



PAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY

FACULTY OF COMMERCE, HUMAN SCIENCES AND EDUCATION
DEPARTMENT OF ACCOUNTING, ECONOMICS AND FINANCE

QUALIFICATION : BACHELOR OF ACCOUNTING	
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COURSE: AUDITING 310	COURSE CODE: GAU711S
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DURATION: 3HRS	MARKS: 100

FIRST OPPORTUNITY EXAMINATION QUESTION PAPER	
EXAMINER(S)	DR. K BOAMAH MR D. BENSON DR A SIMASIKU
MODERATOR:	MRS M DIKUUA

THIS QUESTION PAPER CONSISTS OF 14 PAGES
(Excluding this front page)

INSTRUCTIONS

1. Answer ALL the questions and in blue or black ink
2. Start each question on a new page in your answer booklet & show all your workings
3. 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

PERMISSIBLE MATERIALS

1. Examination paper- No study materials are allowed in the examination room
2. Examination script - The examination script should be handed to the invigilator at the end of the examination session

QUESTION 1

(25 marks)

PART A (Multiple choice questions)

. Q1. Despite running a successful company, BJM's board has often needed to be reminded of some fundamental principles and you often have to explain key concepts.

Which of the following statements best defines the external audit?

- a. The external audit is an exercise carried out by auditors in order to give an opinion on whether the financial statements of a company are fairly presented.
- b. The external audit is an exercise carried out in order to give an opinion on the effectiveness of a company's internal control system.
- c. The purpose of the external audit is to identify areas of deficiency within a company and to make recommendations to mitigate those deficiencies.
- d. The external audit provides negative assurance on the truth and fairness of a company's financial statements.

Q2. The board has also struggled to differentiate between its responsibilities and those of the external auditor in circumstances such as the prevention and detection of fraud and error, and compliance with regulations.

Which of the following statements best describes Royal & Associates responsibility regarding BJM's compliance with hygiene regulations, in line with ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements?

- a. Royal & Associates should actively prevent and detect non-compliance with the regulations.
- b. Royal & Associates should perform specific audit procedures to identify possible non-compliance.

- c. Royal & Associates should obtain sufficient appropriate audit evidence about BJM's compliance with the regulations as they have a direct effect on the financial statements.
- d. Royal & Associates' does not have any responsibility as the hygiene regulations do not have a direct effect on the financial statements.

Q3. The partner responsible for the review of hygiene compliance has informed you that the engagement is an assurance engagement.

Which of the following would NOT have been relevant to the auditors in forming this opinion?

- a. The existence of a three-party relationship
- b. The existence of suitable criteria
- c. The determination of materiality
- d. The subject matter

Q4. The partner responsible for the review engagement has asked you to tell him what level of assurance you believe Royal & Associates should provide, and also what type of opinion the firm should give.

What is the level of assurance and type of opinion that can be provided on this review engagement?

- a. Reasonable Positive
- b. Reasonable Negative
- c. Limited Positive
- d. Limited Negative

Q5. The audit engagement partner has told you that the independence threats arising from Royal & Associates' performing the review engagement should be monitored carefully.

Which of the following is likely to cause the audit engagement partner most concern?

- a. According to the ACCA Code of Ethics and Conduct, Royal & Associates' is prohibited from providing other assurance services to an audit client.
- b. The review engagement is likely to give rise to a self-review threat, as the outcomes of the review could form the basis of the financial statements which the audit team will audit.
- c. The lucrative nature of the review engagement may make the external audit team less inclined to require management to make adjustments or to issue a modified audit opinion, for fear of losing the review engagement.
- d. If the new review engagement causes Royal & Associates' fee income from BJM to exceed 15% of the firm's total fees, the Code of Ethics and Conduct states that the new engagement must be turned down.

(Total = 10 marks)

PART B

You are an audit senior for Mills & Co. Mills & Co was recently appointed as external auditors of Sleptight Co for the year ending 31 March 20X0 and you are in the process of planning the audit. The previous auditors issued an unmodified audit opinion last year and access to prior year working papers has been granted.

Sleptight principal activity is the manufacture and sale of expensive high-quality beds which are largely sold to luxury hotels and owners of holiday apartments. Each bed is crafted by hand in the company's workshop. Construction of each bed only begins once a customer order is received, as each customer will usually want their bed to have a unique feature or to be in a unique style.

