

COURSE CODE: ACF 415 (M) 2019

UNIVERSITY OF ESWATINI
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM VI / B COM IV

TITLE OF PAPER : AUDITING 1

COURSE CODE : AC 417/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) Discuss FIVE advantages and FIVE disadvantages of outsourcing an internal audit department. (10 marks)

(b) Madusha Co has a sales income of E550 million and employs 1,200 people in 9 different locations.

Madusha Co provides various financial services from pension and investment advice to individuals, to maintaining cash books and cash forecasting in small to medium-sized companies. The company is owned by six shareholders, who belong to the same family; it is not listed on any stock-exchange and the shareholders have no intention of applying for a listing. However, an annual audit is required by statute and additional regulation of the financial services sector is expected in the near future.

Most employees are provided with on-line, real-time computer systems, which present financial and stock market information to enable the employees to provide up-to-date advice to their clients. Accounting systems record income, which is based on fees generated from investment advice. Expenditure is mainly fixed, being salaries, office rent, lighting and heating, etc. Internal control systems are limited; the directors tending to trust staff and being more concerned with making profits than implementing detailed controls.

Four of the shareholders are board members, with one member being the chairman and chief executive officer.

The financial accountant is not a Chartered Accountant, although has many years' experience in preparing financial statements.

Required:

Discuss the reasons for and against having an internal audit department in Madusha Co. (15 marks)

(25 marks)

QUESTION 2

Woodies Co is a company listed on a stock exchange. It manufactures furniture which it supplies to a wide range of retailers across the SADC. The company has an internal audit (IA) department and its year-end is 31 December 2019. You are an audit supervisor with Benkosi & Co, preparing the draft audit programmes and reviewing extracts from the internal controls documentation in preparation for the interim audit. The key areas covered by the draft audit programme are as follows:

Sales

Woodies Co generates revenue through visits by its sales staff to customers' premises. Sales ledger clerks, who work at head office, carry out credit checks on new customers prior to being accepted and then set their credit limits. Sales staff visit retail customers' sites personally and orders are completed using a four-part pre-printed order form. One copy is left with the customer, a second copy is returned to the sales ordering department, the third is sent to the warehouse and the fourth to the finance department at head office. Each sales

order number is based on the sales person's own identification number in order to facilitate monitoring of sales staff performance.

Retail customers are given payment terms of 30 days and most customers choose to pay their invoices by bank transfer.

Each day Menzi Dube, a finance clerk, posts the bank transfer receipts from the bank statements to the cash book and updates the sales ledger. On a monthly basis, she performs the bank reconciliation.

Purchases and inventory

Receipts of raw materials and goods from suppliers are processed by the warehouse team at head office, who agree the delivery to the purchase order, check the quantity and quality of goods and complete a sequentially numbered goods received note (GRN). The GRNs are sent to the finance department daily. On receipt of the purchase invoice from the supplier, Sizwe Gule, the purchase ledger clerk, matches it to the GRN and order and the three documents are sent for authorisation by the appropriate individual. Once authorised, the purchase invoices are logged into the purchase ledger by Sizwe, who utilises document count controls to ensure the correct number of invoices has been input.

The company values its inventory using standard costs, both for internal management reporting and for inclusion in the year-end financial statements. The basis of the standard costs was reviewed approximately 18 months ago.

Payroll

Woodies Co employs a mixture of factory staff, who work a standard shift of eight hours a day, and administration and sales staff who are salaried. All staff is paid monthly by bank transfer. Occasionally, overtime is required of factory staff. Where this occurs, details of overtime worked per employee is collated and submitted to the payroll department by a production clerk. The payroll department pays this overtime in the month it occurs. At the end of each quarter, the company's payroll department sends overtime reports which detail the amount of overtime worked to the production director for their review.

Woodies Co's payroll package produces a list of payments per employee which links into the bank system to produce a list of automatic bank transfer payments. The finance director reviews the total to be paid on the list of automatic payments and compares this to the total payroll amount to be paid for the month per the payroll records. If any issues arise, then the automatic bank transfer can be manually changed by the finance director.

