

UNIVERSITY OF ESWATINI
DEPARTMENT OF BUSINESS ADMINISTRATION
MAIN EXAMINATION PAPER MAY 2019

DEGREE AND

YEAR OF STUDY : MASTER OF BUSINESS ADMINISTRATION

TITLE OF PAPER : ADVANCED AUDITING

COURSE CODE : ACF632

TOTAL MARKS : 100 MARKS

TIME ALLOWED : THREE (3) HOURS

- INSTRUCTIONS :
1. This paper consists of **TEN (10)** numbered pages including this page.
 2. There are **Three (3)** questions, answer **ALL** questions.
 3. Begin solution to each question on a new page.
 4. Show all the necessary workings.
 5. Round off as you deem appropriate.

Note: You are reminded that in assessing your work, account will be taken of accuracy of the language and general quality of expression, together with layout and presentation of your answer.

THIS PAPER MUST NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR OR SUPERVISOR.

Question 1-[50 Marks]

Read the passage below and answer questions that follow:

The Gijima Company decided to launch a new model of a tricycle for kids between 3 and 7 years old in the highly competitive Eswatini tricycle market. Although Gijima was a long established and profitable manufacturer of tricycles, the competition was becoming too difficult. It was threatening the profitability of the company in the long term. The appointment of a new chief executive officer **Mr Khosi Zweli** saw the company changing its future prospects. He decided to launch a new tricycle. His slogan for the new model was “make it speedy and pricy”. The key concept in the new model was communicated to Zahara Shongwe, the head of the design team. Mr Khosi Zweli then communicated to Ms Zahara Shongwe that instead of taking the usual 48 months to launch the new product it should be done in only 24 months. He repeated the slogan “make it speedy and pricy”. This again was about making more profits. Ms Zahara Shongwe told part of the design team privately that 24 months was too short to ensure that the new design was safety tested.

In order to reduce the manufacturing costs, **Zahara Shongwe** and her team worked out one way of increasing profits would be to widen the wheel base of the axle connecting the two rear wheels to prevent the tricycle from tipping over due to increased acceleration. This would result in an increasing selling price as the speedy tricycle would become popular with kids. Eswatini kids between 3 and 7 years are known to love speedy tricycles. This practice was a deviation from normal as the design of a tricycle is not supposed to support high speeds as it is meant for kids. Its design should be to tip over as soon as speeds were reaching dangerous levels so as to prevent serious injuries that can be sustained at high speeds. **Zahara Shongwe** and her team’s designs were incorporated into the final designs of the prototype. In order to reduce the time to market the factory started to be prepared for production (a process called “tooling up” the factory) but before the prototype was fully tested.

When the prototype of the Gijima tricycle went through a range of accident tests, it was established that there was a potential risk of kids falling backwards because of the quick initial acceleration of the tricycle from rest. For this reason, there was a request from production to fit the tricycle with a vertical safety canvas mounted on the axle connecting the two rear wheels to prevent kids from falling backwards. However, no action was taken as the board thought it too expensive to retool the production line in order to fit the Gijima tricycle with a safety canvas to protect the kids from falling backwards. This was also part of the company’s low cost strategy. Hence the Gijima tricycle went into production without the safety canvas.

The Gijima tricycle quickly became a very successful product for the Gijima Company. It began to sell over a million units a year. However, two years later there were reports from hospitals of increased head injuries on kids between 3 and 7 years old as a result of falling from tricycles. The injuries were mainly at the back of the head as a result of them falling backwards from tricycles. In a study conducted by the major hospital in Manzini it was noted that all these injuries were connected to a fast moving tricycle. The study connected the injuries to the Gijima tricycle. The company began to receive claims from lawyers acting on behalf of the families whose kids were injured on the Gijima tricycle. Gijima accepted legal advice to pay

compensation to the families of the victims of the Gijima tricycle.

The board met to discuss the options that can make the tricycles safer. It was decided that they could be made safer by adding a canvas extension that would be mounted on the axle connecting the two back wheels that would stop kids from falling backwards. **Nkululeko Dhlamini** the finance director said that there were two options to the board's decision. One option would be to make a universal recall of all the **Gijima tricycles** and fit them with the safety canvas. This would be done at the company's expense. This would require the retooling of the production line to ensure that all the future **Gijima tricycles** would be fitted with the safety canvas. The second option was the compensation option. Under this option the company would not recall existing tricycles nor would it make changes to the existing production line but it would continue to pay compensation to all victims and their families if, or when a serious liability arose as a result of kids falling backwards from the tricycle.

