

**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) Your firm has been approached by the managing director of Abacus Leasing, a limited liability company, to tender for the audit. The previous auditors have resigned after a loss of confidence in them by the board of Abacus Leasing. This concerned the disapproval by the board of a qualified audit report issued by the outgoing auditors which referred to inadequate internal controls in Abacus Leasing's systems.

The company leases equipment to building contractors, many of whom have insufficient cash resources to purchase the equipment outright. Some lessees have been refused credit elsewhere. Since formation three years ago, Abacus Leasing's turnover has doubled each year and lease receivables now represent over 80% of the company's gross assets. The company is now experiencing difficulty in collecting a substantial amount of overdue lease payments. Abacus Leasing has no formal system for approval of new customers or any laid down procedures for the repossession of assets where the terms of the lease agreements have been broken.

The company is managed by a board of three directors with a dominant managing director who owns 95% of the share capital. The directors and senior management are largely remunerated by 'performance bonus' based on new sales. The company does not have an audit committee.

Required:

- (i) Describe the procedures an audit firm should undertake before accepting a potentially high risk audit such as that of Abacus Leasing. **(5 marks)**
- (ii) Describe the factors in relation to the audit of Abacus Leasing that would affect your assessment of the inherent risk. **(7 marks)**
- (iii) Describe the procedures you will carry out to control the audit including reviewing the work of audit staff. **(8 marks)**
- (b) Describe the reasons why auditors use working papers to record their work and consider whether it is necessary for auditors to record all their audit work. **(5 marks)**

(Total 25 marks)

QUESTION 2

- (a) The new audit trainee of your firm of registered auditors has asked you to advise him on the reliability of the following types of third party evidence.
- Valuation of land and buildings by a valuer.
 - The replies to a receivables' circularisation.
 - The letter received from the bank.

Required:

- (i) Discuss the reliability of each of the three types of third party evidence listed above, and consider the accuracy of the valuations they provide. *(9 marks)*
- (ii) For valuations provided by a valuer, describe the work you would carry out to check the independence, qualifications and experience of the valuer and the accuracy of the valuation. *(5 marks)*
- (iii) Define the control environment, discuss the factors that auditors take into account when assessing the control environment, and describe how the auditors' assessment of control environment affects their assessment of control risk. *(6 marks)*
- (b) Describe the matters you should consider at the planning stage to assess the effectiveness of the internal audit department. *(5 marks)*

(Total 25 marks)

QUESTION 3

(i) While you were having lunch with an Accountant friend, you become involved in a discussion on auditing accounts receivable. Your friend comments that, "In many audits in which accounts receivable is material, the requirement of confirming customer balances is a waste of time and would not be performed by competent auditors if it were not recommended by the Institute of Chartered Accountants. When internal controls are excellent and there are a large number of small accounts receivables from customers who do not recognise the function of confirmation, it is a meaningless procedure. In these situations tests of controls are far more effective than confirmations."

(a) Explain the audit procedure for confirming small amounts of accounts receivable. Evaluate the procedures taking into account your friends' comment above.

(5marks)

(b) State how an auditor controls confirmations

(5marks)

(c) List five areas the auditor must pay particular attention to.

(5marks)

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

Required:

(a) Explain why auditors write to companies' bankers, and provide a list of the audit procedures for bank confirmations

(6 marks)

(b) What are the matters you would expect banks to confirm?

(4 marks)

(Total 25 marks)

QUESTION 4

- (i) Identify and explain the three alternative opinions that may be appropriate when the client's financial statements are not in accordance with Generally Accepted Accounting Principles. Under what circumstance is each appropriate. *(15marks)*
- (ii) The following two paragraphs were taken from the First Bank audit report, an international bank with its head office in Swaziland. The report has been modified for changes in current reporting standards.

Independent Auditor's report

'We have audited the accompanying consolidated balance sheets for First Bank and subsidiaries as of December 31 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

As explained in the notes to the financial statements, the Bank has charged goodwill and certain other intangible assets acquired in two separate acquisitions directly to shareholders equity. Under generally accepted accounting principles, these intangibles should have been recorded as assets and amortised to income over future periods.

Required

- (a) Which condition requiring a departure from an unqualified opinion exists for the portion of the foregoing report? *(5marks)*
- (b) What audit opinion should be written for the audit report and why? *(5marks)*

(Total 25 marks)

End of Question Paper