

UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING AND FINANCE
MAIN EXAMINATION QUESTION PAPER

MAY 2011

ACADEMIC YEAR 2010/2011

DEGREE/YEAR OF STUDY : **B COM IV (Full Time)
Level 6 (IDE – Part Time)**

TITLE OF PAPER : **AUDITING**

COURSE CODE : **AC 404**

TIME ALLOWED : **THREE (3) HOURS**

TOTAL MARKS : **100**

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: CALCULATOR

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR/SUPERVISOR.

QUESTION 1

- (a) (i) Define a 'test of control' and a 'substantive procedure' **(4 marks)**
- (ii) State one test of control and one substantive procedure in relation to sales invoicing. **(3 marks)**
- (b) Super Clean is a window cleaning company. Customers' windows are cleaned monthly, the window cleaner then posts a stamped addressed envelope for payment through the customer's front door. SHW has a large number of receivable balances and these customers pay by cheque or cash, which is received in the stamped addressed envelopes in the post.

The following procedures are applied to the cash received cycle:

1. A junior clerk from the accounts department opens the post and if any cheques or cash have been sent, she records the receipts in the cash received log and then places all the monies into the locked small cash box.
2. The contents of the cash box are counted each day and every few days these sums are banked by which ever member of the finance team is available.
3. The cashier records the details of the cash received log into the cash receipts day book and also updates the sales ledger.
4. Usually on a monthly basis the cashier performs a bank reconciliation, which he then files, if he misses a month then he catches this up in the following month's reconciliation.

Required:

For the cash cycle of Super Clean:

- (i) Identify and explain three deficiencies in the system. **(3 marks)**
- (ii) Suggest controls to address each of these deficiencies. **(3 marks)**
- (iii) List five tests of controls the auditor of Super Clean would perform to assess if the controls are operating effectively. **(5 marks)**
- (c) Describe seven substantive procedures an auditor would perform in verifying a company's bank balance. **(7 marks)**

(Question 1 Total : 25 marks)

QUESTION 2

- (a) You are the audit manager of Vusi & Co and you are planning the audit of Mango Fones Co, which has been an audit client for four years and specialises in

manufacturing luxury mobile phones. During the planning stage of the audit you have obtained the following information:

- The employees of Mango Fones Co are entitled to purchase mobile phones at a discount of 10%. The audit team has in previous years been offered the same level of staff discount.
- During the year the financial controller of Mango Fones was ill and hence unable to work. The company had no spare staff able to fulfil the role and hence a qualified audit senior of Vusi & Co was seconded to the client for three months. The audit partner has recommended that the audit senior work on the audit as he has good knowledge of the client.
- The fee income derived from Mango Fones was boosted by this engagement and along with the audit and tax fee, now accounts for 16% of the firm's total fees.
- From a review of the correspondence files you note that the partner and the finance director have known each other socially for many years and in fact went on holiday together last summer with their families.
- As a result of this friendship the partner has not yet spoken to the client about the fee for last year's audit, 20% of which is still outstanding.

Required:

- (i) Explain the ethical threats which may affect the independence of Vusi & Co's audit of Mango Fones Co. **(6 marks)**
 - (ii) For each threat explain how it might be avoided. **(6 marks)**
- (b) Describe the steps an audit firm should perform prior to accepting a new audit engagement. **(6 marks)**
 - (c) ISA 320 Materiality in Planning and Performing an Audit provides guidance on the concept of materiality in planning and performing an audit.

Required:

Define materiality and determine how the level of materiality is assessed.

(7 marks)

(Question 2 Total : 25 marks)

QUESTION 3

- (a) ISA 500 Audit Evidence requires audit evidence to be reliable.

Required:

List four factors that influence the reliability of audit evidence.

(4 marks)

(b) ISA 260 (Revised and Redrafted) Communication with Those Charged with Governance deals with the auditor’s responsibility to communicate with those charged with governance in relation to an audit of financial statements.

Required:

- (i) Describe four specific responsibilities of those charged with governance. **(2 marks)**
- (ii) Explain four examples of matters that might be communicated to them by the auditor. **(4 marks)**

(c) List and explain four methods of selecting a sample of items to test from a population in accordance with ISA 530 (Redrafted) Audit Sampling and Other Means of Testing. **(4 marks)**

(d) List and explain four assertions from ISA 500 Audit Evidence that relate to the recording of classes of transactions. **(4 marks)**

(e) In terms of audit reports, explain the term ‘modified’. **(3 marks)**

(f) List four ways of collecting evidence and give an example for each. **(4 marks)**
(Question 3 Total : 25 marks)

QUESTION 4

(a) Define the going concern assumption. **(3 marks)**

Medimade Co is an established pharmaceutical company that has for many years generated 90% of its revenue through the sale of two specific cold and flu remedies. Medimade has lately seen a real growth in the level of competition that it faces in its market and demand for its products has significantly declined. To make matters worse, in the past the company has not invested sufficiently in new product development and so has been trying to remedy this by recruiting suitably trained scientific staff, but this has proved more difficult than anticipated.

In addition to recruiting staff the company also needed to invest E2 million in plant and machinery. The company wanted to borrow this sum but was unable to agree suitable terms with the bank; therefore it used its overdraft facility, which carried a higher interest rate. Consequently, some of Medimade’s suppliers have been paid much later than usual and hence some of them have withdrawn credit terms meaning the company must pay cash on delivery. As a result of the above the company’s overdraft balance has grown substantially.

The directors have produced a cash flow forecast and this shows a significantly worsening position over the coming 12 months.

The directors have informed you that the bank overdraft facility is due for renewal next month, but they are confident that it will be renewed. They also strongly believe that the new products which are being developed will be ready to market soon and hence trading levels will improve and therefore that the company is a going concern. Therefore they do not intend to make any disclosures in the accounts regarding going concern.

Required:

(b) Identify any six potential indicators that the company is not a going concern and describe why these could impact upon the ability of the company to continue trading on a going concern basis. **(9 marks)**

(c) Explain seven audit procedures that the auditor of Medimade should perform in assessing whether or not the company is a going concern. **(7 marks)**

(d) The auditors have been informed that Medimade's bankers will not make a decision on the overdraft facility until after the audit report is completed. The directors have now agreed to include going concern disclosures.

Required:

Describe the impact on the audit report of Medimade if the auditor believes the company is a going concern but a material uncertainty exists. **(6 marks)**

(Question 4 Total : 25 marks)

END OF QUESTION PAPER