Nkululeko Dhlamini was then asked to do some calculations to estimate the financial effects of the whole Gijima tricycle problem. According to **Nkululeko**, the universal recall of the Gijima tricycle would cost E500 million while the compensation option would cost E300 million in total. **Nkululeko Dhlamini** went on to highlight that even allowing for substantial errors in the calculation there was still a substantial difference between the costs of the two options. He went on to say that because the bonuses of the board were partly dependent on the company's annual profits the board should still continue to pay compensation and not issue a universal recall.

However, **Zahara Shongwe** argued that the company should consider a universal call of the tricycle to ensure that it is safe for kids. Furthermore, this would enable the customers to know that they could still trust Gijima products. She went on to indicate that it is an important part of the company's strategic repositioning and that the company should comply with the expectations of society.

The chief executive officer **Mr Khosi Zweli** was concerned about complying with the expectations of shareholders and how the events might affect the company's share price and long term prospects. The reputation of the company as a strong investment and long term damage to the Gijima brand would be very unfortunate. **Mr Khosi Zweli** argued that the universal recall would send a terrible message to the financial markets and consequently it would damage confidence.

After a lengthy and heated discussion, it was decided to accept the compensation option. This option was for financial reasons. It was also agreed that a discussion of this matter in public should be avoided as it would likely damage the reputation of the company.

However an unknown member of the board outraged by the decision informed the media about the choice the board made and the design process that led to the Gijima tricycle. This resulted in a great deal of negative publicity for Gijima on TV, radio and in the press. The institutional investors demanded an extraordinary general meeting to discuss these issues with the board. They wanted **Mr Khosi Zweli** to explain why the board took this decision. In particular they wanted the chief executive officer to account for how he arrived at the decision not to recall the Gijima tricycle.

Required:

- (a) The lack of a safety canvas was eventually classified as a product and safety risk. Explore the problems leading to the safety canvass problem. Identify and explain internal control measures capable of mitigating the risk in future tricycle development. **[15 Marks]**
- (b) Explain the ethical issues surrounding **Mr Khosi Zweli, Zahara Shongwe and Nkululeko Dhlamini.** **[12 Marks]**
- (c) Distinguish between annual general meetings (AGMs) and extraordinary general meetings (EGMs). Explain the purpose of each and the advantages of holding the EGM to discuss the issues raised by the whistle blower. **[13 Marks]**
- (d) Prepare a statement for the Chief executive officer, to read at the EGM to address the following:
- i. An explanation of the roles of the CEO in managing the issues described at Gijima.
 - ii. A defence of the company's decision not to recall.
- [10 Marks]**

Question 2- [35 –Marks] - [Whittington-Adapted]

Suppose that you are involved in a field work of an audit engagement. The senior on the audit

obtained and documented an understanding of the company's internal controls relating to accounts receivable. The senior also assessed the control risk relating to accounts receivable at a maximum level. Joan is the staff person assigned to the engagement. She requested and obtained from the company an aged accounts receivable schedule listing the total amount owed by each customer as of 31 December 2018. She sent positive confirmation requests to a sample of the company's customers. Review Joan's comments on each of the following confirmations and determine the best conclusion and/or follow-up procedures for each item.

Required 1 – [7 Marks]

Confirmation Letter #1

February 1, 2019
Performance Marine Sales, Inc.
1284 River Road
Kwaluseni, Manzini 40059

Re: Balance at December 31, 2018 - E267, 000

Dear Sirs:

As of December 31, 2018, our records indicate your balance with our company as the amount listed above. Please complete and sign the bottom portion of this letter and return the entire letter to our auditors, JS LLP, PO Box 100, Kwaluseni, Manzini 32806.

A stamped, self-addressed envelope is enclosed for your convenience.

Sincerely,
Aquatic Jet Products, Inc.

The above balance is	Correct	
X	Incorrect (show amount)	E325,000

If incorrect, please provide information that could help to reconcile your account.

