of Turnover	$45,316,793*5%	$2265840
0.5% of Total Assets	$24,589,854*0.5%	$122,949
1% of Equity	$5,789,187*1%	$57,892

Ratio Analysis of Cloud 9 Pty Ltd

Financial Position of Cloud 9 as on 31-12-2011:

Ratios	Formula	2011
Liquidity Ratios		
Current Ratio	Current Asset/Current Liabilities	2.64
Quick Ratio	Cash & cash equivalents + Receivables /Current Liabilities	1.40

Ratios	Formula	2011
Management Efficiency Ratios		
Inventory Turnover Ratio	Cost of Goods Sold/Average Inventory	2.63
Accounts Receivable Turnover Ratio	Net Sales/Average Account Receivables	5.43

Ratios	Formula	2011

Solvency Ratios		
Debt to Equity Ratio	(Long Term Debt + Short Term Debt) /Total Equity	3.25
Times Interest Earned Ratio	EBIT/Interest Expense	2.91

Ratios	Formula	2011
Profitability Ratios		
Gross Profit Margin Ratio	(Gross Profit/Net Sales)*100	0.52
Net Profit Margin Ratio	(Net Profit/Net Sales)*100	0.04
Return on Asset Ratio	(Net Income/Net Assets)*100	0.07
Return on Equity Ratio	(Net Income/Net Equity)*100	0.35

Common Size Statement for the Balance Sheet of Cloud 9

Particulars (Figures in dollars)	31-Dec-11	%	30-Sep-11	%
Current assets				
Cash	1,753,765	7.1	1315324	7.1
Receivables	10,701,064	43.5	8025798	43.5
Inventory	6,263,242	25.5	4697432	25.5
Financial assets	4,075,205	16.6	3056404	16.6

Prepayments	666,054	2.7	499541	2.7
Non-Current Assets				
Deferred tax asset	277,559	1.1	208169	1.1
PPE	852,965	3.5	639724	3.5
Total assets	**24,589,854**	**100.0**	**18442391**	**100.0**
Current Liabilities				
Payables	8,413,818	34.2	6310364	34.2
Provisions	268,581	1.1	201436	1.1
Current tax liabilities	207,893	0.8	155920	0.8
Non-Current Liabilities				
Interest bearing liabilities	9,740,091	39.6	7305068	39.6
Deferred tax liabilities	170,284	0.7	127713	0.7
Total liabilities	**18,800,667**	**76.5**	**14100500**	**76.5**
Issued capital	5,448,026	22.2	4086020	22.2
Reserves	(259,498)	-1.1	-194624	-1.1
Retained profits	600,659	2.4	450494	2.4
Total equity	**5,789,187**	**23.5**	**4341890**	**23.5**
Total Liabilities and	**24,589,854**	**100.0**	**18442391**	**100.0**

equity				

Projected Revenue for the year ending 31-Dec-2011

Based on the factors, Planning Materiality should be set at 5%.

Revenue-Stores	-	
Revenue-Wholesales	33987595	33987595
Total Revenue from normal operations		33987595
Annualized revenue (33987595*12/9)		45316793
Planning Materiality @ 5%		2265840

Conclusion

As per the above research it can be concluded that there are various inherent risk in the business and it is the duty of the auditor to correct and prevent it. We also discussed the common size statement and the financial position of the company through balance sheet and Cloud 9;s ratio analysis.