

Fizzipop manufactures and distributes soft drinks. Its stock is controlled using a real-time system which provides accurate records of quantities and costs of stock held at any point in time. This system is known within the company as the 'Stockpop' system and it is integrated with the purchases and sales system. Fizzipop has an internal audit department whose activities encompass stock.

No year-end stock count takes place. Stock is held in several large warehouses where non-stop production takes place.

Your firm is the external auditor to Fizzipop and you have been asked to perform the audit of stock. Stock include finished goods and raw materials (water, sugar, sweeteners, carbonating materials, flavourings, cans, bottles, bottle tops, fastenings and packaging materials).

Your firm, which has several offices, wishes to rely on the 'Stockpop' system to provide the basis of the figure to be included in the financial statements for stock. Your firm does not wish to ask the company to conduct a year-end stock count.

Required:

- (a) Describe the audit tests that you would perform on the 'Stockpop' system during the year in order to determine whether to rely on it as a basis for the raw materials and finished goods figures to be included in the financial statements. (11 marks)

NB: You are not required to deal with work in progress.

- (b) Describe the audit tests you would perform on the records held by Fizzipop at the year-end to ensure that raw materials and finished goods are fairly stated in the financial statements. (9 marks)

(20 marks)

(a) Audit tests on 'Stockpop' system during the year

- (i) There are two main aspects to the audit of the Stockpop system: those relating to quantities and those relating to costs. In order to rely on the system as a basis for the figure in the financial statements I would need to ensure that management had a system for ensuring that:
 - the system was accurate and up-to-date;
 - errors were investigated and corrected on a regular basis;
 - each item of stock was counted at least once a year (in practice items are likely to be counted more often than this as such systems are often relied on to produce figures for management accounts).
- (ii) I would ask management about the procedures for stock counting and review the related documentation, including stock counting instructions, and form a view as to whether the system was adequate in principle. I would also review the results of any internal audit work on the system design (assuming that I considered the internal audit function to be adequate).
- (iii) I would need to obtain evidence relating to the three items noted in (i) above. I would therefore visit the warehouses during the year, possibly on a rotational basis, to ensure that the system was being operated in the manner prescribed.
- (iv) I would perform certain preliminary analytical procedures to establish which warehouses to visit (such as those where the records indicated that large volumes of stock were held, warehouses that were experiencing problems or had experienced problems in the past, or warehouses that were considered high risk for other reasons). I might use different offices of my own firm for these purposes, and/or I would enlist the help of internal audit. I would review the results of the work already performed by internal audit.
- (v) I would ask local staff about the procedures performed, especially about any variations from the procedures prescribed. I would observe procedures being performed.
- (vi) I would test check records of goods received and goods despatched and trace them through the Stockpop system to ensure that records were accurate and input on a timely basis. I would ensure that the correct corresponding entries for costs had been made in the purchases and sales systems.
- (vii) I would perform my own test checks of stock and trace my counts through the Stockpop, sales and purchases systems.
- (viii) I would consider using CAATs (computer assisted audit techniques), including test data and audit software to establish whether, for example, the system is rejecting entries outside certain pre-determined parameters (cost per unit for example), and that the system highlights any old stock, or any exceptions such as negative stock quantities.
- (ix) I would review all exception reports produced by the system to see if there were any recurring or old items and to ensure that all errors and exceptions were being dealt with on a timely basis.

(b) Audit tests on records at year-end

- (i) I would analytically review the year-end records to establish the overall quantities and costs of stock and the quantities and costs of raw materials and finished goods.
- (ii) I would ask management about any problems experienced with the system at, or close to, the period-end and about how they had been dealt with to ensure that they had been appropriately resolved.
- (iii) I would also ask management about the likely level of write-down of either raw materials or finished goods (stock being of inadequate quality or spoiled, for example). I would compare this with prior years and form an opinion as to its appropriateness. I would check the calculation of the provision and review exception reports close to the period-end.
- (iv) I would obtain schedules of the costs and quantities to be included in the financial statements and trace these back to the output of the Stockpop system noting and substantiating any significant adjustments.
- (v) I would enquire as to how accurate cut-off had been achieved. I would perform cut-off tests on the records by tracing samples of goods received and despatch notes just before and just after the year-end to the Stockpop, sales and purchases systems in order to ensure that costs had been correctly allocated to the correct accounting period. I would also perform this test in reverse, from the Stockpop, sales and purchases systems through to goods received and despatch notes.
- (vi) I would ensure that the valuation method used by Fizzipop was in accordance with SSAP 9 *Stocks and Long Term Contracts* and that, for example, the system was adequate to ensure that finished goods included an appropriate element of labour and overhead costs.