The business is family run and all the shares in Sleptight are owned by the two joint managing directors. The directors are two sisters, Anna, and Sophie Jones, and they both have a number of other business interests. As a result, they only spend a few days a week working at the company and rely on the small accounts department to keep the finances in order and to keep them informed. There is no finance director, but the financial controller is a qualified accountant.

Sleptight requires customers who place an order to pay a deposit of 40% of the total order value at the time the order is placed. The beds will take 4 to 8 weeks to build, and the remaining 60% of the order value is due within a week of the final delivery. Risks and rewards of ownership of the beds do not pass to the customer until the beds are delivered and signed for. Beds also come with a two-year guarantee and the financial controller has made a provision in respect of the expected costs to be incurred in relation to beds still under guarantee.

Although the company does have some employees working in the workshop, it often uses external subcontractors to help make the beds in order to fulfil all its orders. These subcontractors should invoice Sleptight at the end of each month for the work they have carried out, but sometimes do not get round to it until the following month.

The company undertakes a full count of raw materials at the year end. The quantities are recorded on inventory sheets and the financial controller assigns the costs based on the cost assigned in the previous year or, if there was no cost last year, using the latest invoice. Most beds are made of oak or other durable woods and the cost of these raw materials is known to fluctuate considerably.

It is expected that work in progress will be insignificant this year, but there will be a material amount of finished goods awaiting dispatch. Anna Jones will estimate the value of these finished goods and has said she will take into account the order value when doing so.

There has been steady growth in sales in recent years and in January 20X0 Sleptight purchased a building close to its existing workshop. Anna and Sophie plan to turn this into another workshop which should more than double its existing manufacturing

capacity. The new workshop is currently undergoing extensive refurbishment in order to make it suitable for bed manufacturing.

The purchase of the new premises was funded by a bank loan repayable in monthly instalments over 12 years and has covenants attached to it. These covenants are largely profit related measures and if they are breached the bank has the option to make the remaining loan balance repayable immediately.

Auditors are required to plan and perform an audit with professional scepticism, to exercise professional judgement and to comply with ethical standards.

REQUIRED

(i) Explain what is meant by 'professional scepticism' and why it is so important that the auditor maintains professional scepticism throughout the audit. (3)

(ii) Define 'professional judgement' and describe TWO areas where professional judgement is applied when planning an audit of financial statements. (3)

(iii) Describe Mills & Co's responsibilities in relation to the physical inventory count that will take place at the year end. (4)

PART C

Write down the letter representing the correct answer [5 marks)

1. The assertions are best described as:

1.1 the representations by management which are embedded in the financial statements.

1.2 the accounting policies used in the financial statements.

1.3 the principles embodied in the reporting framework adopted by the company.

1.4 the disclosures made by the directors responsible for the

preparation of the financial statements.

2. The auditor's objective when using audit sampling is

to:

2.1 keep the cost of the audit within a reasonable but acceptable cost budget.

2.2 provide a reasonable basis on which to draw conclusions about the population from which the sample is drawn.

2.3 address one of the limitations of an audit.

2.4 identify only those misstatements or deviations which are material.

3. What type of opinion is issued when the auditor, having obtained sufficient appropriate audit evidence concludes that misstatements individually or in the aggregate are material and pervasive to the financial statements?

3.1 Adverse

3.2 Qualified

3.3 Disclaimer

3.4 Unqualified

4. In terms of ISA 500 – Audit Evidence, the auditor is required to obtain

4.1 relevant and appropriate evidence

4.2 sufficient appropriate evidence

4.3 reliable and sufficient evidence

4.4 relevant, reliable, and corroborative evidence.

5. When an entity is not able to continue in future and it does not disclose this in financial statements, it is a clear violation of:

5.1 Substance over form

5.2 Accrual basis

5.3 Prudence concept

5.4 Going concern

QUESTION 2

(25 marks)

You are the audit senior and currently planning the audit of an existing client, Smartwear (Pty) Ltd.

As you go through the planning process you record your steps on your firm's "standard planning memorandum" form. Assisting you during this planning stage is your junior colleague, Nola Apollos.

Whilst conducting the audit planning stage, Nola Apollos asks you the following questions:

a) It seems to me that you are not carrying out any preliminary engagement activities which I read somewhere are very important. I have three questions for you, sir.

