

**UNIVERSITY OF SWAZILAND**  
**DEPARTMENT OF ACCOUNTING**  
**SUPPLEMENTARY 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****Introduction and client background**

You are an audit senior in Staple and Co and you are commencing the planning of the audit of Ebumnandzini Paints Co for the year ending 31 August 2010.

Ebumnandzini Paints Co is a paint manufacturer and has been trading for over 50 years, it operates from one central site, which includes the production facility, warehouse and administration offices.

Ebumnandzini sells all of its goods to large home improvement stores, with 60% being to one large chain store Homewares. The company has a one year contract to be the sole supplier of paint to Homewares. It secured the contract through significantly reducing prices and offering a four-month credit period, the company's normal credit period is one month.

**Goods in/purchases**

In recent years, Ebumnandzini has reduced the level of goods directly manufactured and instead started to import paint from South Asia. Approximately 60% is imported and 40% manufactured. Within the production facility is a large amount of old plant and equipment that is now redundant and has minimal scrap value. Purchase orders for overseas paint are made six months in advance and goods can be in transit for up to two months. Ebumnandzini accounts for the inventory when it receives the goods.

To avoid the disruption of a year-end inventory count, Ebumnandzini has this year introduced a continuous/perpetual inventory counting system. The warehouse has been divided into 12 areas and these are each to be counted once over the year. The counting team includes a member of the internal audit department and a warehouse staff member. The following procedures have been adopted;

1. The team prints the inventory quantities and descriptions from the system and these records are then compared to the inventory physically present.
2. Any discrepancies in relation to quantities are noted on the inventory sheets, including any items not listed on the sheets but present in the warehouse area.
3. Any damaged or old items are noted and they are removed from the inventory sheets.
4. The sheets are then passed to the finance department for adjustments to be made to the records when the count has finished.
5. During the counts there will continue to be inventory movements with goods arriving and leaving the warehouse.

At the year-end it is proposed that the inventory will be based on the underlying records. Traditionally Ebumnandzini has maintained an inventory provision based

on 1% of the inventory value, but management feels that as inventory is being reviewed more regularly it no longer needs this provision.

**Finance Director**

In May 2010 Ebumnandzini had a dispute with its finance director (FD) and he immediately left the company. The company has temporarily asked the financial controller to take over the role while they recruit a permanent replacement.

The old FD has notified Ebumnandzini that he intends to sue the company for unfair dismissal. The company is not proposing to make any provision or disclosures for this, as they are confident the claim has no merit.

**Required:**

- (a) Identify and explain the audit risks identified at the planning stage of the audit of Ebumnandzini Paints Co. [7 marks]
- (b) Discuss the importance of assessing risks at the planning stage of an audit. [4 marks]
- (c) List and explain suitable controls that should operate over the continuous/perpetual inventory counting system, to ensure the completeness and accuracy of the existing inventory records at Ebumnandzini Paints Co. [8 marks]
- (d) Describe THREE substantive procedures the auditor of Ebumnandzini Paints Co should perform at the year-end in confirming each of the following:
- (i) The valuation of inventory; [3 marks]
  - (ii) The completeness of provisions or contingent liabilities. [3 marks]

**Question 2**

- a) State the **threats** contained in the *code of ethics and conduct* and for each threat, list one example of a circumstance that may create the threat and what safeguard could be put in place for that particular threat. **[10 marks]**
- b) You are the audit manager of Tham & Vusi LLP and you are planning the audit of ONE 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 ONE 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 ONE 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 Tham & Vusi LLP 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 ONE 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 Tham & Vusi LLP's audit of ONE Fones Co; and **[5 Marks]**
- (ii) For each threat explain how it might be avoided. **[5 Marks]**
- c) Describe the steps Tham & Vusi LLP should perform prior to accepting a new audit engagement. **[5 Marks]**

**Question 3**

- a) 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]
- b) List and explain FOUR assertions from ISA 500 *Audit Evidence* that relate to the recording of classes of transactions. [4 Marks]
- c) In terms of audit reports, explain the term 'modified'. [2 Marks]
- d) Explain the importance of the bank letter and describe the procedures used to obtain confirmations from the bank. [5 marks]
- e) Describe how you would check a client's bank reconciliation. [10 marks]

**Question 4**

During the course of your audit of the non-current assets of Eastern Engineering Inc at 31 March 2011, two problems have arisen:

- (a) The calculations of the cost of direct labour incurred on assets in the course of construction by the company's employees have been accidentally destroyed for the early part of the year. The direct labour cost involved is E10,000.
- (b) The company incurred development expenditure of E25,000 spent on a viable new product which will go into production next year and which is expected to last for ten years. The direct labour cost involved is E10,000.
- (c) Other relevant financial information is as follows:

|                                     | E       |
|-------------------------------------|---------|
| Profit before tax                   | 100,000 |
| Non-current asset additions         | 133,000 |
| Assets constructed by company       | 34,000  |
| Non-current asset at net book value | 666,667 |

**Required**

- a) List the general forms of qualification available to auditors in drafting their report and state the circumstances in which each is appropriate. [5 Marks]
- b) State whether you feel that a qualified audit report would be necessary for each of the two circumstances outlined above, giving reasons in each case. [10 Marks]
- c) On the assumption that you decide that a qualified audit report is necessary with respect to the treatment of the revaluation, draft the section of the report describing the matter (the whole report is not required). [3 Marks]
- d) Outline the auditors' general responsibility with regard to the statement in the directors' report concerning the valuation of land and buildings. [3 Marks]
- e) Describe what you would do should the above issues been discovered in the following circumstances:
  - i. After signing the audit report but before file assemble date [2 Marks]
  - ii. After signing the report and after the file assembly date [2 Marks]