

**COURSE CODE: AC 404/IDE AC404 (M) 2009**

**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) Apple provides scientific services to a wide range of clients. Typical assignments range from testing food for illegal additives to providing forensic analysis on items used to commit crimes to assist law enforcement officers.

The annual audit is nearly complete. As audit senior you have reported to the engagement partner that Apple is having some financial difficulties. Income has fallen due to the adverse effects of two high-profile cases, where Apple's services to assist the prosecution were found to be in error. Not only did this provide adverse publicity for Apple, but a number of clients withdrew their contracts. A senior employee then left Apple, stating lack of investment in new analysis machines was increasing the risk of incorrect information being provided by the company.

A cash flow forecast prepared internally shows Apple requiring significant additional cash within the next 12 months to maintain even the current level of services. Apple's auditors have been asked to provide negative assurance report on this forecast.

**Required:**

- (i) Define 'going concern' and discuss the auditor's responsibilities in respect of going concern. (4 marks)
- (ii) State the audit procedures that may be carried out to try to determine whether or not Apple is a going concern. (8 marks)
- (iii) Explain the audit procedures the auditor may take where the auditor has decided that Apple is unlikely to be a going concern. (4 marks)
- (b) Zee (Pty) Ltd has a significant number of cash transactions and recent non-current asset purchases have been financed by a bank loan. This loan is repayable in equal annual repayments for the next five years.

**Required:**

- (i) Explain the procedures to obtain a bank report for audit purposes for Zee (Pty) Ltd's bank and substantive procedures that should be carried out on the report. (5 marks)
- (ii) List the further substantive procedures that should be carried out on the bank balances in Zee (Pty) Ltd's financial statements. (4 marks)
- (25 marks)

**QUESTION 2**

Palm Co assembles fridges, microwaves, washing machines and other similar domestic appliances from part procured from a large number of suppliers. As part of the interim audit work two weeks prior to the company year-end you testing the procurement and purchases system and attending the inventory count.

*Procurement and purchases system*

Parts inventory is monitored by the stress manager. When the quantity of a particular part falls below re-order levels, an e-mal is sent to the procurement department detailing the part required and the quantity to order. A copy of the e-mail is filed in the store manager's computer.

Staff in the procurement department checks the e-mail; allocate the order to authorized supplier using Electronic Data Interchange (EDI). A copy of the EDI order is filed in the order database by the computer system. The order is identified by a unique order number.

When goods are received at Palm, the stores clerk confirms that the inventory agrees to the delivery note and checks the order database to ensure that the inventory were in fact ordered by Palm. (Delivery is refused where goods do not have a deliver note).

The order in the order database is updated to confirm the receipt of goods, and the perpetual inventory system is updated to show the receipt of inventory. The physical goods are added to the parts store and the paper delivery note is stamped with the order number and is filed in the goods inwards department.

The supplier sends a purchase invoice to Palm using EDI; invoices are automatically routed to the accounts department. On receipt of the invoice, the accounts clerk checks the order database, matches the invoices details with the database and updates the dataset to confirm the receipt of the invoice. The invoice is added to the purchases database, where the purchase daybook (PDB) and suppliers' individual account in the payables ledger are automatically updated.

**Required:**

- (a) **List five audit procedures that an auditor would normally carry out on the purchases system at Palm Co, explaining the reason for each procedure.**  
(10 marks)
- (b) **List four audit procedures that an auditor will normally perform prior to attending the client's premises on the day of the inventory count.**  
(3 marks)

- (c) On the day of the inventory count, you attended depot nine at Palm. You observed the following activities:
1. Pre-numbered count sheets were being issued to the client's staff carrying out the count. The count sheets show the inventory ledger balances for checking against physical inventory.
  2. All count staff were drawn from the inventory warehouse and were counting in teams of two.
  3. Three counting teams were allocated to each area of the stores to count, although the teams were allowed to decide which pair of staff counted which inventory with each area. Staff was warned that they had to remember which inventory had been counted.
  4. Information was recorded on the count sheets in pencil so that amendments could be made easily when required.
  5. Any inventory not located on the pre-numbered inventory sheets was recorded on separate inventory sheets- which were numbered by staff as they were used.
  6. At the end of the count all count sheets were collected and the numerical sequence of the sheets checked; the sheets were not signed.

