

UNIVERSITY OF SWAZILAND

DEPARTMENT OF ACCOUNTING

MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM IV

TITLE OF PAPER : AUDITING 2

COURSE CODE : 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) Describe external auditor's responsibilities and the work that the auditor should perform in relation to the going concern status of companies. (6 marks)

(b) Describe the possible audit reports that can be issued where the going concern status of a company is called into question; your answer should describe the circumstances in which they can be issued. (6 marks)

Talk is a large telecommunications company that is listed on a stock exchange. It is highly geared because, like many such companies, it borrowed a large sum to pay for a licence to operate a mobile phone network with technology that has not proved popular. The company's share price has dropped by 50% during the last three years and there have been several changes of senior management during that period. There has been considerable speculation in the press over the last six months about whether the company can survive without being taken over by a rival. There have been three approaches made to the company by other companies regarding a possible takeover but all have failed, mainly because the bidders pulled out of the deal as a result of the drop in share prices generally.

The company has net assets, but has found it necessary to severely curtail its capital investment program. Some commentators consider this to be fundamental to the future growth of the business, others consider that the existing business is fundamentally sound. It has also been necessary for the company to restructure its finances. Detailed disclosures of all of these matters have always been made in the financial statements. No reference has been made to the going concern status of the company in previous auditor's reports on financial statements and the deterioration in circumstances in the current year is no worse than it has been in previous years.

Required:

(c) On the basis of the information provided above, describe the audit report that you consider is likely to be issued in the case of Talk, giving reasons. (6 marks)

(d) Explain the difficulties that would be faced by Talk and its auditors if Talk's audit report made reference to going concern issues. (7 marks)

(25 marks)

QUESTION 2

(a) Describe the auditor's responsibility for subsequent events occurring between:

(i) The year-end date and the date the auditor's report is signed; and

(ii) The date the auditor's report is signed and the date the financial statements are issued. (7 marks)

(b) Savemore Co operates a chain of food wholesalers across the country and its year end was 31 March 2017.

The final audit is nearly complete and it is proposed that the financial statements and audit report will be signed on 13 June 2017. Revenue for the year is E78 million and profit before taxation is E7.5 million. The following events have occurred subsequent to the year end.

Receivable

A customer of Savemore Co has been experiencing cash flow problems and its year-end balance is E0.3 million.

The company has just become aware that its customer is experiencing significant going concern difficulties.

Savemore believe that as the company has been trading for many years, they will receive some, if not full, payment from the customer; hence they have not adjusted the receivable balance.

Lawsuit

A key supplier of Savemore Co is suing them for breach of contract. The lawsuit was filed prior to the year end, and the sum claimed by them is E1 million. This has been disclosed as a contingent liability in the notes to the financial statements; however correspondence has just arrived from the supplier indicating that they are willing to settle the case for a payment by Savemore Co of E0.6 million. It is likely that the company will agree to this.

Warehouse

Savemore Co has three warehouses; following extensive rain on 10 May 2017 significant rain and river water flooded the warehouse located in Bass. All of the inventory was damaged and has been disposed of. The insurance company has already been contacted. No amendments or disclosures have been made in the financial statements.

Required:

For each of the three events above:

(i) discuss whether the financial statements require amendment;

(ii) describe audit procedures that should be performed in order to form a conclusion on the amendment; and

(iii) explain the impact on the audit report should the issue remain unresolved. (18 marks)

Note: The total marks will be split equally between each event.

(25 marks)

QUESTION 3

Shiny Window Glass Co (Shiny) 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. Shiny's year end is 31 March.

Shiny is finalising the arrangements for the year-end inventory count, which is to be undertaken on 31 March 2017.

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 Shiny 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 Shiny Window Glass Co:

- (i) Identify and explain SIX deficiencies; and**
- (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 Zwane & Co and are responsible for the audit of inventory for Shiny. You will be attending the year-end inventory count on 31 March 2017.

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

Required:

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

(25 marks)

QUESTION 4

Your firm is the external auditor of Mlangeni Trading, a privately owned incorporated business, and you are auditing the financial statements for the year ended 30 November 2016. Mlangeni Trading has sales of E11 million and trade receivables at 30 November 2016 were E2.1 million.

The engagement partner has asked you to consider the relative reliability and independence of evidence from third parties and certain matters relating to the circularization of receivables.

In relation to part (b) (ii) of the question, the partner has explained that judgment would be used to select receivables which appear to be doubtful and those which would be selected using the monetary unit sampling (Emalangi unit sampling) technique describe in part (b) (i).

Required:

(a) Consider the relative reliability and independence of the following types of evidence from third parties.

- (i) Replies to a circularization of receivables to confirm trade receivables.**

- (ii) **Vendor's statements to confirm accounts payable balances.**
(8 marks)

(b) **Describe the audit work you would carry-out in following up the responses to the circularization of receivables where:**

(i) **The customer disagrees with the balance and provides a different balance.**

(ii) **No reply to the circularization has been received from the customer and all attempts of obtaining reply have failed.**

(8 marks)

(c) Sizwe (Pty) Ltd has a significant number of cash transactions and recent non-current asset purchases have been financed by a bank loan. This loan is repayable in equal annual instalments for the next five years:

Required:

(i) **Explain the procedures to obtain a bank report for audit purposes from Sizwe's bank and the substantive procedures that should be carried out on that report.**
(4 marks)

(ii) **List the further substantive procedures that should be carried out on the bank balances in Sizwe's financial statements.**
(5 marks)

(25 marks)

End of Question Paper