



**PAMIBIA UNIVERSITY**  
OF SCIENCE AND TECHNOLOGY

**FACULTY OF MANAGEMENT SCIENCES**

**DEPARTMENT OF ACCOUNTING, ECONOMICS AND FINANCE**

<b>QUALIFICATION: BACHELOR OF ACCOUNTING</b>	
<b>QUALIFICATION CODE: 07BAC</b>	<b>LEVEL: 6</b>
<b>COURSE CODE: AUT 621S</b>	<b>COURSE NAME: AUDITING 202</b>
<b>SESSION: JANUARY 2019</b>	<b>PAPER: THEORY</b>
<b>DURATION: 3 HOURS</b>	<b>MARKS: 100</b>

<b>SECOND OPPORTUNITY EXAMINATION QUESTION PAPER</b>	
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<b>INSTRUCTIONS</b>
<ol style="list-style-type: none"><li>1. Answer ALL the questions.</li><li>2. Start each question on a new page, number the answers correctly and clearly.</li><li>3. Write clearly and neatly.</li><li>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 and any assumptions made by the candidate should be clearly stated.</li></ol>

**PERMISSIBLE MATERIALS**

**THIS QUESTION PAPER CONSISTS OF - 10 - PAGES (excluding this front page)**

**Question 1****(10 marks)****You are required to:**

Select the most appropriate answer for each of the following questions, answer by the number only.

**1. Risk assessment procedures are carried out to:**

- 1.1 specifically identify fraud and other significant risks
- 1.2 identify and assess the risk of material misstatement at the financial statement level and assertion level
- 1.3 provide a basis for establishing the audit strategy
- 1.4 provide a basis for determining the scope of the audit

**2. Which of the following risks can be controlled by the auditor:**

- 2.1 significant risks.
- 2.2 detection risk
- 2.3 control risk
- 2.4 inherent risk

**3. Risk assessment procedures will usually consist of:**

- 3.1 a combination of further and other procedures
- 3.2 substantive procedures only
- 3.3 substantive procedures and tests of controls
- 3.4 inquiry, observation and inspection as well as analytical procedures

**4. All other factors being equal, an increase in the assessed risk of material misstatement will:**

- 4.1 decrease audit risk
- 4.2 increase audit risk
- 4.3 have no effect on audit risk
- 4.4 increase significant risk

**5. Which of the following functions does not relate to the acquisitions and payments cycle:**

- 5.1 receiving of goods
- 5.2 credit management
- 5.3 ordering of goods
- 5.4 all the above relate to the cycle

**6. The logging and follow up of amendments to the creditors Masterfile is regarded as:**

- 6.1 a detective control
- 6.2 a general control
- 6.3 a preventive control
- 6.4 an output control

**7. Which of the following is regarded as a control activity?**

- 7.1 reviewing key performance indicators and ratios
- 7.2 providing on-going training to all employees
- 7.3 assessing the likelihood and frequency of risks which have been identified
- 7.4 assessing whether internal controls are effective over time.

**8. With regard to the payment of creditors by EFT, physical devices such as “dongles” and random number generators with produce “one time” passwords are regarded as additional:**

- 8.1 identification controls
- 8.2 authorisation controls
- 8.3 authentication controls
- 8.4 approval controls

**9. Which of the following is not an assertion in the context of auditing?**

- 9.1 occurrence
- 9.2 accuracy
- 9.3 completeness
- 9.4 materiality

**10. Audit risk is made up of the following components:**

- 10.1 inherent risk and materiality
- 10.2 inherent risk and significant risk
- 10.3 control risk, detection risk and inherent risk
- 10.4 control risk and materiality

**Question 2****(20 marks)**

You are the audit manager of Parris and Hardy Incorporated, an audit firm. Your firm has just been appointed as auditor of Kidz (Pty) Ltd, a family-owned children's toy manufacturer. It is June 2014, and you are planning the audit for the year ending 30 September 2013. Since its formation, 20 years ago, the company has concentrated on its core product ranges of battery-operated vehicles (such as fire engines) and dolls.

