

UNIVERSITY OF SWAZILAND  
DEPARTMENT OF ACCOUNTING  
MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM IV  
TITLE OF PAPER : AUDITING 1  
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 INVIGILATOR.

**QUESTION 1**

You are the audit manager of Menzi & Co and you are briefing your team on the approach to adopt in undertaking the review and finalisation stage of the audit. In particular, your audit senior is unsure about the steps to take in relation to uncorrected misstatements.

During the audit of Greens Estates the following uncorrected misstatement has been noted.

The property balance was revalued during the year by an independent expert valuer and an error was made in relation to the assumptions provided to the valuer.

**Required:**

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

You are the auditor of Candy, a limited liability company which manufactures and sells small cuddly toys by mail order. The company is managed by Mr Jones and two assistants. Mr Jones authorises important transactions such as wages and large orders, one assistant maintains the payables ledger and orders inventory and pays suppliers, and the other assistant receives customer orders and despatches cuddly toys. Due to other business commitments Mr Jones only visits the office once per week.

At any time, about 100 different types of cuddly toys are available for sale. All sales are made cash with order – there are no receivables. Customers pay using credit cards and occasionally by sending cash. Turnover is over \$5.2 million.

You are planning the audit of Candy and are considering using some of the procedures for gathering audit evidence recommended by ISA500 as follows:

- (i) Analytical Procedures
- (ii) Inquiry
- (iii) Inspection
- (iv) Observation
- (v) Re-calculation

**Required:**

**(b) For EACH of the above procedures:**

**(i) Explain its use in gathering audit evidence.** (5 marks)

**(ii) Describe one example for the audit of Candy.** (5 marks)

**(c) Discuss the suitability of each procedure for Candy, explaining the limitations of each.** (10 marks)

**(25 marks)**

**QUESTION 2**

**(a) Explain what is meant by 'corporate governance' and why it is important.** (4 marks)

**(b)** Guava Co has been trading for over 20 years and obtained a listing on a stock exchange five years ago. It provides specialist training in accounting and finance.

The listing rules of the stock exchange require compliance with corporate governance principles, and the directors are fairly confident that they are following best practice in relation to this. However, they have recently received an email from a significant shareholder, who is concerned that Guava Co does not comply with corporate governance principles.

Guava Co's board is comprised of six directors; there are four executives who originally set up the company and two non-executive directors who joined Guava Co just prior to the listing. Each director has a specific area of responsibility and only the finance director reviews the financial statements and budgets.

The chief executive officer, Daniel Brown, set up the audit committee and he sits on this sub-committee along with the finance director and the non-executive directors. As the board is relatively small, and to save costs,

Daniel Brown has recently taken on the role of chairman of the board. It is the finance director and the chairman who make decisions on the appointment and remuneration of the external auditors. Again, to save costs, no internal audit function has been set up to monitor internal controls.

The executive directors' remuneration is proposed by the finance director and approved by the chairman. They are paid an annual salary as well as a generous annual revenue related bonus.

Since the company listed, the directors have remained unchanged and none have been subject to re-election by shareholders.

**Required:**

**Describe SIX corporate governance weaknesses faced by Guava Co and provide recommendations to address each weakness, to ensure compliance with corporate governance principles.** (12 marks)

**(c) Explain the auditor's ethical responsibilities with regard to client confidentiality and when they have an:**

**(i) obligatory responsibility; and**

**(ii) voluntary responsibility to disclose client information.**

(5 marks)

(d) Mango is aware that subsequent to the stock exchange listing it will need to establish an audit committee and has asked for some advice in relation to this.

**Required:**

**Explain the benefits to Mango of establishing an audit committee.**

(4 marks)

**(25 marks)**

### **QUESTION 3**

You are a member of the recently formed internal audit department of Orange Co (Orange). The company manufactures tinned fruit and vegetables which are supplied to large and small food retailers. Management and those charged with governance of Orange have concerns about the effectiveness of their sales and despatch system and have asked internal audit to document and review the system.

#### **Sales and despatch system:**

Sales orders are mainly placed through Orange's website but some are made via telephone. Online orders are automatically checked against inventory records for availability; telephone orders, however, are checked manually by order clerks after the call. A follow-up call is usually made to customers if there is insufficient inventory. When taking telephone orders, clerks note down the details on plain paper and afterwards they complete a three part pre-printed order form. These order forms are not sequentially numbered and are sent manually to both despatch and the accounts department.

As the company is expanding, customers are able to place online orders which will exceed their agreed credit limit by 10%. Online orders are automatically forwarded to the despatch and accounts department.

A daily pick list is printed by the despatch department and this is used by the warehouse team to despatch goods.

The goods are accompanied by a despatch note and all customers are required to sign a copy of this. On return, the signed despatch notes are given to the warehouse team to file.

The sales quantities are entered from the despatch notes and the authorised sales prices are generated by the invoicing system. If a discount has been given, this has to be manually entered by the sales clerk onto the invoice.

Due to the expansion of the company, and as there is a large number of sale invoices, extra accounts staff have been asked to help out temporarily with producing the sales invoices. Normally it is only two sales clerks who produce the sales invoices.

**Required:**

**(a) Describe TWO methods for documenting the sales and despatch system; and for each explain an advantage and a disadvantage of using this method.** (6 marks)

**(b) List TWO control objectives of Orange Co's sales and despatch system.** (2 marks)

**(c) Identify and explain SIX deficiencies in Orange Co's sales and despatch system and provide a recommendation to address each of these deficiencies.** (12 marks)

**(d) List and explain the purpose of FIVE items that should be included on every working paper prepared by the audit team.** (5 marks)

**(25 marks)**

**QUESTION 4**

Lion & Co (Lion) is a firm of Chartered Certified Accountants which has seen its revenue decline steadily over the past few years. The firm is looking to increase its revenue and client base and so has developed a new advertising strategy where it has guaranteed that its audits will minimise disruption to companies as they will not last longer than two weeks. In addition, Lion has offered all new audit clients a free accounts preparation service for the first year of the engagement, as it is believed that time spent on the audit will be reduced if the firm has produced the financial statements.

The firm is seeking to reduce audit costs and has therefore decided not to update the engagement letters of existing clients, on the basis that these letters do not tend to change much on a yearly basis. One of Lion's existing clients has proposed that this year's audit fee should be based on a percentage of their final pre-tax profit. The partners are excited about this option as they believe it will increase the overall audit fee.

Lion has recently obtained a new audit client, Apple Brothers Co (Apple), whose year end is 31 December. Apple requires their audit to be completed by the end of February; however, this is a very busy time for Lion and so it is intended to use more junior staff as they are available. Additionally, in order to save time and cost, Lion have not contacted Apple's previous auditors.

**Required:**

**(a) Describe the steps that Lion should take in relation to Apple:**

**(i) Prior to accepting the audit; and** (5 marks)

**(ii) To confirm whether the preconditions for the audit are in place.** (3 marks)

- (b) State **FOUR** matters that should be included within an audit engagement letter. (2 marks)
- (c) (i) Identify and explain **FIVE** ethical risks which arise from the above actions of Lion & Co; and
- (ii) For each ethical risk explain the steps which Lion & Co should adopt to reduce the risks arising.

Note: The total marks will be split equally between each part. (10 marks)

- (d) In the context of ISA 530 *Audit Sampling and Other Means of Testing*, explain and provide examples of the terms 'sampling risk' and 'non-sampling' risk. (5 marks)

(25 marks)