

UNIVERSITY OF SWAZILAND  
DEPARTMENT OF ACCOUNTING  
SUPPLEMENTARY EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM IV  
TITLE OF PAPER : AUDITING  
COURSE CODE : AC 417  
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 INVIGILATER.

**QUESTION 1**

(a) Your firm has been approached by the managing director of Abacus Leasing, a limited liability company, to tender for the audit. The previous auditors have resigned after a loss of confidence in them by the board of Abacus Leasing. This concerned the disapproval by the board of a qualified audit report issued by the outgoing auditors which referred to inadequate internal controls in Abacus Leasing's systems.

The company leases equipment to building contractors, many of whom have insufficient cash resources to purchase the equipment outright. Some lessees have been refused credit elsewhere. Since formation three years ago, Abacus Leasing's turnover has doubled each year and lease receivables now represent over 80% of the company's gross assets. The company is now experiencing difficulty in collecting a substantial amount of overdue lease payments. Abacus Leasing has no formal system for approval of new customers or any laid down procedures for the repossession of assets where the terms of the lease agreements have been broken.

The company is managed by a board of three directors with a dominant managing director who owns 95% of the share capital. The directors and senior management are largely remunerated by 'performance bonus' based on new sales. The company does not have an audit committee.

**Required:**

- (i) **Describe the procedures an audit firm should undertake before accepting a potentially high risk audit such as that of Abacus Leasing.** (5 marks)
  - (ii) **Describe the factors in relation to the audit of Abacus Leasing that would affect your assessment of the inherent risk.** (7 marks)
  - (iii) **Describe the procedures you will carry out to control the audit including reviewing the work of audit staff.** (8 marks)
- (b) **Describe the reasons why auditors use working papers to record their work and consider whether it is necessary for auditors to record all their audit work.** (5 marks)

**(25 marks)**

## QUESTION 2

- (a) The new audit trainee of your firm of registered auditors has asked you to advise him on the reliability of the following types of third party evidence.
- Valuation of land and buildings by a valuer.
  - The replies to a receivables' circularisation.
  - The letter received from the bank.

### Required:

- (i) **Discuss the reliability of each of the three types of third party evidence listed above, and consider the accuracy of the valuations they provide.** (9 marks)
- (ii) **For valuations provided by a valuer, describe the work you would carry out to check the independence, qualifications and experience of the valuer and the accuracy of the valuation.** (5 marks)
- (iii) **Define the control environment, discuss the factors that auditors take into account when assessing the control environment, and describe how the auditors' assessment of control environment affects their assessment of control risk.** (6 marks)
- (b) **Describe the matters you should consider at the planning stage to assess the effectiveness of the internal audit department.** (5 marks)
- (25 marks)**

## QUESTION 3

Pear International Co (Pear) is a manufacturer of electrical equipment. It has factories across the country and its customer base includes retailers as well as individuals, to whom direct sales are made through their website. The company's year end is 30 September 2016. You are an audit supervisor of Apple & Co and are currently reviewing documentation of Pear's internal control in preparation for the interim audit.

Pear's website allows individuals to order goods directly, and full payment is taken in advance. Currently the website is not integrated into the inventory system and inventory levels are not checked at the time when orders are placed. Goods are despatched via local couriers; however, they do not always record customer signatures as proof that the customer has received the goods. Over the past 12 months there have been customer complaints about the delay between sales orders and receipt of goods. Pear has investigated these and found that, in each case, the sales order had been entered into the sales system correctly but was not forwarded to the despatch department for fulfilling.

Pear's retail customers undergo credit checks prior to being accepted and credit limits are set accordingly by sales ledger clerks. These customers place their orders through one of the sales team, who decides on sales discount levels.

Raw materials used in the manufacturing process are purchased from a wide range of suppliers. As a result of staff changes in the purchase ledger department, supplier statement reconciliations are no longer performed. Additionally, changes to supplier details in the purchase ledger master file can be undertaken by purchase ledger clerks as well as supervisors.

In the past six months Pear has changed part of its manufacturing process and as a result some new equipment has been purchased, however, there are considerable levels of plant and equipment which are now surplus to requirement. Purchase requisitions for all new equipment have been authorised by production supervisors and little has been done to reduce the surplus of old equipment.

**Required:**

**(a) In respect of the internal control of Pear International Co:**

**(i) Identify and explain FIVE deficiencies;**

**(ii) Recommend a control to address each of these deficiencies; and**

**(iii) Describe a test of control Apple & Co would perform to assess if each of these controls is operating effectively.** (15 marks)

Pear's directors are considering establishing an internal audit department next year, and the finance director has asked about the differences between internal audit and external audit and what impact, if any, establishing an internal audit department would have on future external audits performed by Apple & Co.

**Required:**

**(b) Distinguish between internal audit and external audit.** (5 marks)

**(c) Explain the potential impact on the work performed by Apple & Co during the interim and final audits, if Pear International Co was to establish an internal audit department.**

(5 marks)

**(25 marks)**

**QUESTION 4**

(a) ISA 300 *Planning an Audit of Financial Statements* provides guidance to assist auditors in planning an audit.

**Required:**

**Explain the benefits of audit planning.** (4 marks)

(b) ISA 530 *Audit Sampling* provides guidance on methods for selecting a sample of items for testing.

**Required:**

**Identify and explain THREE methods of selecting a sample.** (3 marks)

(c) **Explain the external auditors' responsibilities in relation to the prevention and detection of fraud and error.** (4 marks)

(d) ISA 400 *Risk Assessment and Internal Control* defines the terms of 'audit risk', 'inherent risk', 'control risk', and 'detection risk'.

It also states that:

*When developing the audit approach, the auditor considers the preliminary assessment of control risk (in conjunction with the assessment of inherent risk) to determine the appropriate detection risk to accept for the financial statement assertions.....*

**Required**

(i) Distinguish between inherent risk at the **entity level** and at the **account balance and class of transactions level**. Identify factors, at each level, that will be considered by the auditors in arriving at their assessment of inherent risk.

(6 marks)

(ii) 1 Explain how the preliminary assessment of control risk affects:

- The mix of tests of control and substantive procedures,
- The design of substantive procedures. (5 marks)

2 Identify other factors that affect the auditors' decision as to the extent of substantive procedures.

(3 marks)

**(25 marks)**

**End of Question Paper**