

**UNIVERSITY OF SWAZILAND**  
**DEPARTMENT OF ACCOUNTING AND FINANCE**  
**EXAMINATION PAPER MAY 2019 ACADEMIC YEAR 2018/2019**

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

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**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 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 US 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 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**

Discuss the types of threats evident in the above scenario, and the safeguards that you can apply to eliminate the identified threats.

(Total Marks 25)

### 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 (11 Marks)

(Total Marks 25)



**QUESTION FOUR**

- a) Identify the five categories of control activities and give an example each  
**(15 Marks)**
  
- b) Briefly describe what a qualified opinion, adverse opinion and disclaimer of opinion means and the circumstances under which each of these types of audit opinion may be issued  
**(5 Marks)**

**Total 20 Marks**

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