Signature	Title
	Date

Response: We placed an order for E58, 000 on December 26, 2018.

Joan's note to file:

Per discussion with the controller, the order for E58, 000 was shipped FOB shipping point on December 30, 2018, and was received by the customer on January 3, 2019. Therefore, no entry has been made to record the sale in 2018.

Required 2-[7 Marks]

Confirmation Letter #2

February 1, 2019
 West Coast Ski Center, Inc.
 163 Tide Avenue
 Kwaluseni, Manzini 93940

Re: Balance at December 31, 2018 - E414,000

Dear Sirs:

As of December 31, 2018, our records indicate your balance with our company as the amount listed above. Please complete and sign the bottom portion of this letter and return the entire letter to our auditors, JS LLP, PO Box 100, Kwaluseni, Manzini 32806.

A stamped, self-addressed envelope is enclosed for your convenience.

Sincerely,
 Aquatic Jet Products, Inc.

The above balance is	Correct	
X	Incorrect (show amount)	E320,000

If incorrect, please provide information that could help to reconcile your account.
 Response: We made a payment of E94, 000 on December 12, 2018.

Signature	Title
	Date

Joan's note to file:

Per discussion with the controller, the company received the payment of E94, 000 on December 15, 2018, and posted it to "Other Income."

Required 3-[7 Marks]

Confirmation Letter #3

February 1, 2019
 Fish & Ski World, Inc.
 5660 Ocean Blvd.
 Kwaluseni, Manzini78373

Re: Balance at December 31, 2018- E72, 000

Dear Sirs:

As of December 31, 2018, our records indicate your balance with our company as the amount listed above. Please complete and sign the bottom portion of this letter and return the entire letter to our auditors, JS LLP, PO Box 100, Kwaluseni, Manzini 32806.

A stamped, self-addressed envelope is enclosed for your convenience.

Sincerely,
 Aquatic Jet Products, Inc.

The above balance is	Correct	
X	Incorrect (show amount)	E163,000

Invoice #4212	E72,000
Invoice #4593	E66,000
Invoice #4738	E25,000

Signature	Title
	Date

Joan's note to file:

Invoices #4593 and 4738 are not on the A/R aging report at December 31, 2018.

Required 4-[7 Marks]

Confirmation Letter #4

February 1, 2019
 NC Boating Center, Inc.
 110 Windward Blvd.
 Kwaluseni, Manzini 33715

Re: Balance at December 31, 2018 - E239, 000

Dear Sirs:

As of December 31, 2018, our records indicate your balance with our company as the amount listed above. Please complete and sign the bottom portion of this letter and return the entire letter to our auditors, JS LLP, PO Box 100, Kwaluseni, Manzini 32806.

A stamped, self-addressed envelope is enclosed for your convenience.

Sincerely,
 Aquatic Jet Products, Inc.

The above balance is	Correct	
X	Incorrect (show amount)	E

If incorrect, please provide information that could help to reconcile your account.

Response: We cannot determine the balance due at December 31, 2018.

Signature	Title
	Date

Joan's note to file:

No amount was confirmed on the response letter.

Required 5-[7 Marks]

Confirmation Letter #5

February 1, 2019
 Desert Boats
 2135 W. Lane Ave.
 Kwaluseni, Manzini 85287

Re: Balance at December 31, 2018 - E60, 000

Dear Sirs:

As of December 31, 2018, our records indicate your balance with our company as the amount listed above. Please complete and sign the bottom portion of this letter and return the entire letter to our auditors, JS LLP, PO Box 100, Kwaluseni, Manzini 32806.

A stamped, self-addressed envelope is enclosed for your convenience.

Sincerely,
 Aquatic Jet Products, Inc.

The above balance is	Correct	
X	Incorrect (show amount)	0

If incorrect, please provide information that could help to reconcile your account.

Response: We paid the entire amount on December 30, 2018. So the balance is completely incorrect.

Signature	Title
	Date

Joan's note to file:

I found cash recorded as received in the cash receipts journal on January 3, 2019.

Question 3-[15 Marks] - [Whittington-Adapted]

3. a. Describe the principal purpose of internal controls relating to plant and equipment. **[1 Mark]**
3. b. List and describe the major controls applicable to plant and equipment. **[14 Marks]**