NAMIBIA UNIVERSITY
OF SCIENCE AND TECHNOLOGY

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

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

| SECOND OPPORTUNITY QUESTION PAPER | |
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| EXAMINERS: | Kuhepa Tjondu |
| MODERATOR: | Marko Tandota |

## 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 6 PAGES (Including this front page)**

**Question 1** **(30 marks)**

You are an audit supervisor of Christoff & Co and you are planning the audit of Hilifa Co, a listed company, for the year ending 31 March 2023. The company manufactures computer components and forecast profit before tax is N$33.6 million and total assets are N$79.3 million.

Hilifa Co distributes its products through wholesalers as well as via its own website. The website was upgraded during the year at a cost of N$1.1 million. Additionally, the company entered into a transaction in February to purchase a new warehouse which will cost N$3.2 million. Hilifa Co's legal advisers are working to ensure that the legal process will be completed by the year end. The company issued N$5 million of irredeemable preference shares to finance the warehouse purchase.

During the year the finance director has increased the useful economic lives of fixtures and fittings from three to four years as he felt this was a more appropriate period. The finance director has informed the engagement partner that a revised credit period has been agreed with one of its wholesale customers, as they have been experiencing difficulties with repaying the balance of N$1.2 million owing to Hilifa Co. In January 2023, Hilifa Co introduced a new bonus based on sales targets for its sales staff. This has resulted in a significant number of new wholesale customer accounts being opened by sales staff. The new customers have been given favourable credit terms as an introductory offer, provided goods are purchased within a two-month period. As a result, revenue has increased by 5% on the prior year.

The company has launched several new products this year and all but one of these new launches have been successful. Feedback on product Luge, launched four months ago, has been mixed, and the company has just received notice from one of their customers, Piet Co, of intended legal action. They are alleging the product sold to them was faulty, resulting in a significant loss of information and an ongoing detrimental impact on profits. As a precaution, sales of the Luge product have been halted and a product recall has been initiated for any Luge products sold in the last four months.

The finance director is keen to announce the company's financial results to the stock market earlier than last year and in order to facilitate this, he has asked if the audit could be completed in a shorter timescale. In addition, the company is intending to propose a final dividend once the financial statements are finalised.

Hilifa Co's finance director has informed the audit engagement partner that one of the company's non-executive directors (NEDs) has just resigned, and he has enquired if the partners at Christoff & Co can help Hilifa Co in recruiting a new NED.

Specifically, he has requested the engagement quality control reviewer, who was until last year the audit engagement partner on Hilifa Co, assist the company in this recruitment. Christoff & Co also provides taxation services for Hilifa Co in the form of tax return preparation along with some tax planning advice. The finance director has recommended to the audit committee of Hilifa Co that this year's audit fee should be based on the company's profit before tax. At today's date, 20% of last year's audit fee is still outstanding and was due to be paid three months ago.

**Required:**

(a) Define audit risk and the components of audit risk. **(4 marks)**

(b) Describe EIGHT audit risks, and explain the auditor's response to each risk, in planning the audit of Hilifa Co. **(16 marks)**

**Note:** Prepare your answer using two columns headed Audit risk and Auditor's response respectively.

(c) (i) Identify and explain FIVE ethical threats which may affect the independence of Christoff & Co's audit of Hilifa Co, and

(ii) For each threat, suggest a safeguard to reduce the risk to an acceptable level.

**Note:** The total marks will be split equally between each part. Prepare your answer using two columns headed Ethical threat and Possible Safeguard respectively.
**(10 marks)**

**Question 2** **(25 marks)**

Ndinelao Co manufactures women's clothing and its year end was 31 July 2023. You are an audit supervisor of Jaunty & Co and the year-end audit for Ndinelao Co is due to commence shortly.

The draft financial statements recognise profit before tax of N$2.6m and total assets of N$18m. You have been given responsibility for auditing receivables, which is a material balance, and as part of the audit approach, a positive receivables circularisation is to be undertaken.

At the planning meeting, the finance director of Ndinelao Co informed the audit engagement partner that the company was closing one of its smaller production sites and as a result, a number of employees would be made redundant. A redundancy provision of N$110,000 is included in the draft financial statements.

**Required:**

(a) Describe the steps the auditor should perform in undertaking a positive receivables circularisation for Ndinelao Co. **(5 marks)**

(b) Describe substantive procedures, other than a receivables circularisation, the auditor should perform to obtain sufficient and appropriate audit evidence to verify EACH of the following assertions in relation to Ndinelao Co's receivables:

(i) Accuracy, valuation and allocation **(4 marks)**

(ii) Completeness, and **(4 marks)**

(iii) Rights and obligations. **(2 marks)**

(c) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to the redundancy provision at the year end.
**(5 marks)**

**(d)** A few months have now passed and the audit team is performing the audit fieldwork including the audit procedures which you recommended over the redundancy provision. The team has calculated that the necessary provision should amount to N$305,000. The finance director is not willing to adjust the draft financial statements.

