

UNIVERSITY OF ESWATINI
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM IV
TITLE OF PAPER : AUDITING 1
COURSE CODE : ACF 415
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

(a) The auditor has a responsibility to design audit procedures to obtain sufficient and appropriate evidence. There are various audit procedures for obtaining evidence, such as external confirmation.

Required:

Apart from external confirmation:

- (i) State and explain FIVE procedures for obtaining evidence and;
(ii) For each procedure, describe an example relevant to the audit of purchases and other expenses. (10 marks)

(b) Falcon (Pty) Ltd operates an airline business. The company's year-end is 31 January 2019.

You are the audit senior and you have started planning the audit. Your manager has asked you to have a meeting with the client and to identify any relevant audit risks so that the audit plan can be completed. From your meeting you ascertain the following:

In order to expand their flight network, Falcon (Pty) Ltd will need to acquire more airplanes; they have placed orders for another six planes at an estimated total cost of \$20m and the company is not sure whether these planes will be received by the year end. In addition the company has spent an estimated \$15m on refurbishing their existing planes. In order to fund the expansion Falcon (Pty) Ltd has applied for a loan of \$25m. It has yet to hear from the bank as to whether it will lend them the money.

The company receives bookings from travel agents as well as directly via their website. The travel agents are given a 90-day credit period to pay Falcon (Pty) Ltd, however, due to difficult trading conditions a number of the receivables are struggling to pay. The website was launched in early 2018 and has consistently encountered difficulties with customer complaints that tickets have been booked and paid for online but Falcon (Pty) Ltd has no record of them and hence has sold the seat to another customer.

Falcon (Pty) Ltd used to sell tickets via a large call centre located near to their head office. However, in May they closed it down and made the large workforce redundant.

Required:

Using the information provided above, describe FIVE audit risks and explain the auditor's response to each risk in planning the audit of Falcon (Pty) Ltd.

(15 marks)

(25 marks)

QUESTION 2

(a) Contrast the role of internal and external auditors. (8 marks)

(b) Tiger (Pty) Ltd designs and manufactures luxury motor vehicles. The company employs 2,500 staff and consistently makes a net profit of between 10% and 15% of sales. Tiger (Pty) Ltd is not listed; its shares are held by 15 individuals, most of them from the same family. The maximum shareholding is 15% of the share capital.

The executive directors are drawn mainly from the shareholders. There are no non-executive directors because the company legislation in Tiger (Pty) Ltd's jurisdiction does not require any. The executive directors are very successful in running Tiger (Pty) Ltd, partly from their training in production and management techniques, and partly from their 'hands-on' approach providing motivation to employees.

The board is considering a significant expansion of the company. However, the company's bankers are concerned with the standard of financial reporting as the financial director (FD) has recently left Tiger (Pty) Ltd. The board is delaying provision of additional financial information until a new FD is appointed.

Tiger (Pty) Ltd does have an internal audit department, although the chief internal auditor frequently comments that the board of Tiger (Pty) Ltd does not understand his reports or provide sufficient support for his department or the internal control systems within Tiger (Pty) Ltd. The board of Tiger (Pty) Ltd concurs with this view. Anders & Co, the external auditors have also expressed concern in this area and the fact that the internal audit department focuses work on control systems, not financial reporting. Anders & Co are appointed by and report to the board of Tiger (Pty) Ltd.

The board of Tiger (Pty) Ltd is considering a proposal from the chief internal auditor to establish an audit committee.

The committee would consist of one executive director, the chief internal auditor as well as three new appointees.

One appointee would have a non-executive seat on the board of directors.

Required:

Discuss the benefits to Tiger (Pty) Ltd of forming an audit committee. (17 marks)

(25 marks)

QUESTION 3

(a) Internal control systems are designed, amongst other things, to prevent error and misappropriation.

Required:

Describe the errors and misappropriations that may occur if purchases and capital expenditure are not properly controlled. (7 marks)

(b) Pony is a high-quality, private motor manufacturing company. It has recently joined a consortium for the purchase of parts. Pony's purchases and capital expenditure systems are not integrated.

Purchases and capital expenditure

There are complex internal rules relating to what constitutes a purchase, and what constitutes capital expenditure and the budgets for both are tightly controlled. Problems associated with the internal rules result in a significant number of manual adjustments to the management accounts which take up an excessive amount of management time.

The system for authorising capital expenditure is not well controlled which results in some capital items being acquired without proper consideration, at the monthly meetings of the capital expenditure committee.

Purchase orders

Purchase orders are generated automatically by the computerised inventory system when inventory levels fall below a given level in the context of scheduled production. This system does not work well because the system uses outdated purchasing and production patterns and many manual adjustments are required. The orders are reviewed by the production controller and her junior managers and changes are made informally by junior clerical staff in the production controller's department.

Some of the purchases are input into the buying consortium system which shows the optimum supplier for any combination of cost, delivery time and specification. This system has only been in operation for a few months. The system takes up a substantial amount of disk space on the company's computers and is suspected of causing problems in other systems. It is difficult to use and so far, only two of the production controller's junior managers are able to use it. As a result, the parts ordered through the system are sometimes of the incorrect specification or are delivered late. The remaining purchases are ordered directly from manufacturers, as before, through a reasonably well-controlled buying department.

Required:

Set out, in a form suitable for inclusion in a report to management, the weaknesses, potential consequences and your recommendations relating to the purchases and capital expenditure systems of Pony.

(18 marks)

(25 marks)

QUESTION 4

(a) Internal controls over non-current assets are designed to ensure the orderly and efficient running of the business, adherence to management policies, safeguarding of assets, the prevention of fraud and error and the completeness and accuracy of the accounting records.

Required:

List the internal controls that a small printing company with office equipment, motor vehicles and plant and machinery should have in place to achieve the objectives described above. (10 marks)

(b) Audit sampling is a technique for drawing conclusions about the characteristics of a population by testing a sample drawn therefrom. Internal and external auditors use it for both tests of controls, and substantive testing.

Required:

Explain the following:

- (i) Judgement sampling and statistical sampling;
- (ii) A representative sample;
- (iii) Tolerable error;
- (iv) Two different methods of selecting a representative sample;

NB: Parts (i) – (v) carry equal marks. (8 marks)

(c) The concept of materiality is fundamental to the work of auditors. Matters that are immaterial are not reported in financial statements.

Required:

(i) Explain the concept of materiality and describe how materiality affects the audit work performed by auditors; (7 marks)

(25 marks)