

UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING AND FINANCE
EXAMINATION PAPER MAY 2018 ACADEMIC YEAR 2017/2018

PROGRAMME OF STUDY	Bachelor of Commerce
YEAR OF STUDY	Year 3 (Full Time/Part Time)
TITLE OF THE PAPER	Principles of Auditing
COURSE CODE	AC/ACF 316
TIME ALLOWED	Three (3) Hours

INSTRUCTIONS

- 1. There are Four (4) questions, ANSWER ALL.**
- 2. Begin the solution to each question on a new page.**
- 3. The marks awarded for a question are indicated at the end of each question.**

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 layout and presentation of your answer.

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR / SUPERVISOR.

QUESTION ONE

You are a partner at the auditing firm of MVC (Incorporated). The firm is a medium sized auditing firm with various offices throughout the country. A variety of professional services are provided which range from auditing work to management and consultancy services.

You were recently approached by the managing partner of Tickbirds and Partners, another medium sized auditing practice, to provide them with legal advice on a claim which was instituted against the auditing firm (Tickbirds & Partners). The background information to the claim is as follows:

For the past four years Tickbirds and Partners have been the auditors of Smart Jewellers Limited, a retailer of expensive jewellery. A copy of the annual financial statements are sent to the Smart Jewellers' bankers, First Bankers, annually on the understanding that they can contact the auditors directly if they wish to clear up any aspect of the financial statements. First Bankers deal with all of Smart Jewellers' money matters and have provided Smart Jewellers with a long-term loan of R8.5 million with which to finance its operations.

In May 20X9 Jean Botha, and audit manager of Tickbirds and Partners, who has handled the audit of Smart Jewellers for the past four years, began the audit for the year ended 31 March 20X9. As he was familiar with the operations of Smart Jewellers, Jean kept fewer and fewer working papers of the audit procedures performed and the evidence obtained each year. However, a week after beginning the current audit Jean died in a motor car accident. As a result of the work pressures and the shortage of staff, the partners of Tickbirds and Partners appointed Mr Duzi, a retired accountant of one of the firm's clients, to complete the audit.

Mr Duzi studied Jean Botha's working papers of the previous year and reached the conclusion that all that would be necessary to complete the audit would be to review Smart Jeweller's schedules which the accountant prepared, together with the inventory records for their accounting accuracy. He did this, and after he had failed to detect any material errors, he informed Miss Ngweni, the partner in charge of the audit, that the audit had been completed successfully. On the basis of this, Miss Ngweni issued an unqualified audit report on Smart Jewellers' annual financial statements for 20X9.

Shortly after year-end, a large fraud in respect of inventory was detected at the organization, which led to the company's liquidation. First Bankers lost their full exposure of R8.5 million in Smart Jewellers and intended to sue Tickbirds and Partners for this amount.

The above facts give rise to the request by the managing partner of Tickbirds and Partners. You have been provided with all possible information and working papers have been made available to you.

From the working papers you have concluded that no management representation letter had been obtained from management of Smart Jewellers. However, Mr Duzi had made a note in the audit file that management had refused to provide this. No further work had been performed in this respect.

- a) Name the four steps of the audit process. **4 Marks**
- b) Discuss and conclude whether Tickbirds & Partners complied with the ISA's with respect to performing the audit (referring particularly to each of the four steps of the audit process you identified above). **14 Marks**
- c) Discuss and conclude whether Tickbirds & Partners complied with the quality control requirements as per ISA 220. **12 Marks**

(Total Marks 30)

QUESTION TWO

You are an audit partner at City Inc., a small auditing firm based in Mbabane. One of your biggest clients is Mbabane (Pty) Ltd ("Mbaban"), for whom you have been doing bookkeeping and compiling financial statements for the past five years. Mbaban recently got rid of their auditors for reasons that Jabulani (the managing director of Mbaban) says are "not really important", so he has now approached you (City Inc.) to be the new auditors of Mbaban. Jabulani says since he knows you so well, he feels he can trust you with the audit of his company, and that it should be easy anyway since you know everything that is going on. Jabulani promises that, should you take Mbaban as an audit client, he will pay you twice as he pays for the bookkeeping services. This will mean that the total revenue from Mbaban would make up more than half of City Inc.'s annual revenue.