**Required:**

Discuss the issue and describe the impact on the auditor's report, if any, should this issue remain unresolved. **(5 marks)**

**Question 3** **(25 marks)**

Althea Co manufactures and distributes car tyres to a wide customer base both in its country and across the rest of the continent. Its year end was 30 April 2023. It is 1 July 2023. You are an audit manager of Pandu & Co and you are reviewing extracts of the documentation describing Althea Co's sales and dispatch system following completion of the interim audit.

Althea Co has grown in size over the previous 18 months. All new customers undergo credit checks prior to being accepted and credit limits are subsequently set by the receivables ledger clerks who record the new customer details, assign a unique customer number and set credit limits in the master data file. The company's credit controller is currently on secondment to the internal audit department for six months and no replacement has been appointed.

Customers wishing to order goods, telephone the company's sales order department and provide their unique account details. Sequentially numbered four-part sales orders are generated for all orders, after checking available inventory levels. One copy is retained by the sales ordering team to enable them to monitor progress of the sales orders, one copy is sent to the customer, one copy is sent to one of the company's warehouses for dispatch and the final copy is sent to the finance department. Upon dispatch, a three-part goods dispatch note (GDN) is completed which is assigned the same sequential number as the order number; one copy is sent with the goods, one remains with the warehouse and one is sent to the finance department.

Due to the recent growth of the company, and as there are a large number of sales invoices, additional temporary staff members have been appointed to help the salesclerks to produce the sales invoices. The sales invoices are prepared using quantities from the GDNs and prices from the authorised sales prices list, which is updated every six months. This year, in line with its main competitors, the company offered a 10% discount on all orders placed during one weekend in late November. Where a discount has been given, this has to be manually entered by the salesclerks onto the sequentially numbered invoice.

Customer statements are no longer being generated and sent out. The company only reconciles the receivables ledger control account at the end of April in order to verify the year-end balance.

**Required:**

(a) List FIVE control objectives of Althea Co's sales and dispatch system.

**(5 marks)**

(b) As the external auditor of Althea Co, write a report to management in respect of the sales and dispatch system described which:

(i) Identifies and explains NINE deficiencies in the sales and dispatch system and recommends a control to address each of these deficiencies: and

(ii) Includes a covering letter

**Note:** Prepare your answer using two columns headed Control deficiency and Control recommendation respectively. The total marks will be split equally between each part.

**Two marks will be awarded within this requirement for the covering letter.**

**(20 marks)**

**Question 4** **(20 marks)**

Cobra Industries Co (Cobra) develops and manufactures a wide range of fast moving consumer goods. The company's year-end is 31 December 2022 and the forecast profit before tax is N$8.3 million. You are the audit manager of Neptune & Co and the year- end audit is due to commence in January. The following information has been gathered during the planning process:

**Inventory count**

Cobra's raw materials and finished goods inventory are stored in 12 warehouses across the country. Each of these warehouses is expected to contain material levels of inventory at the year-end. It is expected that there will be no significant work in progress held at any of the sites. Each count will be supervised by a member of Cobra's internal audit department and the counts will all take place on 31 December, when all movements of goods in and out of the warehouses will cease.

**Research and development**

Cobra spends over N$2 million annually on developing new product lines. This year it incurred expenditure on five projects, all of which are at different stages of development. Once they meet the recognition criteria under IAS 38 Intangible Assets for development expenditure, Cobra includes the costs incurred within intangible assets. Once production commences, the intangible assets are amortised on a straight line basis over five years.

**Required:**

(a) Explain FOUR factors which influence the reliability of audit evidence. **(4 marks)**

(b) Describe the procedures to be undertaken by the auditor BEFORE and DURING the inventory count of Cobra Industries Co in order to gain sufficient appropriate audit evidence. **(8 marks)**

(c) Describe substantive procedures the auditor should perform to obtain sufficient and appropriate audit evidence in relation to Cobra Co'sresearch and development expenditure. **(4 marks)**

During the audit, the team discovers that one of the five development projects, valued at N$980,000 and included within intangible assets, does not meet the criteria for capitalisation. The finance director does not intend to change the accounting treatment adopted as she considers this an immaterial amount.

**Required:**

(d) Discuss the issue and describe the impact on the auditor's report, if any, if the issue remains unresolved. **(4 marks)**

**THE END**