NAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY

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

QUALIFICATION: BACHELOR OF ACCOUNTING (HONOURS)	
QUALIFICATION CODE: 08BOAH	LEVEL: 8
COURSE CODE: AUD812S	COURSE NAME: ADVANCED AUDIT
SESSION: NOVEMBER 2024	PAPER: THEORY AND APPLICATION
DURATION: 3 HOURS	MARKS: 100

FIRST OPPORTUNITY EXAMINATION QUESTION PAPER	
EXAMINERS:	Dumisani R. Muzira
MODERATOR:	Marko Tondota

INSTRUCTIONS

- This question paper is made up of FOUR (4) questions.
- Start each question on a new page.
- Answer All the questions and in blue or black ink.
- You are advised to pay due attention to expression and presentation. Failure to do so will cost you marks.
- Start each question on a new page in your answer booklet and show all your workings.
- Questions relating to this paper 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 assumption made by the candidate should be clearly stated.

PERMISSIBLE MATERIALS

Non-programmable calculator/financial calculator

THIS QUESTION PAPER CONSISTS OF 5 PAGES (Including this front page)

Question 1 **(25 marks)**

R & R is a listed construction company with annual sales of $350 million and its draft income statement shows profit from operations for the year ended 31 December 2022 of $40 million. This is the first audit by this audit firm. Enquiry of the previous auditor revealed no reasons for concern. On completing audit work at the company's premises, the audit senior drafts a memo, extracts from which are reproduced below:

(a) **Inventory valuation**

Inventories include $7 million, at cost, of scrap rubber. This material is widely used as a road surface in other countries. Contracts for road building with this country's Highways Agency, the state authority for road construction, do not currently permit the use of this material. However, the matter was known to be under review and, on being offered a special purchase of this material, R & R speculated on a favourable outcome of the review and purchased the material. In February 2023, shortly before the financial statements were approved by the directors, the Highways Agency reported that it would not, currently, accept the use of this material. If used on non Highways Agency contracts the material's net realisable value would not exceed $2 million. The chief financial officer maintains that, as the Highways Agency report was issued after the balance sheet date, the write down of the inventory should be reflected in the next period's financial statements. **(10 marks)**

(b) **Depreciation**

In 2018 the company purchased two computer-controlled earth movers at a cost of $2,500,000 each and a further two at the same price in 2019. Depreciation has been provided at 10% straight line, the same basis as it previously depreciated conventional earth movers. This year, 2022, the company decided that improvements in technology made it worthwhile scrapping their first two computer-controlled movers and replacing them with the latest model at a cost of $4,000,000 each. The company's chief engineer tells you that technology is developing so rapidly it appears likely they will continue to replace these machines every five years. The chief financial officer claims that the depreciation rate of 10% is in line with industry standard and reflects the physical life of the machines. He argues that continued improvements in technology cannot be foreseen and that there is no justification for increasing depreciation to 20% because of the possibility of technological obsolescence. **(15 marks)**

Required

Explain the effect of each matter on:

a) the financial statements and

b) if the company were to refuse to amend the financial statements, on the auditor's report. (Your answer should consider materiality where appropriate).

Question 2 **(25 marks)**

a) The engagement partner assigned to the audit of Dee Ltd is married to the CEO of Dee Ltd. The CEO of Dee Ltd receives a bonus based on profits.

Required:

Describe the ethical concerns prior to accepting Dee Ltd as a statutory client. (5)

b) How can management use the fraud diamond theory to prevent and detect fraud (20)

Question 3 **25 marks**

"It is astonishing to note how Arthur Andersen could miss such an elementary fraud. It was maybe the simplest fraud that could have been detected easily by anyone who cared to look carefully at the accounts. WorldCom hired Andersen to perform a standard audit, not a fraud audit. Although WorldCom fraud was a straight forward lie that would not have been possible without the involvement of the entire group, the fraud could have been missed. To save their skin, Andersen blamed Sullivan for withholding information during the audit. However, when they discovered that certain expenses had been reported as investments, Andersen immediately announced that their reports on WorldCom's financial statements for 2001 should not be relied upon. Ultimately, WorldCom had to go for bankruptcy which was the biggest bankruptcy in the world to date. Immediately after the bankruptcy, 17 000 employees were laid off. Sullivan was fired and ultimately arrested for the accounting manipulations."

Adapted from the paper on Ethics In Accounting by Dr. Lucian Cernsca

REQUIRED:

a) Explain 'professional skepticism' in auditing. (5)

b) Describe substantive analytical procedures that could be used to give evidence on the following assertions: (20)

(1) Completeness of accruals

(2) Accuracy of overdraft interest expense

(3) Accuracy of wages expense

(4) Cut-off of sales revenue

Question 4 **(25 Marks)**

Gamston and Keyworth

International Standard on Auditing 700: The Auditor's Report on Financial Statements standardises the contents of the audit report and the form of qualified reports.

Your firm is the auditor of the following two companies, and you have been asked to consider the form of qualified or unqualified audit report which should be given.

a) Gamston Burgers has a loss–making branch and it has included non-current assets relating to the branch at $710,000 after deducting an allowance for impairment in value of $250,000. The directors believe that if operating changes are made and economic conditions improve, there is a reasonable probability of the branch trading satisfactorily, which will result in the current value of tangible assets exceeding $710,000. However, under the current circumstances, the directors consider the extent of any impairment in value to be uncertain. You have obtained all the evidence you would have reasonably expected to be available.

If trading conditions do not improve, your audit investigations have concluded that the branch will have to close. If the branch closes, the tangible assets will be worthless, as the property is leased and the cost of moving any tangible assets will be more than their net realisable value. If the tangible assets are worthless, you have concluded that the effect will be material, but it will not result in the financial statements being misleading.

(b) Keyworth Supermarket sells food to the general public and customers pay in cash or by cheque. Your audit tests reveal that controls over cash takings and custody of the inventory are weak, and you have not been able to obtain sufficient evidence to quantify the effect of any misappropriation of inventory or cash takings. You have concluded as follows:

i. If the uncertainty relates to all the company's sales, it could result in the financial statements being misleading

ii. If the uncertainty relates to only the sale of fresh fruit and vegetables, which comprise 10% of the company's sales, it will have a material effect on the financial statements but it will not result in them being misleading.

Required

(a) List and briefly describe the contents of an unqualified audit report. **(9 marks)**

b) Give the form of an unqualified or qualified audit report you would give in each of the following situations and support your opinion:

(i) On the financial statements of Gamston Burgers if you agree with the directors' statements about the uncertainty relating to the value of the tangible assets of the branch.

(ii) On the financial statements of Gamston Burgers if you have come to the conclusion that trading conditions will not improve and the company will close the branch. Thus, the tangible assets will be worthless.

(iii) On the financial statements of Keyworth Supermarket if the uncertainty about the misappropriation of inventory and cash takings relates to all the company's sales.

(iv) On the financial statements of Keyworth Supermarket if the uncertainty about the misappropriation of inventory and cash takings relates only to the sale of fresh fruit and vegetables which comprise 10% of the company's sales. **(16 marks)**

THE END