

COURSE CODE: AC418 (M) 2013

**UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER**

DEGREE/YEAR OF STUDY : B COM IV

TITLE OF PAPER : AUDITING 2

COURSE CODE : AC 418

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

Some organisations conduct inventory counts once a year and external auditors attend those counts. Other organisations have perpetual systems (i.e. they conduct continuous inventory counting) and do not conduct a year end count.

Required:

- (a) **Explain why year-end inventory counting is important to the auditors of organisations that do not have perpetual inventory systems.** (6 marks)
- (b) **Describe audit procedures you would perform in order to rely on a perpetual inventory system in a large, dispersed organisation.** (6 marks)
- (c) BedMaster is a family-owned company which retails beds, mattresses and other bedroom furniture items. The company's year-end is 30 June 2013. The only full inventory count takes place at the year-end. The company maintains up-to-date computerised inventory records.
- Where the company delivers goods to customers, a deposit is taken from the customer and customers are invoiced for the balance after the delivery. Some goods that are in stock at the year-end have already been paid for in full – customers who collect goods themselves pay by cash or credit card.
- Staff at the company's warehouse and shop will conduct the year-end count. The shop and warehouse are open seven days a week except for two important public holidays during the year, one of which is 1 July. The company is very busy in the week prior to the inventory count but the shops will close at 15.00 hours on 30th June and staff will work until 17.00 hours to prepare the inventory for counting. The company has a high turnover of staff. The following inventory counting instructions have been provided to staff at BedMaster.
- (i) The inventory count will take place on 1 July 2013 commencing at 09.00 hours. No movement of inventory will take place on that day.
 - (ii) The count will be supervised by Mr Dlamini, the inventory controller. All staff will be provided with pre-printed, pre-numbered inventory counting sheets that are produced by the computerised system. Mr Dlamini will ensure that all sheets are issued, and that all are collected at the end of the count.
 - (iii) Counters will work on their own, because there are insufficient staff for them to work in pairs, but they will be supervised by Mr Dlamini and Mrs Dube, an experienced shop manager who will make checks on the work performed by counters. Staff will count inventory with which they are most familiar in order to ensure that the count is completed as quickly and efficiently as possible.
 - (iv) Any inventory that is known to be old, slow-moving or already sold will be highlighted on the sheets. Staff are required to highlight any inventory that appears to be soiled or damaged.
 - (v) All inventory items counted will have a piece of paper attached to them that will show that they have been counted.

- (vi) All inventory that has been delivered to customers but that has not yet been paid for in full will be added back to the inventory quantities by Mr Dlamini.

Required:

Describe the weaknesses in BedMaster's inventory counting instructions and explain why these weaknesses are difficult to overcome. (13 marks)

(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;**
 - (ii) **Explain the two different types of positive confirmation and the advantages and disadvantages of each;**
 - (iii) **List the reconciling items highlighted by external confirmation of accounts receivable.** (8 marks)
- (b) **Describe the principal risks associated with financial statement assertions relating to receivables.** (5 marks)
- (c) Puppies (Pty) Ltd is a small company which manufactures high quality shoes and sells them to small retailers. This is your first year as auditor. Puppies 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 a 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 Puppies. (12 marks)

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

(25 marks)

QUESTION 3

(a) Define the going concern assumption. (4 marks)

Vapour (Pty) Ltd 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. Vapour 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 E2m 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 Vapour'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 for 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 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 the audit procedures that the auditor of Vapour should perform in assessing whether or not the company is a going concern. (7 marks)
- (d) The auditors have been informed that Vapour'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 Vapour if the auditor believes the company is a going concern but a material uncertainty exists. (5 marks)

(25 marks)

QUESTION 4

Tasty Foods (Pty) Ltd is a company that runs a chain of fast food restaurants. The company has a centralised operating style and managers of individual restaurants have very limited decision-making powers on day-to-day operational matters. The company's centralised administration is responsible for the buying of food, the payment of staff, the maintenance and cleaning of restaurants by staff employed by a national agency, and all other matters relating to the running of the business. The company has good internal controls over purchasing. Inventory counts are conducted at each restaurant at the year-end. Your firm has recently been appointed as auditor to Tasty Foods.

Required:

- (a) List the account headings you would expect to find in Tasty Foods's schedule of accounts payable and accrued expenditure. (4 marks)
- (b) Describe and give reasons for the audit tests you would carry out to obtain audit evidence for Tasty Foods's accounts payable and accrued expenditure. (15 marks)
- (c) Explain the difficulties faced by auditors, and the decisions that auditors have to make, in conducting direct confirmations of accounts payable. (6 marks)

End of Question Paper