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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE
PROGRAMME

YEAR II SEMESTER II (INTAKE III/IV – GROUP A)
END SEMESTER EXAMINATION – JULY 2016

AFM 20730 Audit & Assurance

Date : 20th July 2016
Time : 9.00 a.m. – 12.00 p.m.
Duration : Three (03) hours

Instructions to Candidates:

- Answer **ANY FIVE (05)** questions.
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Question No. 01

A. Towards the end of an audit, it is common for the auditor to seek a letter of representation (written representations) from the management of the client company.

Required

i. Explain why auditors seek letter of representation.

(02 marks)

ii. List six matters commonly included in the letter of representation.

(03 marks)

iii. Explain why management of an entity sometimes unwilling to sign a letter of representation and describe the actions an external auditor can take if management refuses to sign a letter of representation.

(05 marks)

B. You are the audit manager in charge of the audit of Solaman, a limited liability company. The company's year end is 31 December, and Solaman has been a client of the firm for seven years. The company has been in the business of purchase and sale of fittings for ships including anchors, compasses, sails etc. Clients vary in size from small businesses making yacht to large companies maintaining large luxury cruise ships. No manufacturing takes place in Solaman.

Information about the company's financial performance is as follows:

	<i>2015 Forecast</i> Rs.'000	<i>2014 Actual</i> Rs.'000
Revenue	45,928	40,825
Cost of sales	(37,998)	(31,874)
Gross profit	7,930	8,951
Administration costs	(4,994)	(4,758)
Distribution costs	(2,500)	(2,500)
Net profit	436	1,693

Information about the company's financial position is as follows:

	<i>2015 Forecast</i> Rs.'000	<i>2014 Actual</i> Rs.'000
Non-current assets (at net book value)	3,600	4,500
<i>Current assets</i>		
Inventory	200	1,278
Receivables	6,000	4,052
Cash and bank	500	1,590
Total assets	10,300	11,420
<i>Capital and reserves</i>		
Share capital	1,000	1,000
Accumulated profits	5,300	5,764
Total shareholders' funds	6,300	6,764
Non-current liabilities	1,000	2,058
Current liabilities	3,000	2,598
	10,300	11,420

Other information

The industry that Solaman trades in has seen moderate growth of 7% over the last year.

- Non-current assets mainly relate to company premises used for storing inventory. Ten delivery vehicles are owned by the company with a net book value of Rs.300,000.
- One of the directors of the company purchased a yacht during the year.
- Inventory is stored in ten different locations across the country, with your firm again having offices close to seven of those locations.
- A computerized inventory control system was introduced in August 2015. Inventory balances are now obtainable directly from the computer system. The client does not intend to count inventory at the year-end but rely instead on the computerized inventory control system.

Required

Using the information provided above, identify high-risk areas that you should concentrate in your audit work of Solaman for the year ending 31 December 2015.

(10 marks)

(Total 20 marks)

Question No. 02

VIVA is a company that provides call center services for a variety of organizations. It operates in a medium sized city and your firm is the largest audit firm in the city. VIVA is owned and run by two entrepreneurs with experience in this sector and has been in existence for five years. It is expanding rapidly in terms of its client base, the number of staff it employs and its profits. It is now 15 June 2016 and you have been approached by VIVA to perform the audit for the year ending 30 June 2016. Your firm has not audited this company before. VIVA has had three different firms of auditors since its incorporation.

VIVA's directors have indicated to you informally that the reason they wish to change auditors is because of a disagreement with previous auditor about certain disclosures in the financial statements in the last year. The directors consider that the disagreement is a trivial matter and have indicated that the company accountant will be able to provide you with the details once the audit has commenced. Your firm has explained that before accepting the appointment, there are various matters to be considered within the firm and other procedures to be undertaken, some of which will require the co-operation of the directors. Your firm has other clients that operate call centres. The directors have asked your firm to commence the audit immediately because audited accounts are needed by the VIVA by 30 July 2016. Your firm is very busy at this time of year.

Required

- i. Explain the matters to consider within your firm and the other procedures that must be undertaken before accepting the appointment as auditor to VIVA.

(10 marks)

- ii. Explain why it would be inappropriate to commence the audit before consideration of the matters and the procedures referred to in (i) above have been completed.

(06 marks)

- iii. Explain the purpose of an engagement letter and list its contents.

(04 marks)

(Total 20 marks)

Question No. 03

- A. There are similarities and differences between the responsibilities of internal and external auditors. Both internal and external auditors have responsibilities relating to the prevention, detection and reporting of fraud, but their responsibilities are not the same. Both internal and external audit are part of an organization's overall corporate governance arrangements. Sometimes, the responsibilities of internal auditors are outsourced to external organizations.

Required

- i. Explain the difference between the responsibilities of internal auditors and external auditors for the prevention, detection and reporting of fraud and error.

(05 marks)

- ii. Outline the issues that should be considered when an organization decides to outsource the internal audit function.

