

UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM

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) Contrast the role of internal and external auditors.

(10 marks)

(b) Conoy Co designs and manufactures luxury motor vehicles. The company employs 2,500 staff and consistently makes a net profit of between 10% and 15% of sales. Conoy Co is not listed; its shares are held by 15 individuals, most of them from the same family. The maximum shareholding is 15% of the share capital.

The executive directors are drawn mainly from the shareholders. There are no non-executive directors because the company legislation in Conoy Co's jurisdiction does not require any. The executive directors are very successful in running Conoy Co, partly from their training in production and management techniques, and partly from their 'hands-on' approach providing motivation to employees.

The board are considering a significant expansion of the company. However, the company's bankers are concerned with the standard of financial reporting as the financial director (FD) has recently left Conoy Co. The board are delaying provision of additional financial information until a new FD is appointed.

Conoy Co does have an internal audit department, although the chief internal auditor frequently comments that the board of Conoy Co do not understand his reports or provide sufficient support for his department or the internal control systems within Conoy Co. The board of Conoy Co concur with this view. Anders & Co, the external auditors have also expressed concern in this area and the fact that the internal audit department focuses work on control systems, not financial reporting. Anders & Co are appointed by and report to the board of Conoy Co.

The board of Conoy Co are considering a proposal from the chief internal auditor to establish an audit committee.

The committee would consist of one executive director, the chief internal auditor as well as three new appointees.

One appointee would have a non-executive seat on the board of directors.

Required:

Discuss the benefits to Conoy Co of forming an audit committee.

(15 marks)

(25 marks)

QUESTION 2

Auditors obtain several different confirmations from various sources during the course of their audit.

Required:

Describe the *audit evidence* provided by each of the confirmations listed below, the *practical difficulties* in obtaining them and the *alternative audit evidence* available when they are not provided:

- (a) Management representations. (6 marks)
- (b) Direct confirmation of receivables. (7 marks)
- (c) Confirmation of inventory held by third parties. (6 marks)
- (d) Reports provided by auditors of third party service organisations. (6 marks)

(25 marks)

QUESTION 3

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.

(9 marks)

- (b) Describe the principal risks associated with financial statement assertions relating to receivables. (4 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 \$750,000, 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 Goodfoot. (12 marks)

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

(25 marks)

QUESTION 4

(a) ISA 505, *External Confirmations*, states that 'the auditor should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level'.

Required:

(i) List **FOUR** examples of external confirmations. (4 marks)

(ii) For **EACH** of the examples in (i) above explain:
ONE audit assertion that the external confirmation supports, and
ONE audit assertion that the external confirmation does **NOT** support. (8 marks)

(b) Jayne Co 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 instalments for the next five years.

Required:

(i) Explain the procedures to obtain a bank report for audit purposes from Jayne Co's bank and the substantive procedures that should be carried out on that report. (6 marks)

(ii) List the further substantive procedures that should be carried out on the bank balances in Jayne Co's financial statements. (7 marks)

(25 marks)

End of Question Paper