

You are a manager in Foo & Co, responsible for the audit of Grohl Co, a company which produces circuit boards which are sold to manufacturers of electrical equipment such as computers and mobile phones. It is the first time that you have managed this audit client, taking over from the previous audit manager, Bob Halen, last month.

The audit planning for the year ended 30 November 2012 is about to commence, and you have just received an email from Mia Vai, the audit engagement partner.

To: Audit manager
From: Mia Vai, Audit partner, Foo & Co
Subject: Grohl Co – audit planning

Hello

I am meeting with the other audit partners tomorrow to discuss forthcoming audits and related issues. I understand that you recently had a meeting with Mo Satriani, the finance director of Grohl Co. Using the information from your meeting, I would like you to prepare briefing notes for my use in which you:

- (i) Evaluate the business risks faced by Grohl Co; (12 marks)
- (ii) Identify and explain FOUR risks of material misstatement to be considered in planning the audit; (8 marks)

Thank you.

Comments made by Mo Satriani in your meeting

Business overview

Grohl Co's principal business activity remains the production of circuit boards. One of the key materials used in production is copper wiring, all of which is imported. As a cost cutting measure, in April 2012 a contract with a new overseas supplier was signed, and all of the company's copper wiring is now supplied under this contract. Purchases are denominated in a foreign currency, but the company does not use forward exchange contracts in relation to its imports of copper wiring.

Grohl Co has two production facilities, one of which produces goods for the export market, and the other produces goods for the domestic market. About half of its goods are exported, but the export market is suffering due to competition from cheaper producers overseas. Most domestic sales are made under contract with approximately 20 customers.

Recent developments

In early November 2012, production was halted for a week at the production facility which supplies the domestic market. A number of customers had returned goods, claiming faults in the circuit boards supplied. On inspection, it was found that the copper used in the circuit boards was corroded and therefore unsuitable for use.

The corrosion is difficult to spot as it cannot be identified by eye, and relies on electrical testing. All customers were contacted immediately and, where necessary, products recalled and replaced. The corroded copper remaining in inventory has been identified and separated from the rest of the copper.

Work has recently started on a new production line which will ensure that Grohl Co meets new regulatory requirements prohibiting the use of certain chemicals, which come into force in March 2013.

In July 2012, a loan of \$30 million with an interest rate of 4% was negotiated with Grohl Co's bank, the main purpose of the loan being to fund the capital expenditure necessary for the new production line. \$2.5 million of the loan represents an overdraft which was converted into long-term finance.

Other matters

Several of Grohl Co's executive directors and the financial controller left in October 2012, to set up a company specialising in the recycling of old electronic equipment. This new company is not considered to be in competition with Grohl Co's operations. The directors left on good terms, and replacements for the directors have been recruited.

One of Foo & Co's audit managers, Bob Halen, is being interviewed for the role of financial controller at Grohl Co. Bob is a good candidate for the position, as he developed good knowledge of Grohl Co's business when he was managing the audit.

At Grohl Co's most recent board meeting, the audit fee was discussed. The board members expressed concern over the size of the audit fee, given the company's loss for the year. The board members would like to know whether the audit can be performed on a contingent fee basis.

Financial Information provided by Mo Satriani

Extract from draft statement of comprehensive income for the year ended 30 November 2012

	2012 draft	2011 actual
	\$'000	\$'000
revenue	12500	13800
operating costs	(12000)	(12800)
	-----	-----
operating profit	500	1000
finance cost	(800)	(800)
	-----	-----
profit/(loss) before tax	(300)	200
	=====	=====

The draft statement of financial position has not yet been prepared, but Mo states that the total assets of Grohl Co at 30 November 2012 are \$180 million, and cash at bank is \$130,000. Based on draft figures, the company's current ratio is 1.1, and the quick ratio is 0.8.

Required:

Respond to the email from the audit partner