

UNIVERSITY OF SWAZILAND
DEPARTMENT OF ACCOUNTING
MAIN EXAMINATION QUESTION PAPER

DEGREE/YEAR OF STUDY : B COM IV

TITLE OF PAPER : AUDITING 1

COURSE CODE : AC 417

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) Explain what is meant by 'corporate governance' and why it is important. (4 marks)

(b) Muse Co has been trading for over 20 years and obtained a listing on a stock exchange five years ago. It provides specialist training in accounting and finance.

The listing rules of the stock exchange require compliance with corporate governance principles, and the directors are fairly confident that they are following best practice in relation to this. However, they have recently received an email from a significant shareholder, who is concerned that Muse Co does not comply with corporate governance principles.

Muse Co's board is comprised of six directors; there are four executives who originally set up the company and two non-executive directors who joined Muse Co just prior to the listing. Each director has a specific area of responsibility and only the finance director reviews the financial statements and budgets.

The chief executive officer, Daniel Blue, set up the audit committee and he sits on this sub-committee along with the finance director and the non-executive directors. As the board is relatively small, and to save costs,

Daniel Blue has recently taken on the role of chairman of the board. It is the finance director and the chairman who make decisions on the appointment and remuneration of the external auditors. Again, to save costs, no internal audit function has been set up to monitor internal controls.

The executive directors' remuneration is proposed by the finance director and approved by the chairman. They are paid an annual salary as well as a generous annual revenue related bonus.

Since the company listed, the directors have remained unchanged and none have been subject to re-election by shareholders.

Required:

Describe SIX corporate governance weaknesses faced by Muse Co and provide recommendations to address each weakness, to ensure compliance with corporate governance principles. (12 marks)

(c) Explain the auditor's ethical responsibilities with regard to client confidentiality and when they have an:

(i) obligatory responsibility; and

(ii) voluntary responsibility to disclose client information. (5 marks)

(d) Mango (Pty) Ltd is aware that subsequent to the stock exchange listing it will need to establish an audit committee and has asked for some advice in relation to this.

Required:

Explain the benefits to Mango of establishing an audit committee.

(4 marks)

(25 marks)

QUESTION 2

- (a) You are the Audit Manager of Samketi & Associates Chartered Accountants (SD) and you are planning the audit of Lux Phones (Pty) Ltd, which has been an audit client for four years and specializes in manufacturing luxury mobile phones.

During the planning stage of the audit you have obtained the following information. The employees of Lux Phones (Pty) Ltd are entitled to purchase mobile phones at a discount of 10%. The audit team has in previous years been offered the same level of staff discount.

During the year the financial controller of Lux Phones (Pty) Ltd was ill and hence unable to work. The company had no spare staff able to fulfil the role and hence a qualified audit senior of Samketi & Associates was seconded to the client for three months. The audit partner has recommended that the audit senior work on the audit as he has good knowledge of the client. The fee income derived from Lux Phones (Pty) Ltd was boosted by this engagement and along with the audit and tax fee, now accounts for 16% of the firm's total fees.

From a review of the correspondence files you note that the partner and the finance director have known each other socially for many years and in fact went on holiday together last summer with their families. As a result of this friendship the partner has not yet spoken to the client about the fee for last year's audit, 20% of which is still outstanding.

Required:

- (i) **Explain the ethical threats which may affect the independence of Samketi & Associates's audit of Lux Phones (Pty) Ltd; and**

(5 marks)

- (ii) **For each threat explain how it might be avoided.**

(5 marks)

- (b) International Standard on Auditing 300 (revised) *Planning an Audit of Financial Statements*, states that an auditor must plan the audit.

Explain why it is important to plan an audit. (5 marks)

- (c) **Explain the purpose of an engagement letter and list the main contents of this letter.** (6 marks)

- (d) **Explain the concepts of materiality and performance materiality in accordance with ISA 320 *Materiality in Planning and Performing an Audit*.** (4 marks)

(25 marks)

QUESTION 3

Introduction

Lion Industries Co (Lion) manufactures engineering parts. It has one operating site and a customer base spread across Europe. The company's year- end was 30 September 2015. Below is a description of the purchasing and payments system.

Purchasing system

Whenever production materials are required, the relevant department sends a requisition form to the ordering department. An order clerk raises a purchase order and contacts a number of suppliers to see which can dispatch the goods first. This supplier is then chosen. The order clerk sends out the purchase order. This is not sequentially numbered and only orders above \$5,000 require authorisation.

Purchase invoices are input daily by the purchase ledger clerk, who has been in the role for many years and, as an experienced team member, he does not apply any application controls over the input process. Every week the purchase day book automatically updates the purchase ledger, the purchase ledger is then posted manually to the general ledger by the purchase ledger clerk.

Payments system

Lion maintains a current account and a number of saving (deposit) accounts. The current account is reconciled weekly but the saving (deposit) accounts are only reconciled every two months.

In order to maximise their cash and bank balance, Lion has a policy of delaying payments to all suppliers for as long as possible. Suppliers are paid by a bank transfer. The finance director is given the total amount of the payments list, which he authorises and then processes the bank payments.

Required:

(a) As the external auditors of Lion Industries Co, write a report to management in respect of the purchasing and payments system described above which:

- (i) Identifies and explains FIVE deficiencies in the system; and**
- (ii) Explains the possible implication of each deficiency; and**
- (iii) Provides a recommendation to address each deficiency.**

A covering letter is required.

Note: Up to three marks will be awarded within this requirement for presentation and the remaining marks will be split equally between each part.

(15 marks)

(b) Identify and explain FIVE application controls that should be adopted by Lion Industries Co to ensure the completeness and accuracy of the input of purchase invoices.

(5 marks)

(c) You are the audit senior in charge of the audit of Bird Co (Bird), and have been informed by your audit manager that during the year a fraud occurred at the client. A payroll clerk set up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department.

Required:

Describe procedures which should be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud.

(5 marks)

(25 marks)

QUESTION 4

(a) (i) Define a 'test of control' and provide an example of a test of control in relation to the audit of wages and salaries; and

(ii) Define a 'substantive procedure' and provide an example of a substantive procedure in relation to the audit of wages and salaries.

Note: The total marks will be split equally between each part. *(5 marks)*

(b) ISA 500 *Audit Evidence* requires auditors to obtain sufficient and appropriate audit evidence. Appropriateness is a measure of the quality of audit evidence; that is, its relevance and its reliability.

Required:

Identify and explain FOUR factors which influence the reliability of audit evidence. (4 marks)

(c) (i) Describe FIVE types of procedures for obtaining audit evidence; and

(ii) For each procedure, describe an example relevant to the audit of property, plant and equipment.

Note: The total marks will be split equally between each part. (10 marks)

(d) Explain the components of audit risk and, for each component, state an example of a factor which can result in increased audit risk. (6 marks)

(25 marks)

End of Question Paper