

***ELECTIVE (Assurance)***

*Elective examinations are 4 hours in length but are designed so there is minimal time constraint.*

*The examinations are made up of a mix of objective-format and medium- to large-sized, moderately complex cases. The split and length may vary across the Electives to adapt to the learning outcomes required.*

*Elective examinations contain larger and more complex cases than those used for Core 1 and Core 2, requiring a minimum of 60 and a maximum of 120 minutes to complete\*. The assessment of professional skill is in a multi-competency environment, building on prior learnings, but greater than 50% of assessment opportunities will relate to the Elective area being examined.*

*Elective cases require candidates to simulate the “roles” they will play in real life, and, therefore, access is provided to the reference tools they would use, where practical to do so.*

**Fun, Fit and Social Club****Suggested time: (80 minutes)**

It is February 2022, and you are an audit senior at Audit Partners LLP (AP) working on the December 31, 2021, year-end audit for Fun, Fit and Social Club (the Club). This is only AP's second year as the Club's external auditor. The Club is a fitness and social members-only club situated in Muskoka, Ontario, with resources that include a bar and restaurant, squash and tennis courts, a pool, canoe and kayak rentals, boat docking, and a gym. It is a private not-for-profit organization. Each member of the Club has voting rights, and members are generally concerned with how their annual dues are being used.

Jeannie Van der Hooven, the partner on the engagement, has asked for a preliminary discussion about the engagement. Jeannie begins, “The Club has provided us with the internal financial statements for the December 31, 2021, year-end (Appendix I). Prior to our planning meeting with the client next week, I would like you to calculate materiality, including performance materiality. I would also like you to analyze the risk of material misstatement at the financial statement level, including the different components of risk.

“I believe our audit testing can be more efficient. The Club has been working to strengthen internal controls since the previous controller, Monica, was let go in January 2019. While Marty, the new controller, did his best to provide the required details regarding the control environment for last year's audit, details about certain transaction-level controls were lacking. Therefore, our 2020 audit plan was completed with an entirely substantive approach. Please review the

process notes (Appendix II) and suggest which controls to test this year as part of the audit. Since we will be presenting this to the Club at our planning meeting, ensure you explain the financial statement areas and audit risks that will be addressed so the client understands the purpose behind this testing.

“I met with Marty and Clyde, the controller and the general manager of the Club, respectively, prior to beginning the planning for this year. During this meeting, Marty and Clyde informed me that Marty had discovered a prior-period error (Appendix III). The chair of the audit committee, Doug, has been made aware of this error. I would like you to write me a memo summarizing the audit implications for the 2021 audit related to the discovery of this error as well as a discussion of why we did not discover this error as a result of the procedures we perform at year-end. I would also like you to explain the appropriate accounting treatment and financial statement disclosures required to correct this error.”

**APPENDIX I**  
**INTERNAL FINANCIAL STATEMENTS**

*Fun, Fit and Social Club*  
*Statement of Financial Position*  
*As at December 31*

	<b>2021</b>	2020
	<b>(unaudited)</b>	<b>(audited)</b>
<b>Assets</b>		
Cash	\$ 37,600	\$ 48,600
Accounts receivable	858,600	995,900
Inventory	51,500	64,500
Prepaid expenses	32,700	42,600
Initiation fees receivable	55,000	45,500
Tangible capital assets	4,027,300	3,954,500
	<u>\$ 5,062,700</u>	<u>\$ 5,151,600</u>
<b>Liabilities</b>		
Current portion of long-term debt	\$ 55,000	\$ 55,000
Long-term debt	384,700	494,500
Accounts payable and accrued liabilities	107,400	383,000
Unearned fees	1,150,000	1,041,700
	<u>1,697,100</u>	<u>1,974,200</u>
<b>Fund Balances</b>		
Share capital	95,000	95,000
Fund balance	3,270,600	3,082,400
	<u>3,365,600</u>	<u>3,177,400</u>
	<u>\$ 5,062,700</u>	<u>\$ 5,151,600</u>

**APPENDIX I (continued)**  
**INTERNAL FINANCIAL STATEMENTS**

*Fun, Fit and Social Club*  
*Statement of Revenue, Expenditures, and Change in Fund Balances*  
*For the years ended December 31*

	<b>2021</b>	<b>2020</b>
<b>Revenue</b>	<b>(unaudited)</b>	<b>(audited)</b>
Food and beverage	\$ 1,550,300	\$ 1,600,600
Annual fees	1,530,000	1,400,000
Capital contributions	435,000	399,500
Club activities	453,600	436,500
Initiation fees	202,000	218,000
	<u>4,170,900</u>	<u>4,054,600</u>
<b>Expenditures</b>		
Food and beverage operations		
Cost of sales	528,200	516,200
Payroll and benefits	906,200	836,600
Laundry, supplies and other	124,000	125,100
	<u>1,558,400</u>	<u>1,477,900</u>
Administration	755,200	730,400
Building and grounds	639,000	626,000
Club activities	595,600	624,600
Amortization	394,900	384,300
Interest on long-term debt	39,600	44,000
	<u>3,982,700</u>	<u>3,887,200</u>
<b>Excess of revenue over expenditures</b>	<b>\$ 188,200</b>	<b>\$ 167,400</b>
<b>Fund balance, beginning</b>	<b><u>3,082,400</u></b>	<b><u>2,915,000</u></b>
<b>Fund balance, ending</b>	<b><u>\$ 3,270,600</u></b>	<b><u>\$ 3,082,400</u></b>

