You are an audit supervisor of Cupid & Co, planning the final audit of a new client, Prancer Construction Co, for the year ending 30 September 20X7. The company specialises in property construction and providing ongoing annual maintenance services for properties previously constructed. Forecast profit before tax is $13·8m and total assets are expected to be $22·3m, both of which are higher than for the year ended 30 September 20X6.

You are required to produce the audit strategy document. The audit manager has met with Prancer Construction Co's finance director and has provided you with the following notes, a copy of the August management accounts and the prior year financial statements.

Meeting notes

The prior year financial statements recognise work in progress of $1·8m, which was comprised of property construction in progress as well as ongoing maintenance services for finished properties. The August 20X7 management accounts recognise $2·1m inventory of completed properties compared to a balance of $1·4m in September 20X6. A full year-end inventory count will be undertaken on 30 September at all of the 11 building sites where construction is in progress. There is not sufficient audit team resource to attend all inventory counts.

In line with industry practice, Prancer Construction Co offers its customers a five-year building warranty, which covers any construction defects. Customers are not required to pay any additional fees to obtain the warranty. The finance director anticipates this provision will be lower than last year as the company has improved its building practices and therefore the quality of the finished properties.

Customers who wish to purchase a property are required to place an order and pay a 5% non-refundable deposit prior to the completion of the building. When the building is complete, customers pay a further 92·5%, with the final 2·5% due to be paid six months later. The finance director has informed you that although an allowance for receivables has historically been maintained, it is anticipated that this can be significantly reduced.

Information from management accounts

Prancer Construction Co's prior year financial statements and August 20X7 management accounts contain a material overdraft balance. The finance director has confirmed that there are minimum profit and net assets covenants attached to the overdraft.

A review of the management accounts shows the payables period was 56 days for August 20X7, compared to 87 days for September 20X6. The finance director anticipates that the September 20X7 payables days will be even lower than those in August 20X7.

Required:

(c) Using all the information provided describe SEVEN audit risks, and explain the auditor's response to each risk, in planning the audit of Prancer Construction Co.

Note: Prepare your answer using two columns headed Audit risk and Auditor's response respectively. (14 marks)