<u>EXEMPLAR FOR ASSIGNMENT 2</u>

Your firm has just been appointed as the auditor of BNZ Pty Ltd, a manufacturing company. Consider the following situation:

1. A new competitor entered the market four months before year end and since that time, selling prices have fallen significantly. Your inquiries have revealed that the industry expects heavy discounting to continue for the whole next year.

Required

(a) Identify and discuss why the above situation represents a risk.

(b) By applying auditing knowledge, identify the main account or group of accounts affected by this risk in the audit plan.

(c) Identify how the audit plan will be affected by the risks and recommend specific audit procedures to address these risks.

<u>Suggested Solution</u>

(a) Inherent risk is high due to the entry of new competitor in the industry. As the competition caused selling prices to fall prior to balance date, this may cause the net realizable value of the stock on hand at year end to be less than cost. This situation may give management the incentive to manipulate a number of the accounts /balances in the financial reports.

(b) The impact of reduced selling prices will be on inventory value, cash flow and going concern. In the audit plan, the focus will be on major accounts like sales revenue, accounts receivable, expenses, accounts payable as these accounts may be manipulated to make the net profit looked good.

(c) The auditor will need to talk to management regarding the potential going concern issue and their back-up plan to mitigate this problem. The auditor also needs to concentrate on selling prices at and after balance date and perform detail testing on the major day to day accounts (sales revenue, inventory, et) during the year end.