## **APPENDIX II PROCESS DESCRIPTION**

### **Revenue**

#### Food and Beverage

- At the bar and the restaurant, members provide their member numbers when they order. Members receive bills from their servers and sign them. Servers collect the signed bills and give them to the food and beverage manager.
- At the end of each day, the food and beverage manager ensures all sales recorded correspond to signed bills. The manager follows up with the servers if any bills are incomplete.
- The accounts receivable clerk ensures all bills have appropriate sign-offs and posts them to accounts receivable.
- On a monthly basis, the accounts receivable clerk prints members' statements and mails them i to members. Marty reviews the accounts receivable list every month and checksaging.

#### Initiation Fees

- Initiation fees are one-time funds collected when members sign the membership agreement.
- On a monthly basis, Marty prepares the list of all new members and calculates initiation fees.
- Clyde reviews the list of new members and ensures each new member has signed an agreement.
- An initiation fee is not recorded until the signed membership agreement is on file.

#### Cash Receipts

- All payments are received either by cheque, online bank payment, pre-authorized debit or credit card. Pre-authorized debit and credit cards are charged automatically at the end of each month.
- The receptionist opens the mail and prepares a list of all the cheques received using spreadsheet software.
- The accounts receivable clerk receives the cheques and the list prepared by the receptionist and she stamps each cheque to endorse it to the Club's bank account. She credits each member's account with the payment received.
- Deposits of cheques received are dropped off at the bank by various staff members on a rotating basis. A bank receipt is obtained each time and the totals are compared to the spreadsheet. The spreadsheet is initialed by the staff member who dropped off the deposit.
- Marty prepares bank reconciliations on a monthly basis. Clyde reviews the bank reconciliation and indicates his review by initialling.

**APPENDIX II (continued)**  
**PROCESS DESCRIPTION**

**Purchases/Payments**

- When an invoice arrives for a purchase made, the department manager responsible for that area (food and beverage, equipment, etc.) reviews the invoice, initials approval, and forwards it to the accounts payable clerk for payment.
- The accounts payable clerk issues a cheque for payment. He ensures the invoice matches payment on the cheque before sending the invoice and cheque to Marty for review.
- Marty ensures the department manager has approved the invoice and verifies that the amount on the invoice agrees to the cheque. Marty stamps each invoice as paid once the cheque is signed.
- Cheques under \$1,000 require only Marty's signature. Cheques between \$1,000 and \$5,000 require both Marty's and Clyde's signatures. Cheques greater than \$5,000 must be signed by Clyde and the chair of the board of directors.
- All capital expenditures are approved by the board of directors at meetings held during the year, and all work orders and purchase agreements are approved and signed by Marty and Clyde.

**Financial Reporting**

- The monthly financial statements are prepared by Marty and reviewed by Clyde.
- Marty and Clyde present the financial statements and financial summary to the audit committee each month. The following comparisons are included in the financial summary: month-to-date actual versus budget, year-to-date actual versus budget, and year-to-date actual versus prior-year actual. Review and discussion is recorded in the audit committee's minutes. Once satisfied, the audit committee recommends the board of directors to approve the financial statements.
- The board of directors meets the week following the audit committee. Clyde and Doug present the financial statements and financial summary to the board for approval. Review, discussion, and approval are recorded in the board of directors' meeting minutes.

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### **APPENDIX III PRIOR-PERIOD ERROR**

#### **Error**

In January, Marty was preparing historical data comparisons when he discovered that an adjusting entry related to the 2018 year-end audit had mistakenly never been recorded. Both the external auditors and management agreed that the entry should have been booked, but it must have been missed because Monica, the previous controller, had left around that time. The result of the entry not being booked is that 2018 revenue is overstated by \$125,000 and 2018 unearned fees is understated by \$125,000. After analysis, Marty discovered that, at the end of 2021, unearned fees is still understated by \$125,000 and the fund balance is overstated by \$125,000. Marty has already discussed his discovery of the error with Clyde and Doug.

#### **Additional Information**

During the completion of the 2020 audit, AP did not identify any errors based on the testing performed. In fact, the Club required minimal journal entries and appeared to have a strong financial reporting staff in place. The Club's management was also open to making any adjustments suggested by AP. Materiality in 2020 was \$78,000.