

COURSE CODE: ACF 416/AC 418 (M) 2019

**UNIVERSITY OF ESWATINI
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER**

DEGREE/YEAR OF STUDY : B COM IV

TITLE OF PAPER : AUDITING II

COURSE CODE : ACF 416/AC 418

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 an audit manager of Yandisa & Co and you are currently responsible for the audit of Mpilo Co, a company which develops and manufactures health and beauty products and distributes these to wholesale customers. Its draft profit before tax is E6.4m and total assets are E37.2m for the financial year ended 30 April, 2019. The final audit is due to commence shortly and the following matters have been brought to your attention:

Research and development

Mpilo Co spent E1.9m in the current year developing nine new health and beauty products, all of which are at different stages of development. Once they meet the recognition criteria under IAS 38 *Intangible Assets* for development expenditure, Mpilo Co includes the costs incurred within intangible assets. Once production commences, the intangible assets are amortised on a straight line basis over three years. Management believes that this amortisation policy is a reasonable approximation of the assets' useful lives, as in this industry there is constant demand for innovative new products.

Depreciation

Mpilo Co has a large portfolio of property, plant and equipment (PPE). In June 2018, the company carried out a full review of all its PPE and updated the useful lives, residual values, depreciation rates and methods for many categories of asset. The finance director felt the changes were necessary to better reflect the use of the assets. This resulted in the depreciation charge of some assets changing significantly for this year.

Bonus

The company's board is comprised of seven directors. They are each entitled to a bonus based on the draft year-end net assets, excluding intangible assets. Details of the bonus entitlement are included in the directors' service contracts. The bonus, which related to the 2019 year end, was paid to each director in May 2019 and the costs were accrued and recognised within wages and salaries for the year ended 30 April, 2019. Separate disclosure of the bonus, by director, is required by local legislation.

Required:

(a) Describe SEVEN substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Mpilo Co's research and development expenditure. (7 marks)

(b) Describe SEVEN substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the matters identified regarding depreciation of property, plant and equipment. (7 marks)

(c) Describe SIX substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the directors' bonuses.

(6 marks)

During the audit, the team discovers that the intangible assets balance includes E440,000 related to one of the nine new health and beauty products development projects, which does not meet the criteria for capitalisation. As this project is ongoing, the finance director has suggested that no adjustment is made in the 2019 financial statements. She is confident that the project will meet the criteria for capitalisation in 2020.

Required:

(d) Discuss the issue and describe the impact on the auditor's report, if any, should this issue remain unresolved.

(5 marks)

(25 marks)

QUESTION 2

Ingwe Co manufactures motor vehicle components and its year end was 30 April 2019. You are an audit supervisor of Brooks & Co and the final audit is due to commence shortly. Total assets are E43.2m and profit before tax is E7.2m. The following matters have been brought to your attention:

Trade receivables

Ingwe Co's trade receivables ledger is comprised of a large number of customers. In previous years, the audit team has undertaken a positive trade receivables circularisation to confirm year-end balances. However, the customer response rate has historically been low and so alternative audit procedures have been undertaken. A decision has been made that for the current year audit a circularisation will not be performed. The year-end trade receivables balance is E3.9m (2018: E2.8m) and the allowance for trade receivables is E410, 000 (2018: E300, 000).

Bank balances

The bank and cash figure included in Ingwe Co's draft financial statements is comprised of a number of bank account balances: an overdraft of E5.1m which is the company's main current account and E0.2m relating to several savings accounts. The finance director has informed the audit manager that all accounts have been reconciled as at the year end.

The overdraft of E5.1m has increased significantly since the prior year (2018: E1.2m). The directors have informed you that the overdraft facility, which the company requires in order to operate on a daily basis, is due for renewal in August 2019 and that they are confident it will be renewed.

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(a) Describe SEVEN substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Ingwe Co's trade receivables. (7 marks)

(b) Describe SEVEN substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Ingwe Co's bank balances. (7 marks)

(c) Describe SIX audit procedures the auditor should perform in assessing whether or not Ingwe Co is a going concern. (6 marks)

During the final audit, the Finance Director has informed the audit team that Ingwe Co's bankers will not make a decision on the renewal of the overdraft facility until after the auditor's report is signed. The audit engagement partner is satisfied that the use of the going concern basis is appropriate. The directors have agreed to include some brief going concern disclosures in the draft financial statements and the audit team still has to assess the adequacy of these disclosures.

