APPENDIX 12B

SUBSTANTIVE PROGRAMS

EXHIBIT 12B–1 AUDIT PROGRAM FOR INVENTORY AND COST OF GOODS SOLD

A. Inventory
1. Conduct an observation of the company's physical inventory count. Count a sample of inventory items and trace these counts to the final inventory compilation.
2. Select a sample of inventory items. Vouch unit prices to vendors' invoices or other cost records. Recalculate the multiplication of unit times price.
3. Scan the inventory compilation for items added from sources other than the physical count and items that appear to be large round numbers or systematic fictitious additions.
4. Recalculate the extensions and footings of the final inventory compilation for clerical accuracy.
5. For selected inventory items and categories, determine the replacement cost and the applicability of lower-of-cost-or-market valuation.
6. Determine whether obsolete or damaged goods should be written down:
   a. Enquire about obsolete, damaged, unsalable, slow-moving items.
   b. Scan the perpetual records for slow-moving items.
   c. During the physical observation, be alert to notice damaged or scrap inventory.
   d. Compare the listing of obsolete, slow-moving, damaged or unsalable inventory from last year's audit to the current inventory compilation.
7. At year-end, obtain the numbers of the last shipping and receiving documents for the year. Use these to scan the sales, inventory/cost of sales and accounts payable entries for proper cutoff.
8. Read bank confirmations, debt agreements and minutes of the board, and make enquiries about pledge or assignment of inventory to secure debt.
9. Enquire about inventory out on consignment and about inventory on hand that is consigned in from vendors.
10. Confirm or inspect inventories held in public warehouses.
11. Recalculate the amount of intercompany profit to be eliminated in consolidation.
12. Obtain written client representations concerning pledge of inventory as collateral, intercompany sales and other related-party transactions.

B. Cost of Sales
1. Select a sample of recorded cost of sales entries and vouch to supporting documentation.
2. Select a sample of basic transaction documents (such as sales invoices, production reports) and determine whether the related cost of goods sold was figured and recorded properly.
3. Determine whether the accounting costing method used by the client (such as FIFO, LIFO, standard cost) was applied properly.
4. Compute the gross margin rate and compare to prior years.
5. Compute the ratio of cost elements (such as labour, material) to total cost of goods sold and compare to prior years.

EXHIBIT 12B–2 AUDIT PROGRAM FOR CAPITAL ASSETS (FIXED AND INTANGIBLE) AND RELATED ACCOUNTS

A. Capital Assets
1. Summarize and recalculate detail fixed and intangible asset subsidiary records and reconcile to general ledger control accounts(s).
2. Select a sample of capital asset subsidiary records:
   a. Perform a physical observation (inspection) of the fixed assets recorded.
   b. Inspect title documents, if any.
   c. Inspect supporting documention, (i.e., invoices, contracts, purchase agreements) or obtain written confirmation of acquisition and ownership.
3. Prepare, or have client prepare, a schedule of fixed asset additions and disposals for the period:
   a. Vouch to documents, indicating proper approval.
   b. Vouch costs to invoices, contracts or other supporting documents.
   c. Determine whether all costs of shipment, installation, testing and the like have been properly capitalized.
   d. Vouch proceeds (on dispositions) to cash receipts or other asset records.
   e. Recalculate gain or loss on dispositions.
   f. Trace amounts to detail fixed asset records and general ledger control account(s).
4. Prepare an analysis of fixed assets subject to investment tax credit for correlation with tax liability audit work.
5. Observe a physical inventory-taking of the fixed assets and compare with detail capital assets records.

6. Obtain written representations from management regarding pledge of assets as security for loans and leased assets.

B. Depreciation/Amortization
1. Analyze amortization expense for overall reasonableness with reference to costs of assets and average depreciation rates.
2. Prepare, or have client prepare, a schedule of accumulated amortization showing beginning balance, current amortization, disposals and ending balance. Trace to amortization expense and asset disposition analyses. Trace amounts to general ledger account(s).
3. Recalculate amortization expense and trace to general ledger account(s).

C. Other Accounts
1. Analyze insurance for adequacy of coverage.
2. Analyze property taxes to determine whether taxes due on assets have been paid or accrued.
3. Recalculate prepaid and/or accrued insurance and tax expenses.
4. Select a sample of rental expense entries. Vouch to rent/lease contracts to determine whether any leases qualify for capitalization.
5. Select a sample of repair and maintenance expense entries and vouch them to supporting invoices for evidence of property that should be capitalized.

EXHIBIT 12B–3 AUDIT PROGRAM FOR ACCOUNTS PAYABLE

1. Obtain a trial balance of recorded accounts payable as of year-end. Recalculate its total and trace the total to the general ledger account. Vouch a sample of balances to vendors' statements. Review the trial balance for related-party payables.
2. When concerned about the possibility of unrecorded payables, send confirmations to creditors, especially those with small or zero balances and those with whom the company has done significant business.
3. Conduct a search for unrecorded liabilities by examining client reconciliations of suppliers statements to accounts payable control account and cash payments made for a period after year-end.
4. Enquire about terms that justify classifying payables as long term instead of current.
5. For estimated liabilities, such as warranties, determine and evaluate the basis of estimation, and recalculate the estimate.
6. Obtain written client representations about related party payables and pledges of assets as collateral for liabilities.

EXHIBIT 12B–4 AUDIT PROGRAM FOR PREPAID, DEFERRED AND ACCRUED EXPENSES

1. Obtain a schedule of all prepaid expenses, deferred costs and accrued expenses.
2. Determine whether each item is properly allocated to the current or future accounting periods.
3. Select significant additions to deferred and accrued amounts, and vouch them to supporting invoices, contracts or calculations.
4. Determine the basis for deferral and accrual, and recalculate the recorded amounts.
5. Study the nature of each item, enquire of management and determine whether the remaining balance will be recovered from future operations.
6. In other audit work on income and expenses, be alert to notice items that should be considered prepaid, deferred or accrued, and allocated to current or future accounting periods.
7. Scan the expense accounts in the trial balance and compare to prior year. Investigate unusual differences that may indicate failure to account for a prepaid or accrual item.
8. Study each item to determine the proper current or noncurrent balance sheet classification.