(05 marks)

- B. Write audit procedures to vouch goods purchases (local purchases) made by a company

(10 marks)

(Total 20 marks)

Question No. 04

You are an audit manager in an audit firm with ten offices and 250 staff. Your firm is the auditor of Calva, a chain of supermarkets. Your firm has been the auditor of this client for many years. All of the planning work and tests of controls have been completed for Calva for the year ended 31 December 2015.

Staff are still working on substantive procedures. The company operates a continuous inventory checking system with good records and you have tested this system and will be relying on the records for the year-end figure.

The company is intending to invest a substantial amount in opening new stores during the next year and it has been negotiating with both banks and property companies in relation to leases.

Required

A. Describe the objectives of the following and how these objectives will be met in the audit of Calva:

- i. Overall review of financial statements;

(04 marks)

- ii. Review of working papers.

(06 marks)

B. Describe the:

- i. Auditor's responsibilities with regard to subsequent events;

(06 marks)

- ii. Procedures that should be applied during the subsequent events review at Calva.

(04 marks)

(Total 20 marks)

Question No. 05

Humers PLC is a large listed construction company based in the north of the country, whose activities encompass house building and development. The financial statements prepared by the company for the year ended 31st December 2015 shows revenue of Rs.550 million and profit before tax of Rs.70 million.

You are the audit senior involved in the audit of Humers PLC for the year ended 31 December 2015. The following matters have come to your attention during the review stage of the audit in April 2016.

a. Customer going into liquidation

One of Humers PLC's major commercial customers has gone into liquidation shortly after the year-end. As at the year-end, the customer owed the company Rs.7.5 million.

b. Claim for unfair dismissal

One of the company's construction workers, Basil Evans, was dismissed in November 2015 after turning up to work under the influence of alcohol. In December 2016, Mr Evans began a case against the company for unfair dismissal. Lawyers of the company have advised that it will be highly unlikely that he will be successful in his claim.

c. In March 2016 a fire was erupted at one of the company's ten storage depots, destroying Rs.1 million worth of building materials.

Required

For each of the three events at Humers PLC mentioned above:

i. Describe the additional audit procedures you will carry out.

(07 marks)

ii. State whether the financial statements prepared for the year ended 31st December 2015 should be amended in respect of the above events and explain your reasoning.

(07 marks)

iii. Discuss the potential impact of the above events if any on the audit opinion to be expressed in respect of financial statements of the company.

(06 marks)

(Total 20 marks)

Question No. 06

Sunroof Co is a small, family-run company that makes plastic chairs in a variety of shapes and colours for children and 'fun at heart' adults. It buys plastic sheets (which can be cut and bent into the correct shape) and plastic leg which is custom made by another company to Sanroof's requirements. All off-cut plastic is sent back to the supplier who melts it down and re-uses it, for which Sunroof receive a 10% discount off their purchase price.

For the inventory count, the factory manager ensures that no work-in-progress is outstanding. Further production is stopped on the date of inventory count. The factory workers come in early on the day of the inventory count to count the inventory, and they are entitled to go home as soon as inventory count is over. Good controls have always been maintained over the inventory count in previous years. There are no perpetual inventory records. Raw materials are kept in the stores and are only taken out when they are required for production.

You are the audit senior assigned to attend the inventory count. You have just been informed by the factory manager that on the day of the inventory count a large consignment of plastic is going to be delivered. It is the only day that his supplier can make the delivery, and he needs the material to continue with production on the day after the count.

The audit engagement partner has told you that he is aware that Sunroof changed the specification of their customised leg recently, after a series of complaints over the stability of their chairs. Last year's inventory was valued at Rs.200,000 in the statement of financial position, of which Rs.30,000 related to raw material inventory.

Finished goods are carried at the same valuation as there is very little difference between the inventory ranges. Planning materiality for this year has been set at Rs.5,000 on the grounds, at this stage, that the figures are expected to be similar to last year.

Required:

- i. Explain the importance of the inventory count in this situation.

(05 marks)

- ii. Prepare notes for your audit supervisor detailing the procedures you propose to undertake in relation to your inventory count attendance.

(05 marks)

- iii. State the procedures which should be performed in relation to cut-off at the final audit.

(05 marks)

- iv. List the audit procedures you would carry to check the accuracy of valuation of inventory at the final audit.

(05 marks)

(Total 20 marks)

Question No. 07

- A. You are a partner in M Borg, Conno & Co, Chartered Accountants. You are approached by Mr Natali, the Managing director of Navratilova Enterprises Ltd, who request your firm to become auditors of his company. In return for giving you this appointment Mr Natali says that he will expect your firm to waive off 50 per cent of your normal fee charge for the first year's audit. The existing auditors, Messrs Wade, Austin & Co, have not resigned but Mr Natali informs you that they will not be re-appointed in the future.

Required

- i. What action should M Borg, Connors & Co take in response to the request from Mr Natali to reduce their first year's fee by 50 per cent?

(05 marks)

- ii. Are Messrs Wade, Austin & Co have any right not to resign when they know Mr Natali wishes to replace them? Give reasons for your answer.

(05 marks)

- B. Write audit procedures to verify accounts payable (Trade Creditors) balance in a company.

(10 marks)

(Total 20 marks)