The only thing that Jabulani requires of you is that in the audited set of financial statements, you adjust the assets so that Mbaban can appear to have a higher Net Asset Value. "I know you won't be as stubborn or stupid as the last auditor. At least you know better than to jeopardise losing such a big fee- since we are effectively two clients in one", he says to you with a chuckle, (patting you on the back)

Required

- a) Discuss the types of threats evident in the above scenario, and the safeguards that you can apply to eliminate the identified threats. **25 Marks**
- b) Briefly discuss the steps that City Inc. should take before accepting the appointment as the new auditors. **5 Marks**

(Total Marks 30)

QUESTION THREE

- a) explain the difference between tests of controls and substantive procedures **5 Marks**
- b) Explain what is meant by the statement that audit evidence should be **4 Marks**
 - i. sufficient
 - ii. appropriate
- c) Explain how the source and nature of audit evidence influence the reliance that an auditor can place on the evidence for audit purposes **5 Marks**
- d) explain the different directions of testing when performing substantive procedures, and the main assertions addressed by it **6 Marks**

(Total Marks 20)

QUESTION FOUR

You have recently accepted the audit of a new client, Ost Rich Ltd, a company listed on the JSE Securities Exchange, and are in the process of planning your audit. You have obtained the following knowledge of the business through discussions with key staff members and inspection of company documentation and media reports.

Ost Rich Ltd was founded three years ago and is operational in the Ostrich industry. Ost Rich is an export oriented company and exports the majority of their meat to the European Union, Namibia, Switzerland and Hong Kong, with only a small portion of the business relating to the local market. Apart from the meat, they also export leather, feather and egg shells to these countries. The prices for all the ostrich products are dollar based.

The managing director, Mr Vol Struis, and three other directors were the founding members of Ost Rich Ltd and they have a reputation in the business world of being "Cowboys", i.e. shrewd and aggressive businessmen. All four are young and willing to take on a lot of risk.

Salaries for senior management are mainly performance based, with generous bonuses being paid for their contributions to the company's success. This sometimes results in managers making risky business decisions.

A new financial manager was appointed during the year, replacing the previous financial manager who resigned after sharp disagreements with the other directors. The previous financial manager was meticulous in his work, and the directors being young and vibrant

entrepreneurs, regularly did not adhere to the controls he implemented. The new financial manager is still fairly inexperienced in the industry.

Being such dynamic businessmen, the directors view any form of controls as an inhibition of their creative minds; therefore it is not strange that they view the statutory audit function, corporate governance and JSE reporting requirements, as well as other regulatory requirements, as a waste of time and money. During a discussion with Mr Vol Struis he made it quite clear that they expect the auditors to complete their work in the shortest possible time without wasting time on unnecessary procedures.

Your research with regards to the ostrich industry identified the following important matters and developments:

- ✓ South Africa is the biggest exporter of ostrich meat and products with annual exports of R1.8bln
- ✓ About 95% of SA's ostrich meat is exported, and approximately 90% of that is exported to the European Union
- ✓ The outbreak of the Avian influenza virus (bird flu) under ostrich birds in the Eastern Cape resulted in the European Union, Namibia, Switzerland and Hong Kong placing bans on South African poultry products, including ostrich products. The ban excludes Leather, feathers and egg shells
- ✓ The avian flu virus is highly dangerous to birds, but less threatening to humans than the H5N1 virus, which killed 24 people in Asia earlier this year.
- ✓ South African poultry and ostrich farmers stand to lose international market share if the export ban on poultry products continues for a long period of time. With the export ban currently in place, neighbouring countries might source their products elsewhere.
- ✓ The bans were imposed for a month. It could cost farmers R100 million and put 20 000 jobs at risk.
- ✓ The EU will review the ban only once the first 6 000 ostriches have been culled and national zero-surveillance has confirmed no further infections
- ✓ To prevent the spread of the virus to other farms, the agriculture department began culling ostriches in the Eastern Cape, with an estimated 30 000 birds expected to be culled. In terms of the Animal Diseases Act, farmers would be compensated for birds culled during the operation.
- ✓ November and December is the peak season for ostrich exports to Europe
- ✓ The outbreak of bird flu in the Eastern Cape has not slowed down domestic sales of ostrich meat.

Recent management accounts showed an increase in turnover from previous months, which is somewhat surprising in view of the bans placed on ostrich meat and strengthening of the

Rand. The management accounts further showed a substantial deterioration in the liquidity position of the company. Management indicated that they have reached their credit limit at their bank and are currently negotiating an extension of the credit with them. The bank will use the audited financial statements as a basis for their decision.

Required

Discuss the effect the above-mentioned issues would have on the elements of audit risk. Your answer should include an explanation of the specific risk (as identified from the question), which component of audit risk will be affected, as well as whether audit risk will be increased or decreased.

Formulate your answer as follows

Risk & Explanation	Component of audit risk	Increase or decrease
1 mark	0.5 marks	0.5 marks

(Total Marks 20)

.....**End of Paper**.....