1. How would you describe preliminary engagement activities? (1)

2. Why do we carry them out? (4)

3. Can you describe four procedures which will be carried out as preliminary engagement activities? (2)

b) What practical purpose is served by planning the audit? Is it not just done to comply with the auditing standards? (5)

c) I see there are risks called significant risks. What are significant risks and what circumstances might give rise to a risk being significant? (5)

d) As I understand it, analytical review procedures are done at the end of the audit for the purpose of assess the overall reasonableness of the annual financial statements; why are you carrying them out now - we haven't even got the annual financial

statement yet? (3)

e) Can you explain why we need to set planning materiality before we conduct risk assessment procedures? (2)

d) My last question is "What is the differences between audit planning and audit strategy?" I want to know, in this planning that I'm assisting you with, are we planning the audit strategy or the audit plan? (3)

QUESTION 3

(25 marks)

Shilongo and Partners are practicing auditors in Windhoek. They are about to accept the appointment as new auditors of Hope (pty) Limited – a manufacturing business in the Khomas region. Johan Swart is a senior partner in the audit firm. Johan requested one of the junior colleagues to draft the engagement letter for the proposed engagement with Hope Pty Limited. The junior colleague drafted the engagement letter below.

AUDITOR'S LETTERHEAD

The Auditors
PO Box 397
Windhoek.

The Directors Hope (Pty) Ltd
PO Box 100
Windhoek.

15 February 2021

Dear Sirs

You have requested that we audit the financial statements of Hope (Pty) Ltd. We are pleased to confirm acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the

financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence regarding the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Our audit will be designed to provide absolute assurance that all fraud and errors that are material to the financial statements will be discovered.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Since we accept full responsibility for the company's internal control system we will set control risk at low and will not perform any tests of control. We will, thus, spend less time on this audit.

It is our responsibility to prepare financial statements that present fairly the financial position, financial performance and cashflows of the company in accordance with International Financial Reporting Standards. Our auditor's report will explain that management's responsibilities include:

- selecting and applying appropriate accounting policies.
- making accounting estimates that are appropriate in the circumstances.

As part of our audit process, we will request written confirmation from management concerning representations made to us in connection with the audit.

We look forward to full co-operation from your staff and we trust that they will make available to us whatever records, documentation, and other information we request in

connection with our audit.

Fees

Our fees are based on the time spent on your affairs by our partners and staff and on the levels of skill and responsibility involved. These will be agreed with you before they are billed. Our fees, plus expenses, will be billed at appropriate intervals during the course of the year and settlement is due on presentation of our invoices.

We, however, undertake to limit our audit fees for the current year to a maximum of 50% of the fee charged by the previous auditor. The lower fee is based on the following:

- We will use the same personnel to perform the audit and to carry out the accounting work, to benefit from knowledge gained while performing accounting work and to decrease the required extent of audit tests.
- Since we take full responsibility for the company's internal control system, no tests of control will be performed and control risk will be set at low, which will decrease the required extent of substantive procedures.

Preparation of annual financial statements

We shall prepare the annual financial statements of the company from information prepared by us.

Accountancy

We shall process your accounting records on our inhouse computer on a monthly basis and provide detailed financial statements for management's use.

Please sign and return the attached copy of this letter to indicate that it is in

accordance with your understanding of the arrangements for our audit of the financial statements.

The Auditors.

Required

a) Analyse, based on International Standards on Auditing, the engagement letter drafted by the junior colleague. Your answer should include all information omitted and each unacceptable statement, as well as the reason(s) why you consider each to be unacceptable. Present your answer in tabular format as indicated in the table below:

CRITICISMS WITH REGARDS TO ENGAGEMENT LETTER

<i>Information omitted/unacceptable statement</i>	<i>Reasons for unacceptability of statement</i>
1.	
2.	
3.	

(20)

(b) Set out the procedures which you as the new auditors should follow in terms of SAICA code of professional conduct to replace the existing auditor – Johan Swart (5)

QUESTION 4

(25 Marks)

The going concern concept states that companies are expected to continue in business for the unforeseeable period

Required:

(a) List the factors which may cast doubt about a company's ability to trade as a going concern and describe reasons why these factors may indicate that the company may not be a going concern (15)

(c) Describe three commonly used methods of sample selection and the main problems in using each method. (10)

END OF QUESTION PAPER