The current chief financial officer (CFO), Bradley Kooper, took over three years ago from his father, and his intention is to prepare to list the company on the JSE by the end of 2014. Bradley is planning the following initiatives in the current year:

1. The owners of the licensing rights to the 'Wolverine' character are inviting tenders to purchase these rights. Wolverine is a TV programme, currently very popular with five to ten-year-olds. Kidz (Pty) Ltd wants to purchase the licensing rights and launch a range of Wolverine products, aimed at the December 2014 market.
2. Kidz Limited currently outsources its production. There have been problems in the past with product reliability and delivery delays, and so Kidz (Pty) Ltd is purchasing a toy manufacturing company in China. Your firm does not have an affiliated office in China.

Bradley's nephew Brad Pit, who is studying for Part 2 of his PPE exams, was recently appointed as accountant. Bradley has refused to appoint a finance director because he likes to keep control of financial matters himself. Management accounts are produced irregularly. Three years ago, Kidz (Pty) Ltd diversified into the pre-school education market, and entered into a joint venture with Study Boost, a enrichment courses for primary school children. The venture has been loss making since its launch, due to ineffective marketing and strong competition, but Bradley is convinced he can 'turn things around'.

Shares in the company are owned by Bradley and his younger sister, Hazel, who is not involved in the business but has a seat on the board. There are two other non-executive directors, who are both friends of Bradley. There are few senior managers within the company, because Bradley believes that he can run the company better than anyone else, and those that join tend to leave fairly quickly as they have no real power to achieve change.



**Required:**

- a) Explain in details what is meant by business risks. (3 marks)
- b) From the information above, identify all the apparent business risks which exists in Kidz (Pty) Ltd and provide an action that could mitigate these identified business risks. Complete your answer in the following format:

No.	Business risk Identified (6)	Action to mitigate the business risk (11)

(17 marks)

**Question 3**

**(15 marks)**

G4G (Pty) Ltd is a manufacturer of a range of garden and agricultural implements. It is a large company with sound internal controls based on the components of internal control namely:

- Control environment
- Risk assessment process
- The information system and related business processes relevant to financial reporting
- Control activities
- Monitoring of controls

Each of the following pieces of information relates to the revenue and receipts cycle.

1. When launching a new product (implement/tool), G4G (Pty) Ltd.'s safety committee considers carefully whether user safety requirements for the product have been complied with.
2. Employees in the revenue and receipts cycle have their responsibilities clearly defined and are rewarded for excellent service.
3. G4G (Pty) Ltd's agricultural sales representatives visit farmers in their region. Sales orders from farmers are entered by the salesmen on a laptop computer and sent online to the credit control section in the sales department
4. The clerk in the credit control section who receives the sales order (see 3 above) will confirm that the farmer is a valid customer and that he is not behind on his payment terms. If all is in order, the clerk will affect the transfer of the sales order to the "sales order file".

5. When pickers in the finished goods warehouse have selected items to be transferred to despatch, they are required to sign the relevant picking slip.
6. Mary Muggins an employee in the credit management section, works exclusively on “debtor’s relations”. She is in regular contact with debtors, making sure that they pay on time and that they pay the correct amount. Where a debtor is experiencing financial difficulty, Mary Muggins will work out a payment plan to minimize any losses the company may suffer.
7. When an amendment to the debtors (accounts receivable) Masterfile is required, e.g. addition of a new customer, a Masterfile amendment form must be completed. The masterful amendment forms are pre-printed and pre-numbered and must be referenced to supporting documentation e.g. credit application.
8. The board of Tufftool (Pty) Ltd meets every two months. In addition to other matters on the agenda, the financial controller and sales director make a ratio and trend analysis presentation on all major aspects of the revenue and receipts cycle including new accounts opened, bad debts written off, any debtors who have been handed over, achievements of sales targets by sector, region, product, etc.

