

UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

SUPPLEMENTARY EXAMINATION QUESTION PAPER

JULY 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 UNTILL PERMISSION HAS BEEN GRANTED BY THE INVIGILATER.

QUESTION 1

There are similarities and differences between the responsibilities of internal and external auditors. Both internal external auditors have responsibilities relating to the prevention, detection and reporting of fraud, for example, but their responsibilities are not the same. Both internal and external audit are part of an organisation's overall corporate governance arrangements. Sometimes, the responsibilities of internal auditors are out-sourced to external organisations.

Required:

(a) Explain the difference between the responsibilities of internal auditors and external auditors for the prevention, detection and reporting of fraud and error. **(6 marks)**

(b) Explain the role of internal audit in the context of;

(i) corporate governance.

(ii) risk management.

(iii) organisational control. **(12 marks)**

Your answer should include one example of how an internal audit department in a manufacturing company might fulfil its role under each of the headings above.

(c) Outline the issues that should be considered when an organisation decides to out-source the internal audit function. **(7marks)**

(Question 1 Total : 25 marks)

QUESTION 2

ISA 505 External Confirmations deals with a number of different types of external confirmation. External confirmation is a useful method of obtaining audit evidence in relation to accounts receivable.

Required.

(a) In relation to external confirmation of accounts receivable.

(i) explain the difference between a positive and a negative confirmation. **(2 marks)**

(ii) explain the two different types of positive confirmation and the advantages and disadvantages of each. **(4 marks)**

(iii) list the reconciling items highlighted by external confirmation of accounts receivable. **(1 mark)**

- (b) Describe the principal risks associated with financial statement assertions relating to receivables. **(3 marks)**
- (c) Goodfoot is a small company which manufactures high quality shoes and sells them to small retailers. This is your first year as auditor. Goodfoot has a receivables ledger with approximately 750 accounts. A number of the receivables accounts are old, some have nil or credit balances and some should probably be written off. The company's client base is mixed. Bad debts have generally represented about 2% of the total receivables figure and a general provision of 1.5% has been made in the past in addition to any specific provisions. Most of the bad debts relate to smaller customers but there are some very slow moving larger accounts in the current year. The total value of receivables is E750,000, 60% of which comprises some thirty large accounts, and 40% of which comprises large number of small accounts.

You have tested the system of internal controls over receivables and it appears to be working adequately. In your experience external confirmation of receivables in this sector generally have a response rate of just over 50%.

Required:

Describe the audit work you will perform on accounts receivable and bad debts at Goodfoot. **(10 marks)**

Note: You are not required to perform numerical calculations in this question.

- (d) For many companies investments in shares represent a substantial portion of total assets, for others investments are only temporary assets, or merely reflect incidental aspects of company operations. For the auditors, investments in shares can represent assets with high inherent risk.

Required:

Describe the audit procedures which would verify the existence and rights and obligations of investment in shares. **(5 marks)**

(Question 2 Total : 25 marks)

QUESTION 3

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:

- (a) Explain why auditors seek letters of representation. **(5 marks)**

- (b) List the matters commonly included in the letter of representation. (6 marks)
- (c) Explain why it is important to discuss the content of the letter of representation at an early stage during the audit. (3 marks)
- (d) Explain why management is sometimes unwilling to sign a letter of representation and describe the actions an external auditor can take if management refuses to sign a letter of representation. (6 marks)
- (e) Explain the concept of materiality. (5 marks)
- (Question 3 Total : 25 marks)

QUESTION 4

- (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 make 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. (8 marks)

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

Required:

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

- (d) International Standard on Auditing 560 – *Subsequent Events* explains the audit work required in connection with subsequent events.

Required:

List the procedures that can be used prior to the auditor's report being signed to identify events that may require adjustment or disclosure in the financial statements. (5 marks)

(Question 4 Total : 25 marks)

END OF QUESTION PAPER