**Chapter 01 Mini-Case EarthWear Introduction**



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| The purpose of this mini-case is to familiarize you with the EarthWear Mini-case website (and, more specifically, the EarthWear Clothiers Investor and Willis and Adams, CPAs websites, [www.mhhe.com/messier9e](http://highered.mheducation.com/sites/0077862333/information_center_view0/earthwear_annual_report.html)). These sites will be used for mini-cases throughout the semester and will provide hands-on applications for the auditing principles you will be learning. In this case, you will be asked to find several different pieces of information pertaining to EarthWear and its auditor, Willis & Adams, CPAs. |

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| Find the information requested below and record your answers in the space provided as evidence that you've visited the sites. Remember that the purpose of this exercise is to become familiar with these websites, so please take a few minutes to look around. This activity is not meant to be difficult but the more familiar you are with these sites the more time you will save on future assignments. |

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| 1. | Who is the current CEO of EarthWear? |
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| 2. | How much did Accounts Payable change in dollars and percent from 2012 to 2013? |
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| 3. | In which of the last 5 years was EarthWear's Net Income highest, and what was Net Income in that year? |
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| 4. | Does EarthWear use the FIFO or LIFO inventory valuation method? |
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| 5. | What 5 services does Willis & Adams, CPAs provide to clients? Refer to the [Willis & Adams](http://www.mhhe.com/business/accounting/messier9e/willisadams/) website? |
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| 6. | What are the names of the three current staff accountants listed on the Willis & Adams website? |
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| 7. | What is the date of Willis & Adams' most current engagement letter with EarthWear? |
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**PART TWO**

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| In this case you will complete the audit planning memo for the EarthWear engagement. Additional information to help you prepare this memo can be obtained from the [EarthWear](http://www.mhhe.com/business/accounting/messier9e/earthwear/) and [Willis & Adams](http://www.mhhe.com/business/accounting/messier9e/willisadams/) websites. |
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| A planning memo is typically used to summarize the considerations and conclusions involved in several of the audit planning phases you’ve read about in Chapter 3. |

**Chapter 03 Mini-Case Audit Planning Memo Part 1**



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| **1.** | Willis and Adams, CPAs uses the template shown in the "Audit Planning Memorandum" to prepare the planning memo. Some portions have already been completed or begun. These portions are indicated in plain text. Portions highlighted in green will be completed by other auditors; however, brief descriptions of what will be included in these sections of the planning memo are included in the template for instructional purposes. For each of the memo topics that remain to be completed (areas highlighted in yellow), you should address at least two key points about EarthWear Clothiers or the mail order clothing industry. Keep in mind that the points you identify should have important implications for the audit. Address each topic using information from the EarthWear and Willis & Adams websites, the textbook, the work papers provided in this workbook, and prior mini-cases. |

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| **EARTHWEAR CLOTHIERS Audit Planning Memorandum December 31, 2014** |
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| **ENGAGEMENT OBJECTIVES, DELIVERABLES, AND KEY DATES** |
| Picture |
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| **UNDERSTANDING THE BUSINESS** |
| Picture |
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| **BACKGROUND INFORMATION** |
| **· Business Strategy and Target Customers** |
| EarthWear Clothiers generates revenue mainly through the sale of high quality clothing for outdoor sports, such as hiking, skiing, fly-fishing, and white-water kayaking. The company’s product lines also include casual clothes, accessories, shoes, and soft luggage. The company’s key customers are the 18.8 million persons on its mailing list, approximately 6.8 million of whom are viewed as “current customers” because they have purchased from the company in the last 24 months. Market research as of January 2013 indicates that approximately 50 percent of customers are in the 35-54 age group and had a median income of $62,000. Almost two-thirds are in professional or managerial positions. |
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| **·  Suppliers** |
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| Picture |
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| **·  Competition** |
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|  |
| Picture |

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| **·  Social Factors** |
| The company’s results can be affected by changing fashion trends. |
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| **·  Analytical Procedures** |
| \*Days Outstanding in Accounts Receivable is 3.09 and the industry average is 14.10. This ratio indicates that EarthWear collects on sales much more quickly than the rest of the industry. It also represents a significant improvement relative to prior years for EarthWear and is better than expected for this year. This ratio is consistent with a relatively low allowance for doubtful accounts. Controller explains that fast collection rate is a result of increased focus on collection activities and newly implemented incentives for early payment. We will corroborate the client's explanation as a part of our testing in the sales & collection cycle. |

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| **INTERNAL CONTROL ENVIRONMENT** |
| Picture |
|  |
| **AUDIT SCOPE CONSIDERATIONS** |
| Picture |

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| **·  Materiality** |
| Materiality for the 2014 audit is calculated on work paper 3-7. |

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| **COMMUNICATION AND COORDINATION** |
| Picture |
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| **SUMMARY OF AUDIT PLAN** |
| Picture |
|  |
| **AUDIT PLANNING MEMORANDUM APPROVALS** |
| Picture |

