

UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING AND FINANCE

SUPPLIMENTARY 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

Andrew Malcolm Inc. is a relatively new auditing firm owned by Andrew Malcolm. Due to its recent entry into the market, the firm is quite small and is willing to accept almost any client to ensure revenue. During the year, the firm obtained quite a big audit client, Trendy Fashions (Pty) Ltd, which accounted for almost 40% of the firm's revenue. During their recent of several golf sessions stretching from their days together in college, the financial director of Trendy Fashions proposed to Andrew that Andrew Malcolm Inc. do some consulting work for Trendy Fashions, as its easier if the consulting and auditing are done by the same person so that the Financial Director doesn't face "the usual stupid questions from the auditors" repeatedly

If Andrew accepts the consulting engagement, the total fees from Trendy Fashions will almost double, making the total fees from Trendy fashions account for almost 70% of Andrew Malcolm Inc.'s total revenue. This sounds very exciting, because if the fees for this year are high enough, Andrew can declare himself a big bonus and get to take his family on that overseas trip they have been waiting for.

Required

- a) Discuss what threats to the fundamental principles of ethical behavior are evident from the scenario above and what safeguards can Andrew Malcolm put in place to address these threats **15 Marks**
- b) Discuss the two types of independence requirements that auditors should consider for assurance engagements. **10 Marks**

(Total Marks 25)

QUESTION TWO

You are the senior partner of NoChange Inc., a medium audit firm based in Paarl. You are also the auditor of Purl Valli Golf Estates and Spa. The fieldwork for the audit for the year ended 30 September 20X9 has been completed and no material misstatements have been identified. All audit differences that existed at year end have been satisfactorily resolved.

The only outstanding matters regards to the audit, before the audit report can be issued, are the procedures relating to subsequent events and going concern. Once these procedures have been performed, the audit report can be issued, as management has almost completed the financial statements as well.

Required

- a) Prepare the audit report to the members of Purl Valli Golf Estates and Spa assuming that it is appropriate to prepare the financial statements on a going concern basis. **20 marks**
- b) Explain the effect on the auditor's report if the auditor is of the opinion that a material uncertainty regarding an organization's going concern position exists **5 Marks**

(Total Marks 25)

QUESTION THREE

Karna (Pty) Ltd was formed 15 years ago by the current managing director, Ben Smith. Karna (Pty) Ltd has 15 members and Ben Smith is the majority shareholder. Karna (Pty) Ltd is in the waste disposal business and has long term contracts with local government bodies to remove and dispose environmental waste. It operates from 30 branches nationwide.

Sam Smith, Ben's son, was appointed as financial director on 30 January 20X10. Sam, who holds a Bachelor of Science degree, is 27 years old and joined the company on 01 January 20X10. Sam has been a friend of yours since school days.

Finalisation of the audit for the year ended February 20X10 has been delayed due to disagreement between the auditor, Jo Gonno, a sole practitioner and management on the accounting treatment of certain structured finance transactions entered into during January 20X10. You are a partner in a medium sized audit firm with offices in all major cities. Sam approached you at the beginning of March 20X10 for your opinion regarding the accounting issues. You agreed with accounting treatment proposed by management. Gonno thereafter agreed to issue an unqualified audit report for the year ended February 20X10. Sam nevertheless asked Gonno to resign as auditor. Gonno refused to issue his audit report and resign, unless he was paid.

Sam offered you the statutory audit appointment subject to your fee quote being acceptable. Sam is of the opinion that the previous fee was too high. During the course of several meetings with senior management to determine the scope of the audit as a basis for your quote, the following information was obtained:

Pat Knox, who was Gonno's audit manager on the 20X10 audit of Karna (Pty) Ltd, was appointed by Karna (Pty) Ltd in July 20X10 to set up an internal audit department which focuses on branch audits.

- o Karna (Pty) Ltd was very profitable until two years ago, but profitability has declined since then. For the year ended February 20X11 a small loss was incurred as a result of cuts in local government spending.

- Management responded to the declining profitability by re-engaging the budgetary and target system and introducing an incentive bonus scheme for management based on branch performance
- All branches of Karna (Pty) Ltd use common software packages
- Litigation has been instituted against Karna (Pty) Ltd by an environmental lobby group alleging that the company has been discharging pollutants into certain rivers. The directors are of the opinion that these claims cannot be proven.
- Each branch controls its own sales and debtors whilst the purchases and creditors functions are centralised

Required

- a) State the matters you would consider in developing your overall audit plan for the year ended 28 February 20X10, assuming you are appointed as auditor of Karna (Pty) Ltd. **20 Marks**
- b) Give the definition for audit risk and each of its components **4 Marks**
- c) Discuss the relationship between the components of audit risk **6 Marks**

(Total Marks 30)

QUESTION FOUR

- (A) List five services that auditors of public companies are prohibited from performing: **10 Marks**

(B) MULTIPLE CHOICE

- 1) CPAs perform three primary types of Audit that is,
 - A. Operational audit
 - B. Compliance audit
 - C. Financial statement audit
 - D. All of the above
 - E. A and C only
- 2) Which of the following best describes Operational audit
 - A. It requires the constant review by internal auditors of the administrative controls as they relate to the operations of the company
 - B. It concentrates on implementing financial and accounting control in a newly organized company
 - C. It attempts and is designed to verify the fair presentation of the company's results of operations

- D. It concentrates on seeking aspects of operations in which waste could be reduced by the introduction of controls
- 3) In comparison with an external auditor, an internal auditor is more likely to be concerned with
- A. Internal administrative control
 - B. Cost of accounting procedures
 - C. Operational auditing
 - D. Internal control
- 4) Independent auditing can best be described as
- A. A branch of accounting
 - B. A discipline that attests to the results of accounting and other functional operations of data
 - C. A professional activity that measures and communicates financial and business data
 - D. A regulatory function that prevents the issuance of improper financial information
- 5) Which of the following attributes is likely to be unique to the audit work of CPAs as compared to the work performed by practitioners of other professions
- A. Due professional care
 - B. Competence
 - C. Independence
 - D. Complex body of knowledge
- 6) Which of the following services is an attestation engagement
- A. A consulting service engagement to provide computer-processing advice to a client
 - B. An engagement to report on compliance with statutory requirements
 - C. An income tax engagement to prepare federal and state tax returns
 - D. The compilation of financial statements from a client's financial records
- 7) What is the meaning of the Generally accepted auditing standard that requires the auditor to be independent
- A. The auditor must be without bias with respect to the client under audit
 - B. The auditor must adopt a critical attitude during the audit
 - C. The auditor's sole obligation is to third parties
 - D. The auditor may have a direct ownership interest in the client's business if it is not material
- 8) The auditor strives to achieve independence in appearance to
- A. Maintain public confidence in the profession
 - B. To become independent in fact
 - C. Comply with generally accepted auditing standards of field work
 - D. Maintain an unbiased mental attitude
- 9) The independent audit is important to readers of financial statements because it
- A. Determines the future stewardship of the management of the company whose financial statements are audited

- B. Measures and communicates financial and business data included in the financial statements
 - C. Involves the objective examination of and reporting on management prepared statements
 - D. Reports on the accuracy of all information in the financial statements
- 10) A CPA's retention of a client's records as a means of enforcing payment of an over-due audit fee is an action that is
- A. Not addressed by the AICPA code of professional conduct
 - B. Acceptable if sanctioned by the state laws
 - C. Prohibited under AICPA rules of conduct
 - D. A violation of generally accepted auditing standards

10 Marks

(Total Marks 20)

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