Required:

(d) Discuss the issue and describe the impact on the auditor's report of Ingwe Co of adequate AND inadequate going concern disclosure. (5 marks)

(25 marks)

QUESTION 3

Penguin Co is a listed company which manufactures stationery products. The company's profit before tax for the year ended 31 March, 2019 is E16.3m and total assets as at that date are E66.8m. You are an audit supervisor of Jason & Co and you are currently finalising the audit programmes for the year-end audit of your existing client Penguin Co. You attended a meeting with your audit manager where the following matters were discussed:

Trade payables and accruals

Penguin Co purchases its raw materials from a large number of suppliers. The company's policy is to close the purchase ledger just after the year end and the financial controller is responsible for identifying goods which were received pre year-end but for which no invoice has yet been received. An accrual is calculated for goods received but not yet invoiced (GRNI) and is included within trade payables and accruals.

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The audit strategy has identified a risk over the completeness of trade payables and accruals. The audit team will utilise computer assisted audit techniques (CAATs), in the form of audit software while auditing trade payables and accruals.

Bank overdraft and savings accounts

Penguin Co's draft financial statements include a bank overdraft of E2.6m, which relates to the company's main current account. In addition Penguin Co maintains a number of savings accounts. The savings account balances are classified as cash and cash equivalents and are included in current assets. All accounts have been reconciled at the year end.

Directors' remuneration

Penguin Co's board is comprised of eight directors. Their overall remuneration consists of two elements: an annual salary, paid monthly; and a significant annual discretionary bonus, which is paid in a separate payment run on 20 March. All remuneration paid to directors is included within wages and salaries. Local legislation requires disclosure of the overall total of directors' remuneration broken down by element and by director.

Required:

(a) Describe FOUR substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the COMPLETENESS of Penguin Co's trade payables and accruals. (4 marks)

(b) Describe FOUR audit software procedures which could be carried out during the audit of Penguin Co's trade payables and accruals. (4 marks)

(c) Describe SIX substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Penguin Co's year-end bank balances. (6 marks)

(d) Describe FOUR substantive procedures the auditor should perform to confirm the directors' remuneration included in the financial statements at the year end. (4 marks)

A member of your audit team has asked for information on ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* as she has heard this standard is applicable to listed clients such as Penguin Co.

Required:

(e) Identify what a key audit matter (KAM) is and explain how the auditor determines and communicates KAM. (7 marks)

(25 marks)

QUESTION 4

(a) Safe Window Glass Co (Safe) is a glass manufacturer, which operates from a large production facility, where it undertakes continuous production 24 hours a day, seven days a week. Also on this site are two warehouses, where the company's raw materials and finished goods are stored. Safe's year end is 30 June.

Safe is finalising the arrangements for the year-end inventory count, which is to be undertaken on 30 June, 2019.

The finished windows are stored within 20 aisles of the first warehouse. The second warehouse is for large piles of raw materials, such as sand, used in the manufacture of glass. The following arrangements have been made for the inventory count:

The warehouse manager will supervise the count as he is most familiar with the inventory. There will be ten teams of counters and each team will contain two members of staff, one from the finance and one from the manufacturing department. None of the warehouse staff, other than the manager, will be involved in the count.

Each team will count an aisle of finished goods by counting up and then down each aisle. As this process is systematic, it is not felt that the team will need to flag areas once counted. Once the team has finished counting an aisle, they will hand in their sheets and be given a set for another aisle of the warehouse. In addition to the above, to assist with the inventory counting, there will be two teams of counters from the internal audit department and they will perform inventory counts.

The count sheets are sequentially numbered, and the product codes and descriptions are printed on them but no quantities. If the counters identify any inventory which is not on their sheets, then they are to enter the item on a separate sheet, which is not numbered. Once all counting is complete, the sequence of the sheets is checked and any additional sheets are also handed in at this stage. All sheets are completed in ink.

Any damaged goods identified by the counters will be too heavy to move to a central location, hence they are to be left where they are but the counter is to make a note on the inventory sheets detailing the level of damage.

As Safe undertakes continuous production, there will continue to be movements of raw materials and finished goods in and out of the warehouse during the count. These will be kept to a minimum where possible.

The level of work-in-progress in the manufacturing plant is to be assessed by the warehouse manager. It is likely that this will be an immaterial balance. In addition, the raw materials quantities are to be approximated by measuring the height and width of the raw material piles. In the past this task has been undertaken by a specialist; however, the warehouse manager feels confident that he can perform this task.

Required:

- (a) For the inventory count arrangements of Safe Window Glass Co:**
(i) Identify and explain SIX deficiencies; and

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(ii) Provide a recommendation to address each deficiency.

The total marks will be split equally between each part (15 marks)

You are the audit senior of Jason & Co and are responsible for the audit of inventory for Safe. You will be attending the year-end inventory count on 30 June, 2019.

In addition, your manager wishes to utilise computer-assisted audit techniques for the first time for controls and substantive testing in auditing Safe Window Glass Co's inventory.

Required:

(b) Describe FIVE procedures to be undertaken by the auditor DURING the inventory count of Safe Window Glass Co in order to gain sufficient appropriate audit evidence. (10 marks)

(25 marks)