PART THREE

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| In this case you will complete the audit planning memo for the EarthWear engagement. Additional information to help you prepare this memo can be obtained from the [EarthWear](http://auth.mhhe.com/business/accounting/messier8e/earthwear/) and [Willis & Adams](http://www.mhhe.com/business/accounting/messier8e/willisadams/) websites. |
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| A planning memo is typically used to summarize the considerations and conclusions involved in several of the audit planning phases you’ve read about in Chapter 3. |

**Chapter 03 Mini-case Planning Memo Cont. Part 2**



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| **2.** | In addition to the analytical procedures already listed in the memo, analyze an additional four that are useful in the planning process for the EarthWear audit. Discuss the meaning of the analytical procedures included and how they may affect your audit plan/procedures. [Work Paper 3-6](http://ezto.mhhmdemo.mcgraw-hill.com/servlet/TestPilot4/laserwords2/13109797020720911.tp4/minicase_commenttable3.jpg) and the Common Size [Balance Sheet](http://lectures.mhhe.com/connect/0078025435/Chapter%2003/MiniCase_Comment%20table1.jpg) and [Income Statement](http://lectures.mhhe.com/connect/0078025435/Chapter%2003/MiniCase_Comment%20table2.jpg) for EarthWear have been provided to assist you.   |  | | --- | | **Analyze 4 additional analytical procedures that were completed in the planning process.** | |  | | **EarthWear's Quick Ratio is 0.95 and the industry average is 0.15** | |  | |  | | Picture | |  | | **EarthWear's Inventory Turnover is 3.88 and the industry average is 6.20** | |  | |  | | Picture | |  | | **EarthWear's Gross Profit Percentage is 43.90% and the industry average is 38.80%** | |  | |  | | Picture | |  | | **EarthWear's Debt to Equity ratio is 0.50 and the industry average is 0.84** | |  | |  | | Picture | |

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**PART FOUR**

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| In this mini-case you will complete the tests of internal controls on accounts payable for the audit of EarthWear Clothiers' 2012 financial statements. A sample size of 78 accounts payable voucher packets has been selected for the test of internal controls on the accounts payable system. The sample size is designed to provide high level of assurance (or confidence) that a control is operating effectively so long as one or fewer control deviations is observed for each control activity tested. The first 74 voucher packets have already been tested by other staff members and no errors have been found. Your task is to review the remaining four voucher packets. |

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| Enter and evaluate the test results by completing all the fields indicated in Work Paper 6-1 and Work Paper 6-2. For any control activities that are not operating effectively, you are asked to briefly describe the implications for the audit plan (i.e. additional substantive testing to obtain evidence related to a particular assertion, etc.). |

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| Review the list of control activities you are to test as indicated on Work Paper 6-1. The numbers to the left of the control activities correspond with the control activity numbers on Work Paper 6-2. To better understand the control activities you are to observe, please read [Exhibit 11-1](http://ezto.mhhmdemo.mcgraw-hill.com/servlet/TestPilot4/laserwords2/13152290535961813.tp4/exhibit11-1.jpg) in the textbook, which provides a description of EarthWear's purchasing system. |

**References**

**eBook & Resources**

**Section Break**Chapter 06 Mini-Case Tests of Controls (Part 1)

[Assessing Control Risk](javascript:doTextflow('http://connect.mheducation.com/connect/hmEBook.do?action=itemLevel&isbn=0077425987&location=id_0077425987_001_009377&tab=reading');)[Performing Tests of Controls](javascript:doTextflow('http://connect.mheducation.com/connect/hmEBook.do?action=itemLevel&isbn=0077425987&location=id_0077425987_001_009393&tab=reading');)



 1.

value:  
**100.00 points**

**Note:** This question will not be automatically graded.  
It will be sent to your instructor for review.

**Required information**

**Chapter 06 Mini case Tests of Controls (Part 2)**



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| Complete the review of the internal control activities for the vouchers below. Record your findings in the fields on Work Paper 6-2 indicated below. The list of control activities that correspond with the control activity numbers on the schedule can be found on Work Paper 6-1 and a narrative description of the controls can be found in [Exhibit 11-1](http://ezto.mhhmdemo.mcgraw-hill.com/servlet/TestPilot4/laserwords2/13152290535961813.tp4/exhibit11-1.jpg) of the textbook. For each control activity indicate whether there is evidence that the control operated effectively by selecting "Effective" or that it did not operate effectively by selecting "Deviation" from the drop down list in each of the cells in the schedule (Work Paper 6-2). **(Leave no cells blank - be certain to enter "0" wherever required.)** |

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| ***You should download the PDF files required to complete this case from the EarthWear Mini-Cases section of the Student Online Learning Center.*** |
| [**http://www.mhhe.com/messier8e**](http://highered.mcgraw-hill.com/sites/0078025435/information_center_view0/earthwear_annual_report.html) |