**Required:**

Identify the component of which each of the above (1 to 8) relates. Provide a brief explanation for each of your answers. **(15 Marks)**

**Question 4****(15 Marks)**

A friend of yours, Reg Park, recently purchased all the shares in Crazytimes (Pty) Ltd, a wholesaling company which sells all kinds of goods for outdoor pursuits, e.g. Skateboarding BMX, kayaking etc. The company sells only on credit. Debtors pay only by cheque or EFT. The previous owners who were also the directors, spent more time engaged in outdoor pursuits than in looking after the business, choosing to leave the running of the business in the hands of various “managers” and other employees. The goods which the company sells are popular, so the business has survived this ownership neglect, and your friend (an entrepreneur) sees potential in the company. He asked you to have a look at the accounting system and internal controls which you did, only to find that, despite the design, and the documentation of the system being basically sound, the control awareness and proper operation of control activities by employees was poor. The cycle has been broken down into the usual functions for a revenue and receipts cycle and all functions are adequately staffed. On reporting to Reg Park, his response was “OK”, as I am the sole director and will not be involved much in the business I want you to explain two things to me. Firstly, if we assume that the staff are honest but careless or as you say, not very control aware, what could go wrong in the revenue and receipts cycle, and secondly, if some of the staff are dishonest, including the managers, how could they be stealing from or defrauding the company?”

**Required:**

Respond to Reg Park by explaining what could go wrong in the revenue and receipts cycle, assuming that the staff are honest but careless and not very control aware. **(15 Marks)**



**Question 5****(15 marks)**

You are currently employed at StayFit Auditors Inc. One of your clients are Healthnet (Pty) Ltd.

**Background to the business**

The company was founded a few years ago by the managing director, Mr Staal Burger, who is the majority shareholder, to exploit business opportunities from the popularity of the Exercising industry.

Since inception the company has experienced exceptional growth and it intends to list on the Johannesburg Stock Exchange (JSE) within the next year. The company intends to develop the appropriate systems of corporate governance prior to listing.

Until recently the company had a very low gearing.

The compound annual growth in company earnings over the last three years has exceeded 20% p.a. and forecast earnings growth for the year ending 31 March 2018 is in excess of 30%. This is as a result of the company securing some profitable contracts with big corporate companies giving their employees special joining rates.

In addition to earnings based management bonuses, share options are awarded annually to all senior management, based on the extent to which profit targets have been exceeded.

During the current year Healthnet (Pty) Ltd acquired 100% of the shares in a company situated in Argentina. An established health club in the Argentina. The purchase was financed by means of a \$3 million loan from a bank in the United States of America.

A fully computerised accounting system was installed two months ago. Certain problems are being experienced with the new system, with the result that data have been lost and significant delays occurred in data processing. A major advantage of the new system is that it is web-enabled, allowing the company to advertise its products globally and to conduct business through the internet.

While assisting with the preparation of the client's August 2014 VAT return, your staff realised that certain members of the health club are not reflected on the membership Masterfile, and reported the matter to you. Further investigation revealed that Mr Arnold Swartz, the financial director of Healthnet (Pty) Ltd, had sold a number of Platinum membership contracts during the year, but never recorded the details in the company's accounting records.



Upon you confronting Mr Swartz, he explained that this was done at the recommendation of a good friend of his, who also happens to be a Chartered Accountant. This arrangement benefitted both him (as he received money tax free) and Healthnet (Pty) Ltd (as the company was able to reduce Swartz's salary payment). To encourage you to see things his way, Mr Swartz indicated that you and your family could have unlimited free usage of the club facilities for as long as he remained financial director.

In order to win you over even more, he volunteered the procedures followed when it comes to capital expenditure as indicated below:

#### Capital expenditure

Capital expenditure requests are handled by the administration department. The required procedure is that three quotes are obtained for all expenditure in excess of R 500 000 and these are submitted to a tender committee, which then awards the contracts. Tenders in excess of R 4 million must be approved by the board. A quorum for any directors' meeting is that three of the five directors must be present.

