



UNIVERSITY OF ESWATINI

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

MAIN EXAMINATION

OCTOBER 2021

TITLE OF PAPER : AUDITING 11

COURSE CODE : ACF416

TOTAL MARKS : 100 MARKS

TIME ALLOWED : THREE (3) HOURS

- INSTRUCTIONS**
- 1 There are four (4) questions, answer all
 - 2 Begin the solution to each question on a new page.
 - 3 The marks awarded for a question are indicated at the end of each question.
 - 4 Show the necessary workings.
 - 5 Calculations are to be made to zero decimal places of accuracy, unless otherwise instructed.

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.

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SPECIAL REQUIREMENTS: NON-PROGRAMMABLE CALCULATOR

QUESTION 1

- a) ISA 265 Communicating deficiencies in internal control with those charged with Governance and Management. Auditors must report deficiencies in internal control with those charged with governance and management. You are required to explain clearly *what management letter is*, indicating the contents of such a letter. (10 marks)
- b) Briefly explain what is meant by the '*Going Concern Concept*' and describe the test and procedures that the auditor needs to perform to form an opinion on management's conclusion that the company is a going concern as specified by ISA 570 Going Concern. (10 marks)
- c) Distinguish the *three (3) types of modified opinions* that the auditor may issue on financial statements audited by him. (6 marks)
- d) State with details *four (4) circumstances* under which an auditor may issue a qualified opinion. (2 marks) [Total = 30 marks]

QUESTION 2

a) Kings and Queens Toys Company is a manufacturer of children's building block toys; they have been trading for over 35 years and they sell to a wide variety of customers including large and small toy retailers across the country. The company's financial year ends 31 May 2020.

The company has a large manufacturing plant, four large warehouses and a head office. Upon manufacture, the toys are stored in one of the warehouses until they are dispatched to customers. The company does not have an internal audit department.

Sales ordering, goods dispatched and invoicing

Each customer has a unique customer account number and this is used to enter sales orders when they are received in writing from customers. The orders are entered by an order clerk and the system automatically checks that the goods are available and that the order will not take the customer over their credit limit.

For new customers, a sales manager completes a credit application; this is checked through a credit agency and a credit limit entered into the system by the credit controller. The company has a price list, which is updated twice a year. Larger customers are entitled to a discount; this is agreed by the sales director and set up within the customer master file.

Once the order is entered an acceptance is automatically sent to the customer by mail/email confirming the goods ordered and a likely dispatch date. The order is then sorted by address of

customer. The warehouse closest to the customer receives the order electronically and a dispatch list and sequentially numbered goods dispatch notes (GDNs) are automatically generated.

The warehouse team packs the goods from the dispatch list and, before they are sent out, a second member of the team double checks the dispatch list to the GDN, which accompanies the goods.

Once dispatched, a copy of the GDN is sent to the accounts team at head office and a sequentially numbered sales invoice is raised and checked to the GDN. Periodically a computer sequence check is performed for any missing sales invoice numbers.

Fraud

During the year a material fraud was uncovered. It involved cash/cheque receipts from customers being diverted into employees' personal accounts. In order to cover up the fraud, receipts from subsequent unrelated customers would then be recorded against the earlier outstanding receivable balances and this cycle of fraud would continue.

The fraud occurred because two members of staff 'who were related' colluded. One processed cash receipts and prepared the weekly bank reconciliation; the other employee recorded customer receipts in the sales ledger.

An unrelated sales ledger clerk was supposed to send out monthly customer statements but this was not performed. The bank reconciliations each had a small unreconciled amount but no-one reviewed the reconciliations after they were prepared.

The fraud was only uncovered when the two employees went on holiday at the same time and it was discovered that cash receipts from different customers were being applied to older receivable balances to hide the earlier sums stolen.

Required:

Identify and explain controls Kings and Queens should implement to reduce the risk of fraud occurring again and, for each control, describe how it would mitigate the risk. **(10 marks)**

b) You are a manager in D & J Company Limited, responsible for the audit of UNESWA Company Limited, a new audit client of your firm, with a financial year ended 31 July 2021. UNESWA Company's draft financial statements recognise total assets of E55 million, and profit before tax of E15 million. The audit is nearing completion and you are reviewing the audit files.

UNESWA Company designs and creates high-value items of furniture. Approximately half of the Furniture is sold in UNESWA Company's own retail outlets. The other half is sold by external vendors under a consignment stock arrangement, the terms of which specify that UNESWA Company retains the ability to change the selling price of the furniture, and that the vendor is required to return any unsold furniture after a period of nine months. When the vendor sells an item of furniture to a customer, legal title passes from UNESWA Company to the customer.

On delivery of the furniture to the external vendors, UNESWA Company recognises revenue and derecognises inventory. At 31 July 2021, furniture at cost price of E3 million is held at external vendors. Revenue of E4 million has been recognised in respect of this furniture.

Required:

Comment on the matters that should be considered, and explain the audit evidence you should expect to find in your file review in respect of the consignment stock arrangement. **(10 marks)**

c) Your firm also performs the audit of Difficult Times Company Limited, a company which installs windows. Difficult Times Company uses sales representatives to make direct sales to customers. The sales representatives earn a small salary, and also earn a sales commission of 20% of the sales they generate.