**Work Paper 6-1**

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|  | **EARTHWEAR CLOTHIERS Controls Testing Evaluation Summary: Accounts Payable December 31, 2012** | | | | | | |
|  | **Test Results and Evaluation** | | | | | | |
|  | **Description of Control Activities** | **Assertion** | **Number of Deviations Observed** | **Maximum Number of Deviations** | **Accept/Reject** | **Describe Any Necessary Revisions to the Audit Plan** |  |
| 1. | Document package includes all documents appropriate for the transaction. | Occurrence | 0 | 1 |  |  |  |
| 2. | The purchase requisition is signed by a supervisor. | Authorization | 2 | 1 |  |  |  |
| 3. | The purchase order is signed by an authorized purchasing agent. | Authorization | 1 | 1 |  |  |  |  |
| 4. | Quantities on vendor's invoice agree with related receiving report and purchase order, and invoice is mathematically correct. | Accuracy | 1 | 1 |  |  |  |  |
| 5. | All documents in voucher package have been stamped "paid". | Occurrence | 0 | 1 |  |  |  |  |
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**Work Paper 6-2**

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| --- | --- | --- | --- | --- | --- |
| **EARTHWEAR CLOTHIERS Controls Testing Deviation Report: Accounts Payable December 31, 2012** | | | | | |
| **Sample Testing Documentation** | | | | | |
|  | **Control Activity** | | | | |
|  |  |  |  |  |  |
| **Document Number** | **1** | **2** | **3** | **4** | **5** |
| 164210 |  |  |  |  |  |
| 185423 |  |  |  |  |  |
| 190214 |  |  |  |  |  |
| 195840 |  |  |  |  |  |
| 74 additional items | Effective | Effective | Effective | Effective | Effective |
|  |  |  |  |  |  |
| Total Number of Exceptions |  |  |  |  |  |
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**PART FIVE**

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| In this mini-case you will statistically evaluate the tests of controls on accounts payable for the 2014 audit of EarthWear Clothiers, Inc. |

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| Use ACL to compute (1) the Sample Size for each control activity and (2) the Upper Deviation Rate for the sample results provided on Work Paper 8-1. Record the results from ACL in the fields on Work Paper 8-1 indicated below. Please refer to Chapter 8 of the textbook for instructions on using ACL. |

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| **EARTHWEAR CLOTHIERS Control Activities Testing - Sampling and Evaluation Sheet: Accounts Payable December 31, 2014** |
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| **Compute Sample Size** |
| The list below indicates the control activities tested using voucher packets in Part A (Part A was a Chapter 6 assignment, but you can complete this assignment even if you did not complete Part A). Use the information provided below to calculate the sample size using ACL. Please refer to Chapter 8 of the textbook for instructions on how to use ACL to calculate sample sizes. When different sample sizes are computed for control activities that will be tested concurrently, it is common to use the largest sample size computed for testing all control activities **(See Chapter 8 for a more detailed description. Note: For the sampling functions to work in ACL a workbook needs to be open. Any workbook will do. For example, you can open the "Metaphor Employee Data" workbook, which is installed with ACL.)** |

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|  | **Work Paper 8-1** |  | |  |  | |  | |  |
|  | Description of Control Activities | Desired Confidence Level | | Population | Tolerable Deviation Rate (%) | | Expected Population Deviation Rate (%) | | Sample Size |
| 1 | Document packet includes all documents appropriate for the transaction. | 90 | % | 2147 | 5 | % | 1 | % |  |
| 2 | The Purchase Requisition is signed by a supervisor. | 90 | % | 2147 | 10 | % | 4 | % |  |
| 3 | The Purchase Order is signed by an authorized purchasing agent. | 90 | % | 2147 | 10 | % | 1 | % |  |
| 4 | Quantities on vendor's invoice agree with related receiving report and purchase order, and invoice is mathematically correct. | 90 | % | 2147 | 5 | % | 1 | % |  |
| 5 | All documents in voucher packet have been stamped "paid". | 90 | % | 2147 | 10 | % | 1 | % |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Sample Size Used | | | | | | | |  |
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| **Compute Upper Deviation Rate** |
| The list below indicates the test of controls results for each control activity. Use the information provided to evaluate the results using ACL. Please refer to Chapter 8 for instructions on using ACL to evaluate test results and to compute the upper deviation rate. After you compute the upper deviation rate, determine whether the test results met the objectives and can be accepted (i.e., determine whether the computed upper deviation rate is below the tolerable deviation rate noted above for the control activity). Select "Accept" or "Reject" from the drop down menu in each cell of the Accept/Reject column. For control activities that you reject, please indicate necessary revisions to the audit plan. **(Round your deviation rate answers to 2 decimal places. Omit the "%" sign in your response.)** |

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| --- | --- | --- | --- | --- | --- | --- | --- |
|  | Description of Control Activities | Desired Confidence Level | | Sample Size | Number of Deviations | Computed Upper Deviation Rate (%) | Accept/ Reject |
| 1 | Document packet includes all documents appropriate for the transaction. | 90 | % |  | 0 | % |  |
| 2 | The Purchase Requisition is signed by a supervisor. | 90 | % |  | 2 | % |  |
| 3 | The Purchase Order is signed by an authorized purchasing agent. | 90 | % |  | 1 | % |  |
| 4 | Quantities on vendor's invoice agree with related receiving report and purchase order, and invoice is mathematically correct. | 90 | % |  | 1 | % |  |
| 5 | All documents in voucher packet have been stamped "paid". | 90 | % |  | 0 | % |  |
|  | | | | | | | |

**References**

**eBook & Resources**