**Required:**

- (i) List the weaknesses in the control system for counting inventory at depot nine. (3 marks)
- (ii) For each weakness, explain why it is a weakness and explain how the weakness can be overcome. (9 marks)

**(25 marks)**

**QUESTION 3**

You are a manager in the Audit firm of Simelane & Company; and this is your first time you have worked on one of the firms established clients, Ladybird (Pty) Ltd. The main activity of Ladybird (Pty) Ltd is providing investment advice to individuals regarding saving for retirement, purchase of shares and securities and in investing in tax efficient savings schemes. Stark is regulated by the relevant financial services authority.

You have been asked to start the audit planning for Ladybird (Pty) Ltd, by Mr Maziya, a partner in Simelane & Company. Mr Maziya has been the engagement partner for the Ladybird (Pty) Ltd, for the previous nine years and so has excellent knowledge of the client, Mr Maziya has informed you that he would like his daughter Temacanco to part of the audit team his year; Temacanco is currently studying B.Com on a part-time basis. Mr Maziya also informs you that Mr Zwane, the audit senior, received an investment advice from Stark Co during the year and intends to do the same next year.

In an initial meeting with the finance director of Ladybird (Pty) Ltd, you learn that the audit team you learn that the audit team will not be entertained on Ladybird (Pty) Ltd's yacht this year as this could appear to be an attempt to influence the opinion of the audit. Instead he has arranged a balloon flight costing less than one-tenth of the expense of using the yacht and hopes this will be acceptable. The director also states that the fee for taxation services this year should be based on a percentage of tax saved and trust that your firm will accept a fixed fee for representing Ladybird (Pty) Ltd in dispute regarding the amount of sales tax payable to the taxation authorities.

**Required:**

- (a) (i) Explain the ethical threats which may affect the audit of Ladybird (Pty) Ltd. (6 marks)
- (ii) For each ethical threat, discuss how the effect of the threat can be mitigated. (6 marks)
- (b) Discuss the benefits of Ladybird (Pty) Ltd establishing an internal audit department. (9 marks)

(NB: The following question is not related to the case above.

- (c) List and explain four factors that will influence the auditors' judgement regarding the sufficiency of the evidence obtained. (4 marks)

**(25 marks)**

**QUESTION 4**

The date is 3 December 2008. The audit of Jacaranda (Pty) Ltd is nearly complete and the financial statements and the audit report are due to be signed next week. However, the following additional information on two material events has just been presented to the auditor. The company's year-end was 30 September 2008.

***Event 1: Occurred on 10 October 2008***

The springs in a new type of mattress have been found to be defective making the mattress unsafe to use. There have been no sales of this mattress; it was due to be marketed in the next few weeks. The company's insurers estimate that inventory to the value of E750 000 as been affected. The insurers also estimate that mattresses are now only worth E225 000. No claim can be made against the supplier of springs as this company is in liquidation with no prospects of any amounts being paid to third parties. The insurer will not pay Jacaranda (Pty) Ltd for the fall in value of the inventory as the company was under-insured. This entire inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end.

***Event 2. – Occurred 5 November 2008***

Production at the Gobi factory was halted for one day when a truck carrying dye used in colouring the fabrics on mattresses reversed into a metal pylon, puncturing the vehicle allowing dye to spread across the factory premises and into a local river. The Environmental Authority is currently considering whether the release of the dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.

**Required:**

- (a) For each of the two events above:**
  - (i) Explain whether the events are Adjusting Events or Non-Adjusting Events according to IAS 10 - *Events after the reporting period*. (4 marks)**
  - (ii) Explain the auditors' responsibility and the audit procedures and actions that should be carried out according to ISA560 (Redrafted) *Subsequent Events*. (11 marks)**

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- (b) ISA 620 – Using the Work of an Expert explains how an auditor may use an expert to obtain audit evidence.

**Required:**

**Explain three factors that the external auditor should consider when assessing the competence and objectivity of the expert. (3marks)**

- (c) Auditors have various duties to perform in their role as auditors, for example, to assess the truth and fairness of the financial statements.

**Required:**

**Explain three rights that enable auditors to carryout their duties. (3 marks)**

- (d) **List four assertions relevant to the audit of tangible non-current assets and state one audit procedure which provides appropriate evidence for each assertion. (4 marks)**

**(25 marks)**

**End of Question Paper**