# Strategic analysis for risk assessment

MODULE 2 | 2.7.1 | STUDENT COMPANION

The auditor must perform three kinds of **risk assessment procedure**: enquiry, analytical procedures, and observation and inspection. **Strategic analysis** organises what they reveal: **SWOT** sorts internal strengths and weaknesses from external opportunities and threats; a **PESTEL** scan checks six outside forces (political, economic, social and technological, plus legal and environmental); and **value chain analysis** follows how the business creates value, showing where each risk enters the accounts.

## The three risk assessment procedures

The auditor also draws on what was learned when accepting or continuing the engagement, on past audits and on the team discussion. Enquiry alone is never enough: it tells you what people believe, or want you to believe.

| Procedure | What it involves | Why it matters |
|---|---|---|
| Enquiry | Management and others inside the entity: sales staff, warehouse managers, in-house lawyers, internal auditors, the people who run IT | Each sees a different part of the business, and people further from the accounts sometimes speak more freely |
| Analytical procedures | Comparing figures and relationships to find anything unexpected (the next lesson) | An unexpected change points to an account that may be misstated |
| Observation and inspection | Touring the factory, watching goods received and dispatched; reading board minutes, plans, budgets, contracts and reports to regulators | Tests what people say against what actually happens and what is written down |

## A SWOT analysis of Voltana

| | Helpful | Harmful |
|---|---|---|
| **Internal** | **Strengths**<br>• A well-known brand<br>• Its own assembly plant<br>• A large network of trained installers | **Weaknesses**<br>• Dependence on imported cells from a few suppliers<br>• A dominant founder<br>• A new system still settling in |
| **External** | **Opportunities**<br>• Rising electricity prices<br>• Government rebates for home batteries<br>• Payments to households that feed power back to the grid | **Threats**<br>• Cheaper imported batteries<br>• Changes to rebate rules<br>• A stronger US dollar<br>• A technology leap that makes current batteries look old |

**For the auditor,** weaknesses and threats are the most useful corners: that is where pressure and misstatement tend to come from

**Reading the SWOT.** Strengths and weaknesses are internal; opportunities and threats come from outside. Voltana's weaknesses (a few overseas cell suppliers, a dominant founder, a system still settling in) raise control

and fraud risk; its threats (cheaper imports, rebate changes, a stronger US dollar, a technology leap) put pressure on margins and on the value of its stock.

## A PESTEL scan of Voltana

| P \| Political | E \| Economic | S \| Social |
|---|---|---|
| Rebate programs can be expanded, tightened or ended<br>**In the accounts:** A tighter rule could cut sales and make amounts due under the scheme harder to collect | Interest rates, inflation and the exchange rate: customers' ability to buy, and Voltana's costs<br>**In the accounts:** A stronger US dollar raises the cost of imported cells and moves the value of currency contracts | Growing interest in energy independence; concern about safety<br>**In the accounts:** A safety scare could cut demand and leave stock harder to sell |
| **T \| Technological** | **E \| Environmental** | **L \| Legal** |
| Rapid improvement in battery chemistry and software<br>**In the accounts:** A technology leap could leave inventory overvalued | Extreme heat and flooding; growing expectations about recycling old batteries<br>**In the accounts:** Heat feeds the warranty provision; flooding threatens stock | Electrical licensing laws, consumer guarantees under Australian consumer law, rebate scheme rules<br>**In the accounts:** Consumer law could make warranty obligations wider than the written warranty |

## Voltana's value chain

**Support activities**

| Procurement | Technology development | Human resources | Firm infrastructure |
|---|---|---|---|
| Purchases concentrated with a few suppliers | Software costs management may want to treat as an asset | Commissions and bonuses | Governance, finance and IT, including the new system |

**Primary activities, in order**

| Inbound logistics → | Operations → | Outbound and installation → | Marketing and sales → | Service |
|---|---|---|---|---|
| Cells and inverters arrive by sea<br>**In the accounts:** Cut-off for stock in transit; currency on amounts owed overseas | Assembly in the factory<br>**In the accounts:** How inventory is costed | Batteries delivered and installed<br>**In the accounts:** The point revenue should be recognised | A commissioned sales force signs contracts<br>**In the accounts:** Pressure to record sales early | Monitoring subscriptions and warranty repairs<br>**In the accounts:** Deferred revenue; the warranty provision |

**A map:** business activity, then account balance, then assertion

**From activity to assertion.** Each primary activity raises its own accounting questions, and the support activities shape the controls and the pressures behind them: concentrated procurement, software costs that might be capitalised, commissions and bonuses, and the new system.

## Why an auditor cares about marketing

Suppose Voltana's marketing team runs a June promotion: free installation for anyone who signs before 30 June. That could pull a wave of signed contracts into June that won't be installed until July or August. If any are recorded as June revenue, that is a cut-off misstatement, and with bonuses tied to annual growth there is an incentive for it to happen. A marketing decision has become an audit risk.

