

**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**

**TOTAL MARKS : 100 MARKS**

**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 INVIGILATOR.**

### QUESTION 1

Sledge Motor Cars Co (Sledge) manufactures a range of motor cars and its year end is 31 January 2016. You are the audit supervisor of Browns & Co and are currently preparing the audit programmes for the year-end audit of Sledge. You have had a meeting with your audit manager and he has notified you of a number of issues identified during the audit risk assessment process.

#### **Land and buildings**

Sledge have a policy of revaluing land and buildings, this is undertaken on a rolling basis over a five-year period.

During the year Sledge requested an external valuer to revalue a number of properties, including a warehouse purchased in May 2015. Depreciation is charged on a pro rata basis.

#### **Work in progress**

Sledge undertakes continuous production of cars, 24 hours a day, seven days a week. An inventory count is to be undertaken at the year end and Browns & Co will attend. You are responsible for the audit of work in progress (WIP) and will be part of the team attending the count as well as the final audit. WIP constitutes the partly assembled cars at the year end and this balance is likely to be material. Sledge values WIP according to percentage of completion, and standard costs are then applied to these percentages.

#### **Required:**

**(a) Explain the factors Browns & Co should consider when placing reliance on the work of the independent valuer.** (5 marks)

**(b) Describe the substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to:**

**(i) The revaluation of land and buildings and the recently purchased warehouse; and** (7 marks)

**(ii) The valuation of work in progress.** (6 marks)

**(c) During the audit, your team has identified an error in the valuation of work in progress, as a number of the assumptions contain out of date information. The directors of Sledge have indicated that they do not wish to amend the financial statements.**

#### **Required:**

**Explain the steps Browns & Co should now take and the impact on the audit report in relation to the directors' refusal to amend the financial statements.**

(7 marks)  
**(25 marks)**

**QUESTION 2**

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

Vikas (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. Vikas 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 Vikas'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 Vikas should perform in assessing whether or not the company is a going concern.**

(7 marks)

- (d)** The auditors have been informed that Vikas'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 Vikas if the auditor believes the company is a going concern but a material uncertainty exists.**  
(5 marks)

**(25 marks)**

**QUESTION 3**

**(a) Explain the purpose of a management representation letter.**

(5 marks)

**(b)** You are the manager in charge of the audit of Lambos Co, a public limited liability company which manufactures specialist cars and other motor vehicles for use in films. Audited turnover is \$140 million with profit before tax of \$7.5 million.

All audit work up to, but not including, the obtaining of management representations has been completed. A review of the audit file has disclosed the following outstanding points:

***Tiger Co***

The company is facing a potential legal claim from the Tiger company in respect of a defective vehicle that was supplied for one of their films. Tiger maintains that the vehicle was not built strongly enough while the directors of Lambos argue that the specification was not sufficiently detailed. Dropping a vehicle 50 metres into a river and expecting it to continue to remain in working condition would be unusual, but this is what Tiger expected. Solicitors are unable to determine liability at the present time. A claim for \$4 million being the cost of a replacement vehicle and lost production time has been received by Lambos from Tiger. The director's opinion is that the claim is not justified.

***Depreciation***

Depreciation of specialist production equipment has been included in the financial statements at the amount of 10% pa based on reducing balance. However the treatment is consistent with prior accounting periods (which received an unmodified auditor's report) and other companies in the same industry and sales of old equipment show negligible profit or loss on sale. The audit senior, who is new to the audit, feels that depreciation is being undercharged in the financial statements.

**Required:**

**For each of the above matters:**

- (i) discuss whether or not a paragraph is required in the representation letter; and  
(ii) if appropriate, draft the paragraph for inclusion in the representation letter. (14 marks)

(c) A suggested format for the letter of representation has been sent by the auditors to the directors of Lambos.

The directors have stated that they will not sign the letter of representation this year on the grounds that they believe the additional evidence that it provides is not required by the auditor.

**Required:**

**Discuss the actions the auditor may take as a result of the decision made by the directors not to sign the letter of representation.**

(6 marks)

**(25 marks)**

**QUESTION 4**

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

**Required:**

**List the audit 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.** (7 marks)

(b) You are the auditor of Fuelers, a limited liability company which extracts, refines and sells oil and petroleum related products.

The audit of Fuelers for the year ended 30 June 2015 had the following events:

<b>Date</b>	<b>Event</b>
15 August 2015	Bankruptcy of major customer representing 11% of the trade receivables on the balance sheet.
21 September 2015	Financial statements approved by directors.
22 September 2015	Audit work completed and auditor's report signed.
1 November 2015	Accidental release of toxic chemicals into the sea from the company's oil refinery resulting in severe damage to the environment. Management had amended and made adequate disclosure of the event in the financial statements.
23 November 2015	Financial statements issued to members of Fuelers.
30 November 2015	A fire at one of the company's oil wells completely destroys the well. Drilling a new well will take ten months with a consequent loss in oil production during this time.

**Required:**

**For each of the following three dates:**

- 15 August 2015;
- 1 November 2015; and
- 30 November 2015

**(i) State whether the events occurring on those dates are adjusting or non-adjusting according to IAS 10 - *Events after the Reporting Period*, giving reasons for your decision;** (6 marks)

**(ii) Explain the auditor's responsibility and the audit procedures that should be carried out.** (12 marks)

**Note:** Marks are allocated evenly across the three dates.

**(25 marks)**

**End of Question Paper**