One of the contracts you have reviewed, which is to the value of R 550 000, indicated that no alternative quotes had been obtained. In addition, no documents could be produced to support the awarding of the contract.

#### **Required:**

Does the matter constitute a reportable irregularity? State, giving reasons, what action you would take regarding this matter, in terms of the Auditing Profession Act and SAICA's Code of Professional Conduct. **(15 marks)**

**Question 6****(25 Marks]**

You are part of the audit team working at the Windhoek Auditors Incorporated, and you are busy with the audit of Volks-Benz Limited (Volks) for the financial period ending 31 March 2018. This is the first time that Volks will be audited by Africa Auditors.

Volks is a component manufacturer for the automotive industry, supplying among other things engine management, catalytic converter and carbon emissions system component to major vehicle manufacturers based in Namibia. Volks was established six years ago by the directors, Mr Audi, Mr Wagen and Mr Karl, all of whom have been friends since they met at University studying Engineering. All of the directors are shareholders of the company.

The directors are true entrepreneurs for whom failure is not an option, they all invested their entire life savings and maximised their home loans to generate the start-up capital needed six years ago. Volks has shown impressive growth since inception. For the 2017 financial year, Volks, however, recorded a sizeable loss for the first time. During the financial year the directors, however, realised that in order to grow the business to reach its maximum potential, and to sustain the company in the tough current economic environment, they would have to obtain more financing to grow the business further as all the funds (including the bank overdraft facilities) had now been depleted. It was decided at a board meeting held at Wagen's house on in 2015 that the company will apply for a loan from Bank Windhoek as well as a list on the Namibia Stock Exchange (NSX) shortly.

For Bank Windhoek to grant them the loan, specific financial targets for 2018 financial were set. Mr Audi made a comment that this is a bit of "delicate" as the directors are being paid bonuses annually based on the revenue of the company (and he already promised his wife and kids a long overseas holiday), but he also understood the importance of obtaining the loan from the bank. The directors stressed that the audited financial statements had to be ready before 18th April 2018 as Bank Windhoek needed these to decide regarding the grant of the loan.

As part of their growth strategy, and to increase profitability, the directors established a research and development (R&D) department during the year. They also established a relationship with component manufacturers in China and Europe and began importing certain parts used in their manufacturing process. This enabled them to supply certain of their products at a higher profit. The products supplied by Volks are prone to technological advancements, as technology is improving at a rapid rate. Volks have agreements in place with individual clients, whereby specific components are supplied to them on consignment.

Due to their no-nonsense approach to doing business, the directors appointed one of their old university friends, Mr Shikongo as the financial manager of Volks. They reasoned that they would rather groom him into understanding the business of Volks than to appoint someone with experience from another industry. Mr Shikongo is currently busy with his part-time accounting studies because engineering was never actually his passion; hence he did not actually complete his studies engineering studies. Mr Shikongo is genuinely excited about doing the accounting for the entire production process, including inventory valuation. The directors decided that the three of them will all have access to the bank accounts from their cell-phones, and whoever saw it first would approve and authorised all payments submitted by Mr Shikongo as and when they came through to further enhance their no-nonsense way of doing business.

Late in February 2018 when doing audit work on R&D you came across email correspondence between Mr Wagen and a major German motor vehicle manufacturer. From the email, you gathered that Mr Wagen admitted to the programming of a certain range carbon emission measurement components to show a reading which is a 10% lower than the actual level of carbon dioxide which is emitted from the engine on which the component is installed. From a brief discussion with Mr Wagen, he irritably conceded that the environmental laws are too strict and that he merely tried to assist the German motor vehicle manufacturer to comply with the European emission standards. He did not want to discuss this matter any further and asked you to "rather focus on important stuff".

**Required:**

Identify and describe the risk of material statement at the overall financial statement level for the audit of the 2018 annual financial statements of Volks-Benz Ltd. **(25 marks)**