NAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY

FACULTY OF MANAGEMENT SCIENCES

DEPARTMENT OF ACCOUNTING, ECONOMICS AND FINANCE

QUALIFICATION: BACHELOR OF ACCOUNTING	
QUALIFICATION CODE: 07BACC	**LEVEL: 7**
COURSE CODE: AUT GAU711S	**COURSE NAME: AUDITING 310**
SESSION: JUNE 2019	**PAPER: THEORY**
DURATION: 3 HOURS	**MARKS: 100**

FIRST OPPORTUNITY EXAMINATION QUESTION PAPER	
EXAMINER(S)	K. Boamah, A. Simasiku & I. Amutenja
MODERATOR:	C. Gamses

INSTRUCTIONS

1. This question paper is made up of four (4) questions.
2. Answer ALL the questions and in blue or black ink.
3. Start each question on a new page in your answer booklet.
4. Questions relating to this examination may be raised in the initial 30 minutes after the start of the paper. Thereafter, candidates must use their initiative to deal with any perceived error or ambiguities & any assumption made by the candidate should be clearly stated.

THIS QUESTION PAPER CONSISTS OF 8 PAGES (Including this front page)

Question 1 (25 marks)

Melboury (Pty) Ltd (Melboury) is a Namibian incorporated company involved in the manufacturing and sale of niche computer equipment, was formed five years ago by its current chief executive officer (CEO), Nathan Nicks. Melboury is not listed on any stock exchange.

Melboury also has investments in subsidiary companies involved in the sales and distribution of ammunition and nuclear weapons in North Korea. These subsidiaries are not audited by Del Touch. The company currently has 10 branches in Namibia. Due to the increasing demand of niche computer equipment, Melboury has decided to expand its footprint by opening 10 new branches in South Africa and another 10 in Nigeria. Del Touch, a small audit firm with a staff complement comprising 2 audit partners, 2 audit managers and 3 audit trainees has been the auditor of Melboury since its incorporation. Del Touch does not have sister offices in South Africa, Botswana and Nigeria.

At the last AGM, the shareholders of Melboury approved the reappointment of Del Touch as the auditors. The current designated partner, Mr Donovan Del, has been the designated auditor for the last 5 years and therefore can no longer serve as the designated auditor and is required to rotate with Ms Tangi Touch. Ms Tangi Touch and Mr Nathan Nicks the CEO of Melboury, have been close friends since high school and frequently invite each other to braais at their homes. In addition, Ms Tangi Touch does not have prior experience auditing clients operating in the technology industry.

While auditing the prior year financial statements of Melboury, Mr Del, uncovered a series of complex related party transactions which he believed were designed to conceal a fraud perpetrated by Mr Nathan Nicks and the rest of management and directors resulting in the qualification of the prior year audit report. Mr Nathan Nicks, in particular, was very unhappy with the qualified opinion issued by Del Touch as he argued that the related party transaction were in any case going to be eliminated at consolidation and therefore the auditors "should not have wasted time auditing these balance which are causing the audit fee to be so high". Mr Nicks also added that no information regarding related parties will be given to the auditors as it only results in audit procedures that add little to no value. Mr Nicks is therefore refusing to settle the outstanding audit fee of N$ 200 000. In terms of revenue earned from audit clients, Melboury is one of 2 major clients of Del Touch.

The board of directors have indicated that the audit should be completed one month after the financial year end.

Required:

1. In terms of ISA 210 , the objective of the auditor is to accept or continue and audit engagement only when the basis upon which it is to be performed has been agreed through:
    - Establishing whether the preconditions for an audit are present
    - Confirming that there is a common understanding between the auditor and management and those charged with governance of the terms of the audit engagement.

    You are required to name the preconditions that are required to be present. **(5 marks)**

2. Discuss the issues Del Touch should consider prior to accepting the reappointment as auditors of Melboury (Pty) Ltd. **(20 marks)**

QUESTION 2: (25 Marks)

Question 2 (A) **(15)**

Mark Niikondo is the current auditor of Delta (Pty) Ltd. a large manufacturing company. He carried out the following procedures for the Delta.

1. During the inventory count he test counted a sample of inventory items selected from the client's inventory list and compared the quantities counted with those on the client's inventory list.

2. He arranged for the financial manager to obtain a positive confirmation from Delta (Pty) Ltd's major overseas debtor. The debtor sent an email confirming the amount owed to the financial manager who forwarded it to Mark Niikondo.

3. He obtained a bank confirmation relating to the client's bank account (overdraft) direct from the bank. On previous occasions the confirmation from the bank had been incorrect but only by small amounts.

4. He inspected a sample of Delta Pty) Ltd's delivery notes for the signature of Delta (Pty) Ltd's dispatch clerk indicating that the goods had been checked against the internal sales order, as well as the signature of the customer's goods received clerk acknowledging receipt of the goods delivered.

5. He observed the offloading and receiving of deliveries by suppliers, to determine whether the goods were counted by Delta (Pty) Ltd's receiving clerks.

Required:

a) Classify each of the above in terms of its source
   - i) Evidence developed by the auditor
   - ii) Evidence obtained from the third parties
   - iii) Evidence obtained from the client.

