Additional Review Problems for Final Exam

Substantive Analytics

You have been tasked with auditing **advertising expense** during the audit of your client's 12/31/2019 financial statements. You have planned to audit this account using a substantive analytical procedure. The prior year's audited balance was $240,000. Per the prior year audit working papers, this was composed of 80 print advertising spots with magazines/newspapers at an average cost of $2,400 per spot and 1,000 online advertising spots at $48 per spot. Industry trends show that competitors have cut the frequency of print advertising in half this year but have doubled the frequency of online advertising. Further, relative to the prior year, print advertising has increased 5 percent per spot while online has decreased 8 percent per spot. Your client's management reported (unaudited) 2019 advertising expense of $200,000.

Follow the steps of the substantive analytical procedure process discussed in class to **conclude** as to whether your client's 2019 advertising expense is fairly stated. Justify your conclusion.

1. Is it a good candidate for SAP?

    +: Income statement, reasonably predictable, not super volatile

    −: Somewhat subject to management discretion

2. Evaluate reliability of the data

    Agree $200K to current year trial balance

    Agree $240K and prior year quantity/price statistics to prior year audit working papers

    Agree industry data to reliable sources

    Reference controls testing over expensing

3. Create Precise Expectation

$$\text{Ad Expense} = \text{Price} \times \text{Quantity}$$

    Print

    $$(2,400 \times 1.05)(80 \times 0.50) \quad + \quad (48 \times 0.92)(1,000 \times 2)$$
    $$(2,520)(40) \quad\quad\quad + \quad\quad (44.16)(2,000)$$
    $$100,800 \quad\quad\quad + \quad\quad\quad 88,320$$

    Online

    $$\boxed{\$189,120}$$

4. Tolerable Difference Threshold

    If no information on materiality, set equal to 5% of the current year account balance

    $$5\% \times 200,000 = \$10,000$$

    If given pretax income, find overall materiality (e.g., 5% of pretax income) then take 50% or 75% + find tolerable misstatement. For example, if pretax income = 400,000, $400,000 \times .05 \times .75 = \$15,000$

5. Compare

    $$200,000 - 189,120 = 10,880$$

6. Investigate

    $10,880 > 10,000$ so → investigate, corroborate explanations, and quantify difference

Revenue Recognition

Sooner Farms provides horses, horse equipment, and vet services to cattle ranches in the Oklahoma/Texas region. Sales come with no warrantees or right of refund. On December 20, Sooner Farms receives an approved purchase order from J&J Cattle for "10 generic horses that will work real good for herding these dang stubborn cattle, plus one year of vet services, and a new trailer to transport them horses." Per Sooner's catalog, each horse costs $5,000, an adequately sized trailer costs $25,000, and one year's retainer for generic horse services has a standard price of $5,000. No specific individual horses are requested from the herd, all are to be picked up at the same time along with the trailer, and the vet retainer policy is effective as of January 1.

Sooner Farms agrees to sell the package of 10 horses, 1 trailer, and the one-year retainer to J&J for $70,000. J&J Cattle promises payment within 30 days of transfer of ownership. Sooner Farms has a policy that provides a 10 percent discount if payment is made within 15 days of delivery. No customers have ever earned that early payment discount. On January 1, J&J Cattle picks up the 10 horses and the new trailer. On January 20, J&J Cattle pays the invoice.

Follow the steps of ASC 606 as it pertains to this transaction.

1. Is it a contract?
   - + Price is determined, rights established, parties agree, delivery established
   - − Is this buyer going to pay?

2. How many performance obligations?
   1) 10 horses
   2) Trailer
   3) Generic vet service

3. Transaction price = 70,000

4. Allocate transaction price based on relative standalone selling price

Horses 5,000 × 10 =	50,000	50,000/80,000 =	.625 × 70,000 =	43,750
Trailer	25,000	25,000/80,000 =	.3125 × 70,000 =	21,875
Vet	5,000	5,000/80,000 =	.0625 × 70,000 =	4,375
total S.A.S.P.	80,000			70,000

5. Recognize revenue as promises fulfilled

   12/20 — no entry

   1/1 AR   70,000
         Revenue   65,625
         Deferred Rev   4,375

   ÷12

   1/31 Def Rev 365
         Rev   365

   1/20 Cash 70,000
         AR   70,000

Audit Data Analytics

You are auditing a continuing client. One of the client's key controls over revenue is a three-way match for quantity and price between the customer's purchase order, the client's sales invoice, and the client's shipping document. In past years, your firm has tested this control by taking a sample of sales transactions and agreeing both price and quantity across the three documents. This test has always served as a key dual-purpose test over both internal controls and the risk of material misstatement. Instead of taking a sample of these transactions, you decide to leverage your understanding of the client's accounting information system and test the three-way-match for *all* transactions using IDEA.

Follow the steps for performing audit data analytics as detailed in the AICPA's Guide (summarized in the textbook's appendix) and document your planning, completion, and conclusions from this test assuming no notable items were found and using a notable item threshold equal to performance materiality.

1. Plan the ADA

     Purpose? Key dual purpose test of revenue, ICFR

     Assurance? High

     Type? Matching ADA

     Data? All transactions, 3 documents per transaction
            ∨
          sales

     Threshold? Performance materiality

2. Access + Prep the Data

     ETL (Extract, Transform, Load)

3. Establish relevance + reliability of data

     Test controls over: Purchase Order receipt
                         Invoice Processing
                         Shipping

     Tests should be extensive because of the importance of this ADA

4. Perform the ADA

     Use IDEA or tableau to perform 3-way match for quantity and price

5. Evaluate and Conclude

     No notable items found
     Controls are effective
     The risk of material misstatement in revenue appears to be lower than anticipated