## From strategic risk to audit risk

For each strategic risk, ask how likely it is to cause a material misstatement, and which accounts and assertions it would affect. Not every business risk becomes an audit risk, but every audit risk on the plan should trace back to something real about the business.

| Strategic risk | How it could cause a misstatement | Accounts and assertions |
|---|---|---|
| A move to sell through one national retailer | Credit risk concentrated in a single customer | Valuation of receivables |
| A plan to collect and recycle old batteries | Environmental obligations, which may arise before any recycling starts | Provisions: is there a present obligation yet? Completeness and valuation; disclosure |
| A major distribution partner is lost | Sales fall; amounts the partner owes become harder to collect | Revenue; valuation of receivables |
| A June promotion pulls sales forward | Contracts recorded as revenue before installation | Revenue occurrence and cut-off; receivables |

# Practice questions

MODULE 2 | 2.7.1 | TRY THESE BEFORE THE WORKED ANSWERS

**Moonah Marinas Pty Ltd (imagined)** runs six marinas on the east coast with about 1,800 berths, most with waiting lists. Berth holders pay annual licence fees in advance; visitors pay by the night. Each marina also sells fuel and boating supplies and runs a boat lift, repair yard and dry storage. Two marinas sit on seabed leased from the state government, and those leases require Moonah to remove its structures when they end. Moonah bought two marinas last year with a variable-rate bank loan. In March a storm wrecked pontoons at one marina; the insurance claim is still being assessed, and premiums have risen. A new booking and billing system went live in January. Marina managers earn bonuses on berth occupancy, fuel storage and sewage pump-out need environmental licences, and channels must be dredged regularly.

## Question 1 - A SWOT analysis of Moonah

Prepare a SWOT analysis for Moonah, then name the two items most relevant to the audit.

| | Items for Moonah |
|---|---|
| Strengths | |
| Weaknesses | |
| Opportunities | |
| Threats | |

## Question 2 - A PESTEL scan of Moonah

Complete a PESTEL scan for Moonah, linking each force to an account or assertion.

| Force | What it means for Moonah | Account or assertion affected |
|---|---|---|
| Political | | |
| Economic | | |
| Social | | |
| Technological | | |
| Environmental | | |
| Legal | | |

## Question 3 - Map Moonah's value chain

Map each activity in Moonah's value chain to the financial statements.

| Activity | What happens at Moonah | Where it lands in the accounts |
|---|---|---|
| Inbound logistics | | |
| Operations | | |
| Outbound logistics | | |
| Marketing and sales | | |
| Service | | |
| Procurement | | |
| Technology development | | |
| Human resources | | |
| Firm infrastructure | | |

# Worked answers

MODULE 2 | 2.7.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

## Question 1 - SWOT (suggested)

| | Items for Moonah |
|---|---|
| Strengths | Hard-to-copy waterfront sites; waiting lists; fees paid in advance; varied income |
| Weaknesses | Debt-funded acquisitions; storm-exposed pontoons; a new system bedding in; reliance on state leases |
| Opportunities | Higher prices or more berths for the waiting lists; dry storage; electric boat charging |
| Threats | Storms and rising seas; interest rates; insurance premiums; tougher environmental rules |
| Most relevant to the audit | **1. The storm:** impairment of damaged pontoons, repairs versus improvements, and no insurance recovery until virtually certain. **2. Fees in advance through a new system, with occupancy bonuses:** deferred revenue, occurrence and cut-off, billing controls |

## Question 2 - PESTEL (suggested)

| Force | What it means for Moonah | Account or assertion |
|---|---|---|
| Political | State control of seabed leases, rents and renewals | Lease balances; removal provisions; marina values |
| Economic | Interest rates; boat owners' spending; fuel prices | Interest and loan conditions; revenue; fuel stock |
| Social | Growing interest in recreational boating | Revenue; berth fees paid in advance |
| Technological | New booking system; electric boats needing chargers | Billing completeness; capital spending |
| Environmental | Storms, rising seas, dredging, fuel spills | Pontoon impairment; remediation provisions |
| Legal | Environmental licences; lease removal clauses; safety | Non-compliance; provisions; contingent liabilities |

## Question 3 - Value chain (suggested)

| Activity | What happens at Moonah | Where it lands in the accounts |
|---|---|---|
| Inbound logistics | Fuel and supplies for resale | Inventory existence and value; fuel cut-off |
| Operations | Berths, boat lift, repairs, dry storage | Accuracy of fees; repairs in progress |
| Outbound logistics | Fuel at the dock; boats returned | Revenue cut-off; cash handling |
| Marketing and sales | Annual licences sold in advance | Deferred revenue; occurrence |
| Service | Pump-out, security, disputes | Refunds; claims and provisions |
| Procurement | One fuel supplier; dredging contractors | Commitments; capitalising repairs |
| Technology development | New booking and billing system | Capitalised software; billing controls |
| Human resources | Occupancy bonuses; seasonal staff | Bonus accruals; pressure on occupancy |
| Firm infrastructure | Acquisitions, loan, state leases | Asset values; loan conditions; removal provisions |