Required:

In respect of the internal controls of Woodies Co:

- (a) Identify and explain SIX deficiencies;** (7 marks)
- (b) Recommend a control to address each of these deficiencies; and** (9 marks)
- (c) Describe a TEST OF CONTROL the external auditors should perform to assess if each of these controls, if implemented, is operating effectively to reduce the identified deficiency.** (9 marks)
(25 marks)

QUESTION 3

You are a manager in the audit firm of Nkuli & Co; and this is your first time you have worked on one of the firm's established clients, Yandy Co. The main activity of Yandy Co is providing investment advice to individuals regarding saving for retirement, purchase of shares and securities and investing in tax efficient savings schemes. Yandy is regulated by the relevant financial services authority.

You have been asked to start the audit planning for Yandy Co, by Mr Zwane, a partner in Nkuli & Co. Mr Zwane has been the engagement partner for Yandy Co, for the previous nine years and so has excellent knowledge of the client. Mr Zwane has informed you that he would like his daughter Celiwe to be part of the audit team this year; Celiwe is currently studying for her first set of fundamentals papers for her professional qualification. Mr Zwane also informs you that Mr Dlamini, the audit senior, received investment advice from Yandy Co during the year and intends to do the same next year.

In an initial meeting with the finance director of Yandy Co, you learn that the audit team will not be entertained on Yandy Co's yacht this year as this could appear to be an attempt to influence the opinion of the audit. Instead, he has arranged a balloon flight costing less than one-tenth of the expense of using the yacht and hopes this will be acceptable. The director also states that the fee for taxation services this year should be based on a percentage of tax saved and trusts that your firm will accept a fixed fee for representing Yandy Co in a dispute regarding the amount of sales tax payable to the taxation authorities.

Required:

- (a) (i) Explain SEVEN ethical threats which may affect the auditor of Yandy Co. (6 marks)
- (ii) For each ethical threat, discuss how the effect of the threat can be mitigated. (6 marks)
- (b) Discuss the benefits of Yandy Co establishing an internal audit department. (8 marks)
- (c) Explain the factors that should be considered by an external auditor before reliance can be placed on the work performed by a company's internal audit department. (5 marks)

(25 marks)

QUESTION 4

Zoola Cola Co (Zoola) manufactures fizzy drinks such as cola and lemonade as well as other soft drinks and its year end is 31 December 2019. You are the audit manager of Konkhe & Co and are currently planning the audit of Zoola. You attended the planning meeting with the engagement partner and finance director last week and recorded the minutes from the meeting shown below. You are reviewing these as part of the process of preparing the audit strategy.

Minutes of planning meeting for Zoola

Zoola's trading results have been strong this year and the company is forecasting revenue of E85 million, which is an increase from the previous year. The company has invested significantly in the cola and fizzy drinks production process at the factory. This resulted in expenditure of E5 million on updating, repairing and replacing a significant amount of the machinery used in the production process.

As the level of production has increased, the company has expanded the number of warehouses it uses to store inventory. It now utilises 15 warehouses; some are owned by Zoola and some are rented from third parties. There will be inventory counts taking place at all 15 of these sites at the year end.

A new accounting general ledger has been introduced at the beginning of the year, with the old and new systems being run in parallel for a period of two months.

As a result of the increase in revenue, Zoola has recently recruited a new credit controller to collect outstanding receivables. The finance director thinks it is not necessary to continue to maintain an allowance for receivables and so has released the opening allowance of E1.5 million.

In addition, Zoola incurred expenditure of E4.5 million on developing a new brand of fizzy soft drinks. The company started this process in January 2019 and is close to launching the new product into the market place.

The Finance Director stated that in November there was a problem in the mixing of raw materials within the production process which resulted in a large batch of cola products tasting different. A number of these products were sold; however, due to complaints by customers about the flavour, no further sales of these goods have been made. No adjustment has been made to the valuation of the damaged inventory, which will still be held at cost of E1 million at the year end.

As in previous years, the management of Zoola is due to be paid a significant annual bonus based on the value of year-end total assets.

Required:

(a) Explain the term audit risk and the THREE components of audit risk.
(7 marks)

(b) Using the minutes provided, identify and describe SIX audit risks, and explain the auditor's response to each risk, in planning the audit of Zoola Cola Co.
(12 marks)

(c) Identify the main areas, other than audit risks, that should be included within the audit strategy document for Zoola Cola Co; and for each area provide an example relevant to the audit.
(6 marks)

(25 marks)

End of Question Paper