Difficult Times Company's sales manager has discovered that one of the sales representatives has been operating a fraud, in which he was submitting false claims for sales commission based on non-existent sales. The sales representative started to work at Difficult Times Company in January 2021. The forensic investigation department of your firm has been engaged to quantify the amount of the fraud.

Required:

Recommend the procedures that should be used in the forensic investigation to quantify the amount of the fraud. **(10 marks)** **(Total = 30 marks)**

QUESTION 3

a) BDE Company Limited operates a hotel providing accommodation, leisure facilities and restaurants. Its year ends on 31 March. You are the senior associate of ABC and Associates and are currently preparing the audit programmes for the year-end audit of BDE Company Limited. You are reviewing the notes of last week's meeting between the audit manager and finance director where two material issues were discussed.

Depreciation

BDE Company Limited incurred significant capital expenditure during the year for refurbishing the restaurant facilities for the hotel.

The finance director has proposed that the new leisure equipment should be depreciated over 10 years using the straight-line method.

Food poisoning

BDE's directors received correspondence in January from a group of customers who attended a wedding at the hotel. They have alleged that they suffered severe food poisoning from food eaten at the hotel and are claiming substantial damages. BDE's lawyers have received the claim and believe that the lawsuit against the company is unlikely to be successful.

Required:

- i) Describe *substantive procedures* to obtain *sufficient and appropriate audit evidence* in relation to the above two issues. **(6 marks)**
- ii) List and explain the purpose of three items that should be included on every working paper prepared by the audit team during the audit of depreciation and food poisoning of BDE Company Limited. **(3 marks)**

b)

- i) Identify and explain two financial statement assertions relevant to account balances at the year-end **(2 marks)**

For each identified assertion in (i) above, describe a substantive procedure relevant to the

- ii) audit of year –end inventory **(4 marks)**

c) *International Standard on Auditing 560: Subsequent Events* deals with auditor's responsibility towards events that occur after reporting date and especially before the auditor's report is issued. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in the financial statements have been identified. Explain *five (5)* audit procedures to test subsequent events. **(5 marks) (Total = 20 marks)**

QUESTION 4

Africa Beauty, a private company, owned by its directors, manufactures wooden window frames, doors and staircases for domestic houses. It has prepared draft accounts for the year ended 30 September 2021 and you are concerned that they indicate serious going concern problems. The income statements and balance sheets for the last five years (each ended 30 September) are given below.

INCOME STATEMENTS

	2017	2018	2019	2020	2021
	E'000	E'000	E'000	E'000	E'000
Sales	625	787	1,121	1,661	1,881
Cost of sales	(478)	(701)	(962)	(1,326)	(1,510)
Gross profit	147	86	159	335	371
Other expenses	(88)	(86)	(161)	(240)	(288)
Interest	(6)	(9)	(58)	(90)	(117)
Net profit/(loss)	<u>53</u>	<u>(9)</u>	<u>(60)</u>	<u>5</u>	<u>(34)</u>

STATEMENT OF FINANCIAL POSITION

	2017	2018	2019	2020	2021
	E'000	E'000	E'000	E'000	E'000
<i>Assets</i>					
Current assets					
Inventory	67	133	181	307	449
Trade accounts receivable	91	240	303	313	364
	<u>158</u>	<u>373</u>	<u>484</u>	<u>620</u>	<u>813</u>
Net current assets	89	161	544	600	587
<i>Total assets</i>	<u>247</u>	<u>534</u>	<u>1,028</u>	<u>1,220</u>	<u>1,400</u>
<i>Liabilities and shareholders' funds</i>					
Current liabilities					
Trade accounts payable	90	317	355	490	641
Bank overdraft	10	65	211	269	365
Lease creditor	14	28	98	92	59
	<u>114</u>	<u>410</u>	<u>664</u>	<u>851</u>	<u>1,065</u>
Non-current loan	—	—	300	300	300
	<u>114</u>	<u>410</u>	<u>964</u>	<u>1,151</u>	<u>1,365</u>

	2017	2018	2019	2020	2021
	E'000	E'000	E'000	E'000	E'000
Shareholders' funds					
Share capital	17	17	17	17	17
Reserves	116	107	47	52	18
	<u>133</u>	<u>124</u>	<u>64</u>	<u>69</u>	<u>35</u>
Total liabilities and shareholders' Funds	<u>247</u>	<u>534</u>	<u>1,028</u>	<u>1,220</u>	<u>1,400</u>

The company has been in business for about fifteen years. In January 2018 it decided to build a new factory on a site leased from the local authority which would allow a major increase in sales. This new factory with new equipment was completed a year later. The factory was financed by a non-current loan of E300,000 from a merchant bank and an increase in the bank overdraft.

The loan from the merchant bank is secured by a fixed charge on the leasehold factory and the bank overdraft is secured by a second charge on the leasehold factory, a fixed charge on the other non-current assets and a floating charge on the current assets.

The company purchases its main raw material, wood, from timber wholesalers. It sells around 75% of its production to about 12 local and national builders of new domestic houses. The remaining sales are mainly to smaller builders with a very few sales to local builders merchants.

Required

a) In relation to the accounts above, list and briefly describe the factors which indicate that the company may not be a going concern. You should also highlight certain figures and calculate relevant ratios in the accounts. (12 marks)

Note. You will only be given credit for going concern problems which can be determined from the accounts above.

b) Describe the investigations and checks you would carry out, in addition to those described in part (a) above, to determine whether the company is a going concern. (8 marks)(Total = 20 marks)