

**UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER**

DEGREE/YEAR OF STUDY : B COM IV

TITLE OF PAPER : AUDITING

COURSE CODE : AC 404

TIME ALLOWED : THREE (3) HOURS

INSTRUCTIONS

- 1. TOTAL NUMBER OF QUESTIONS ON THIS PAPER: FOUR (4)**
- 2. ANSWER ALL QUESTIONS**
- 3. WHERE APPLICABLE ALL WORKINGS SHOULD BE SHOWN**
- 4. ALL CALCULATIONS ARE TO BE MADE TO THE NEAREST LILANGENI.**

NOTE: YOU ARE REMINDED THAT IN ASSESSING YOUR WORK, ACCOUNT WILL BE TAKEN OF ACCURACY OF THE LANGUAGE AND THE GENERAL QUALITY OF EXPRESSION, TOGETHER WITH THE LAYOUT AND PRESENTATION OF YOUR FINAL ANSWER.

SPECIAL REQUIREMENT: NONE

THIS PAPER IS NOT TO BE OPENED UNTILL PERMISSION HAS BEEN GRANTED BY THE INVIGILATER.

QUESTION 1

- (a) Explain the situations where an auditor may disclose confidential information about a client. (8 marks)

- (b) You are an audit manager in Sizwe & Associates, a firm of Chartered Accountants. You are preparing the engagement letter for the Audit of Robins, a public limited liability company, for the year ending 31 December 2006. Robins has grown rapidly over the past few years, and is now one of your firm's most important clients.

Robins has been an audit client for eight years and Sizwe & Associates has provided audit, taxation and management consultancy advice during this time. The client has been satisfied with the services provided, although the taxation fee for the period to 30 June 2006 remains unpaid.

Audit personnel available for this year's audit are most of the staff from last year, including Mr Mdluli, an audit partner and Mr Gwebu, an audit senior. Mr Mdluli has been the audit partner since Robins became an audit client. You are aware that Mary Mdluli, the daughter of Mr Mdluli, has recently been appointed the financial director at Robins.

To celebrate her new appointment, Mary has suggested taking all of the audit staff out to an expensive restaurant prior to the start of the audit work for this year.

Required:

Identify and explain the risks to independence arising in carrying out your audit of Robins for the year ending 31 December 2006, and suggest ways of mitigating each of the risks you identify. (12 marks)

- (c) The responsibilities of external auditors are not always well understood, especially with regard to detection and reporting of fraud. When external auditors provide non-audit services to their audit clients, it is essential that the auditors make a clear distinction between their audit and non-audit responsibilities.

Required:

Explain the limitations of the external audit in relation to the detection and reporting of fraud. (5 marks)

(25 marks)

QUESTION 2

You are the audit manager in the firm of Becks & Co, an audit firm with ten national offices.

One of your clients, Diamonds Forever, purchases diamond jewellery from three manufacturers. The jewellery is then sold from Diamonds Forever's four shops. This is the only client your firm has in the diamond industry.

You are planning to attend the physical inventory count for Diamonds Forever. Inventory is the largest account on the balance sheet with each of the four shops holding material amounts. Due to the high value of the inventory, all shops will be visited and test counts performed.

With the permission of the directors of Diamonds Forever, you have employed Sizeze, a firm of specialist diamond valuers who will also be in attendance. Sizeze will verify that the jewellery is, in fact, made from diamonds and that the jewellery is saleable with respect to current trends in fashion. Sizeze will also suggest, on a sample basis, the value of specific items of jewellery.

Counting will be carried out by shop staff in teams of two using pre-numbered count sheets.

Required:

- (a) List and explain the reason for the audit procedures used in obtaining evidence in relation to the inventory count of inventory held in the shops.**
(8 marks)
- (b) Explain the factors you should consider when placing reliance on the work of Sizeze.**
(4 marks)
- (c) Describe the audit procedures you should perform to ensure that jewellery inventory is valued correctly.**
(4 marks)

ISA 500 – *Audit evidence* requires that “The Auditor should obtain sufficient appropriate evidence to be able to draw reasonable conclusions on which to base their opinion” The explanatory material contained in within ISA 500 identifies five procedures for obtaining audit evidence. ISA 500 also offers guidance as to assessing the reliability of audit evidence.

Required:

- (i) **Identify and describe the procedures for obtaining audit evidence**
(4 marks)
- (ii) **For each of the procedures, describe an audit test using that procedure to obtain evidence as to the balance of plant and equipment including the related balances of accumulated depreciation and charges to income.**
(5 marks)

(25 marks)

QUESTION 3

- (a) Internal control systems are designed, amongst other things, to prevent error and misappropriation.

Required:

Describe the errors and misappropriations that may occur if the following are not properly controlled:

- (i) receipts paid into bank accounts; (2 marks)
- (ii) payments made out of bank accounts; (3 marks)
- (iii) interest and charges debited and credited to bank accounts. (2 marks)

- (b) A book-selling company has a head office and 25 shops, each of which holds cash (banknotes, coins and credit card vouchers) at the balance sheet date. There are no receivables. Accounting records are held at shops. Shops made returns to head office and head office holds its own accounting records. Your firm has been the external auditor to the company for many years and has offices near to the location of some but not all of the shops.

Required:

List the audit objectives for the audit of cash and state how you would gain the audit evidence in relation to those objectives at the year-end.

- (c) The external auditors of companies often write to companies' bankers asking for details of bank balances and other matters at the year-end. (8 marks)

Required:

Explain why auditors write to companies' bankers and list the matters you would expect banks to confirm. (5 marks)

- (d) Internal and external auditors may review the internal control systems. Explain the reason for their review, distinguish between them. (5 marks)

(25 marks)

QUESTION 4

- (a) Analytical procedures are an important and powerful tool for auditors in explaining the performance of business. They are used at the planning, testing and review stages of the audit.

Required:

Preliminary analytical procedures are often performed on accounting ratios. Explain the possible reasons for the following changes found at the planning stage of the audit:

- (i) an increase in the current ratio;
- (ii) a decrease in the gross profit margin;
- (iii) an increase in the inventory holding period;
- (iv) an increase in dividend cover;
- (v) an increase in capital gearing (leverage) (10 marks)

NB: No marks will be awarded for showing the calculation of the ratio, all parts carry equal marks.

- (b) The concept of materiality is fundamental to the work of auditors. Matters that are immaterial are not reported in financial statements.

Required:

- (i) explain the concept of materiality; (3 marks)
- (ii) describe how materiality affects the audit work performed by auditors, (3 marks)
- (iii) give an example of *qualitative* materiality. (2 marks)

- (c) Towards the end of an audit, it is common for the external auditor to seek a letter of representation (written representations) from the management of the client company.

Required:

- (i) **Explain why auditors seek letters of representation.** (4 marks)
- (ii) **List the matters commonly included in the letter of representation.** (3 marks)

(25 marks)

End of Question Paper