(5)

b) Assess the evidence obtained in terms of reliability, giving reasons to support your assessment. Indicate the assertion to which the evidence would be relevant. (10)

Question 2 (B) **(10 Marks)**

1. You received a memorandum from your audit manager stating that your allowable rate of deviation for certain tests of controls to be conducted in the acquisition cycle on the audit of Buy-It Ltd, should be increased from the prior year's allowable rate deviation.

2. Your evaluation of the extent to which management has failed to monitor internal control in the payroll cycle of Kaupa Ltd, has led you to believe that an increase in the expected rate of deviation over the authorisation of overtime payments on time records is necessary.

3. As a result of information obtained when conducting risk assessment procedures on the audit of Castle (Pty) Ltd, you have concluded that the risk of non-existent inventory being included in the inventory balance at year end is substantially higher than for the prior year's audit. You are about to select a sample of inventory items for existence testing.

4. Due to more efficient and timeous record keeping at Spartam (Pty) Ltd, your audit plan for the year end will include meaningful subsequent receipts testing for the existence of debtors at year end. This is likely to have an effect on the sample size for the planned positive debtor's circularization.

5. The audit manager on the audit of Bolton (Pty) Ltd has instructed the team that he would like to be in a position to gain more assurance from the operating effectiveness of control so that less substantive work can be conducted.

RQUIRED:

Indicate what the effect on the relevant sample sizes would be for each of the situations described (in 1 – 5) above. Consider each situation separately and justify your answer for each.

(10)

TOTAL 15+10 = 25 MARKS)

QUESTION 3 (20 marks)

You have recently completed the audit of Wearever (Pty) Ltd's debtors for the financial year-end 31 March 2018. You had paid particular attention to the allowance for bad debts and having evaluated all the "problem" debtors individually, found that the allowance of N$163 510, which is 10, 5% of debtors was fair and consistent with the allowances for the previous 4 years which had ranged between 10 and 11 percent. Shortly before your manager was due to review your working papers you conducted a final check of the balance on your debtors lead schedule against the draft financial statements. As all aspects of your audit of debtors had been successfully completed, you were surprised to find that they did not agree. On further investigation you established that subsequent to your audit, the allowance for doubtful debts had been reversed.

Besides increasing current assets, the reversal has resulted in an increase of 8 percent in net profit before taxation. You immediately raised the matter with the financial manager who informed you that "the directors decided to reverse the allowance for bad debts at 31st March and to write off any bad debts as and when they occur in the future. As far as we are concerned this is consistent with trends in current accounting theory which aims at fair value accounting".

When you met with your manager to discuss this matter, he decided to take the opportunity to give you some "on the job training" by posing the following questions:

a) What is the justification behind your view that our audit report must be modified? (7)

b) I agree that our audit report must be modified but must we qualify our audit opinion or can we give an emphasis of matter? Can you explain your answer please? (3)

c) If this matter was immaterial we could ignore it for reporting purposes, so what indications do you have that:

1. It is material? (2)
2. It is not actually material and pervasive? (2)

d) Do you regard this as a factual misstatement or a judgmental misstatement? (4)

e) What will the opening phrase in your opinion paragraph be? (2)

Required: Respond to the questions put to you by your manager.

QUESTION 4: **(30 marks)**

(a) Explain how the classification of risks into categories such as 'high', 'medium' or 'low', helps entities manage their businesses. **(6)**

(b) You are the internal auditor of a large private company; Himalaya Plc. Himalaya Plc manufactures a high volume of reasonably priced shoes for elderly people. The company has a trade receivables ledger that is material to the financial statements containing four different categories of account. The categories of account, and the risks associated with them, are as follows:

(i) **Small retail shoe shops**. These accounts represent nearly two thirds of the accounts on the ledger by number, and one third of the receivables by value. Some of these customers pay promptly, others are very slow.

(ii) **Large retail shoe shops** (including a number of overseas accounts) that sell a wide range of shoes. Some of these accounts are large and overdue.

(iii) **Chains of discount shoe shops that buy their inventory centrally**. These accounts are mostly well established 'high street' chains. Again, some of these accounts are large and overdue; and

(iv) **Mail order companies who sell the company's shoes**. There have been a number of large **new** accounts in this category, although there is no history of bad debts in this category.

Receivables listed under (ii) to (iv) are roughly evenly split by both value and number. All receivables are dealt with by the same managers and staff and the same internal controls are applied to each category of receivables. You do not consider that using the same managers and staff, and the same controls, is necessarily the best method of managing the receivables ledger.

Himalayas Plc has suffered an increasing level of bad debts and slow payers in recent years, mostly because of small shoe shops becoming insolvent. The company has also lost several overseas accounts because of a requirement for them to pay in advance. Management wishes to expand the overseas market and has decided that overseas customers will in future be allowed credit terms.

Management has asked you to classify the risks associated with the receivables ledger in order to manage trade receivables as a whole more efficiently. You have been asked to classify accounts as high, medium, or low risk.

Required

(b) Classify the risks relating to the four categories of trade receivables as *high*, *medium,* or *low* and explain your classification. **(8)**

Note. More than one risk classification may be appropriate within each account category

(c) Describe the internal controls that you would recommend to Himalayas to manage the risks associated with the receivables ledger under the headings: *all customers, slow paying customers*, *larger accounts*, and *overseas customers*. **(16)**

.... End ....