

**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

- (a) Yandisa (Pty) Ltd has a number of long and short-term payables, accruals and provisions in its balance sheet.

Required:

Describe the audit procedures you would apply to each of the three items listed below, including those relating to disclosure.

- (i) **THREE procedures for a 10-year bank loan with a variable interest rate and an overdraft (a bank account with a debit balance on the bank statement), both from the same bank.** (6 marks)
- (ii) **FOUR procedures for expense accruals.** (4 marks)
- (iii) **FOUR procedures for trade payables and purchase accruals.** (9 marks)
- (b) Benkosi (Pty) Ltd has a provision in its balance sheet for claims made by customers for product defects under 1-year company warranties.

Required:

Describe the THREE matters you would consider and THREE types of audit evidence you would require for the provision. (6 marks)

(25 marks)

QUESTION 2

Some organisations conduct inventory counts once a year and external auditors attend those counts. Other organisations have perpetual systems (i.e. they conduct continuous inventory counts) and do not conduct a year-end count.

Required:

- (a) **Explain FOUR reasons why year-end inventory counting is important to the auditors of organisations that do not have perpetual inventory systems.** (4 marks)
- (b) **Describe SIX audit procedures you would perform in order to rely on a perpetual inventory system in a large, dispersed organisation.** (6 marks)
- (c) Saturn (Pty) Ltd is a family-owned company which retails beds, mattresses and other bedroom furniture items. The company's year-end

is 31 December 2020. The only full inventory count takes place at the year-end. The company maintains up-to-date computerised inventory records.

Where the company delivers goods to customers, a deposit is taken from the customer and customers are invoiced for the balance after the delivery. Some goods that are in stock at the year-end have already been paid for in full – customers who collect goods themselves pay by cash or credit card.

Staff at the company's warehouse and shop will conduct the year-end count. The shop and warehouse are open seven days a week except for two important public holidays during the year, one of which is 1 January. The company is very busy in the week prior to the inventory count but the shops will close at 15.00 hours on 31 December and staff will work until 17.00 hours to prepare the inventory for counting. The company has a high turnover of staff. The following inventory counting instructions have been provided to staff at Saturn:

- (i) The inventory count will take place on 1 January 2021 commencing at 09.00 hours. No movement of inventory will take place on that day.
- (ii) The count will be supervised by Mr Motsa, the inventory controller. All staff will be provided with pre-printed, pre-numbered inventory counting sheets that are produced by the computerised system. Mr Motsa will ensure that all sheets are issued, and that all are collected at the end of the count.
- (iii) Counters will work on their own, because there is insufficient staff for them to work in pairs, but they will be supervised by Mr Motsa and Mrs Duma, an experienced shop manager who will make checks on the work performed by counters. Staff will count inventory with which they are most familiar in order to ensure that the count is completed as quickly and efficiently as possible.
- (iv) Any inventory that is known to be old, slow-moving or already sold will be highlighted on the sheets. Staff is required to highlight any inventory that appears to be soiled or damaged.
- (v) All inventory items counted will have a piece of paper attached to them that will show that they have been counted.
- (vi) All inventory that has been delivered to customers but that has not yet been paid for in full will be added back to the inventory quantities by Mr Motsa.

Required:

Describe FIVE weaknesses in Saturn's inventory counting instructions and explain why these weaknesses are difficult to overcome. (15 marks)

(25 marks)

QUESTION 3

- (a) **Explain THREE purposes of a management representation letter.**
(6 marks)

(b) You are the manager in charge of the audit of Colt (Pty) Ltd, a public limited liability company which manufactures specialist cars and other motor vehicles for use in films. The audited turnover is E2.1 billion with profit before tax of E115 million.

All audit work up to, but not including, the obtaining of management representations has been completed. A review of the audit file has disclosed the following outstanding issues:

Tiger

The company is facing a potential legal claim from the Tiger Company in respect of a defective vehicle that was supplied for one of their films. Tiger maintains that the vehicle was not built strongly enough while the directors of Colt argued that the specification was not sufficiently detailed. Dropping a vehicle 50 metres into a river and expecting it to continue to remain in working condition would be unusual, but this is what Tiger expected. Solicitors are unable to determine liability at the present time. A claim for \$4 million being the cost of a replacement vehicle and lost production time has been received by Colt from Tiger. The director's opinion is that the claim is not justified.

Depreciation

Depreciation of specialist production equipment has been included in the financial statements at the amount of 10% pa based on reducing balance. However the treatment is consistent with prior accounting periods (which received an unmodified auditor's report) and other companies in the same industry and sales of old equipment show negligible profit or loss on sale. The audit senior, who is new to the audit, feels that depreciation is being undercharged in the financial statements.

Required:

For each of the above matters:

- (i) **Discuss whether or not a paragraph is required in the representation letter; and** (6 marks)
- (ii) **If appropriate, draft the paragraph for inclusion in the representation letter.** (6 marks)

- (c) A suggested format for the letter of representation has been sent by the auditors to the directors of Colt.
The directors have stated that they will not sign the letter of representation this year on the grounds that they believe the additional evidence that it provides is not required by the auditor.

Required:

Discuss the actions the auditor may take as a result of the decision made by the directors not to sign the letter of representation. (7 marks)

(25 marks)

QUESTION 4

Assume today's date is 3rd December 2019. The audit of Dreams (Pty) Ltd is nearly complete and the financial statements and the audit report are due to be signed next week. However, the following additional information on two material events has just been presented to the auditor. The company's year-end was 30 September 2019.

Event 1 – Occurred on 10th October 2019

The springs in a new type of mattress have been found to be defective making the mattress unsafe for use. There have been no sales of this mattress; it was due to be marketed in the next few weeks. The company's insurers estimate that inventory to the value of E11.2 million has been affected. The insurers also estimate that the mattresses are now only worth E3.4 million. No claim can be made against the supplier of springs as this company is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay Dreams for the fall in value of the inventory as the company was underinsured. This entire inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end.

Event 2 – Occurred on 5th November 2019

Production at the Nhlanguano factory was halted for one day when a truck carrying dye used in colouring the fabric on mattresses reversed into a metal pylon, puncturing the vehicle causing dye to spread across the factory premises and into a local river. The Eswatini Environmental Authority is currently considering whether the release of dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.

Required:

- (a) **For each of the two events above:**
- (i) **Explain whether the events are adjusting or non-adjusting according to IAS 10 *Events After the Reporting Period*.** (5 marks)

(ii) Explain the *auditors' responsibility, the audit procedures, and actions* that should be carried out according to ISA 560 (Redrafted) *Subsequent Events*. (12 marks)

(b) Assume that the date is now 20 December 2019. The financial statements and the audit report have just been signed, and the annual general meeting is to take place on 10 January 2020. The Environmental Agency has issued a report stating that Dreams Co is in breach of environmental legislation and a fine of E13.5 million will now be levied on the company. The amount is material to the financial statements.

Required:

Explain FOUR additional audit procedures the auditor should carry out in respect of this fine. (8 marks)

(25 marks)