

BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTANCY

EXAMINATION PAPER

JUN 2024

PROGRAMMES:

Bachelor of Accountancy Honours Degree

Bachelor of Business Administration Honours Degree in Police & Security Studies

Bachelor of Commerce Honours Degree in Financial Intelligence

AUDITING PRINCIPLES & PROCEDURES II (AC 206)

**DURATION: 3 HOURS
MARKS)**

(100

INSTRUCTIONS TO CANDIDATES

1. Answer all questions in Section A and Section B.
 2. All questions in Section A carry 2 marks each and marks for questions in Section B are given in brackets at the end of each question.
 3. Start each question on a new page.
 4. No cell phones are allowed in the examination room.
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SECTION A: 30 MARKS

1. Your audit client is in a highly competitive industry with the majority of the competition coming from overseas. Its products have a relatively short life cycle and product development is continuous in order to keep up with competitors. Which assertion should the auditors concentrate their efforts to prove when auditing the inventory account?
 - A. Existence.
 - B. Completeness.
 - C. Rights and obligations.
 - D. Valuation and allocation.
2. When testing the valuation of the trade payables balance in an audit client's statement of financial position, which one of the following tests would provide the most reliable audit evidence?
 - A. Carry out a check of the outstanding balances to details of invoices issued by the creditors in the payables ledger and payments made to them by the client.
 - B. Ask the audit client to provide details of payments made to creditors in the first four weeks after the accounting year-end.
 - C. Inspect the audit client's records of the monthly reconciliation carried out on the payables balance.
 - D. Inquire about the procedures for checking statements issued by suppliers with the payables section manager.
3. Which one of the following does not describe a category of sampling risk?
 - A. The sample selected is too small and therefore the auditor does not have sufficient evidence to form a conclusion relating to the population.
 - B. The auditor selects a population that does not provide evidence to support the audit objectives.
 - C. The auditor fails to spot errors in the sample of items that they test.
 - D. The auditor selects a sample from an incomplete population.

4. When planning the audit, the auditor must make enquiries of management. Which one of the following is not an appropriate enquiry of management about fraud?
- A. The auditor should ask about management's communications with employees about ethical behaviour.
 - B. The auditor should ask management about their assessment of the risk that the financial statements may be materially misstated due to fraud.
 - C. The auditor should ask management if they are personally engaged in fraudulent activity, including fraudulent financial reporting and misappropriation of assets.
 - D. The auditor should ask management about any communications with those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
5. Which one of the following would not be considered a substantive audit procedure?
- A. Obtaining a letter from the bank confirming an account balance.
 - B. Using audit software to identify all accounts receivable over 90 days outstanding.
 - C. Taking a sample of purchase orders and checking that all orders over \$10 000 are authorised by a purchasing officer.
 - D. Multiplying the number of employees on each pay scale by the yearly pay rate to determine an estimate of payroll expense.
6. Your audit client has not written inventory down to net realisable value in accordance with IAS 2 Inventories. The write-down would reduce current assets by 15 per cent. What type of audit opinion would you issue?
- A. a qualified opinion
 - B. an adverse opinion
 - C. a disclosure as a key audit matter
 - D. an unmodified opinion with an Emphasis of Matter paragraph
7. Which one from the following is not part of a systems-based audit approach?
- A. Identification of the key controls to assess the extent to which the auditors may rely on them
 - B. Tests of control on identified key controls

- C. Using tests of control to draw conclusions concerning the internal control system
 - D. A maximum number of substantive testing procedures on the transactions
8. Which of the following is not an objective of the audit planning?
- A. To set out the way in which the objectives and other priorities will be achieved
 - B. To define how the audit evidence necessary to achieve the objectives will be obtained
 - C. To perform data analysis to identify major weaknesses
 - D. To identify the resources that will be needed and actually employed in audits
9. You are an audit manager in NAB & Co, a large audit firm which specialises in the audit of retailers. The firm currently audits Goofy Co (Goofy), a food retailer, but Goofy's main competitor, Mickey Co (Mickey, has approached the audit firm to act as auditors. Both Goofy and Mickey are listed companies. Goofy is concerned that if NAB & Co audits both companies then confidential information could pass across to Mickey.

Before NAB & Co can accept appointment as Mickey's auditors, they must determine whether the preconditions for an audit are met and obtain management's agreement that it acknowledges and understands its responsibilities.

Which of the following is not included in the agreement obtained by the auditor?

- A Management's responsibility for preparing the financial statements
- B Management's responsibility for internal control to enable the preparation of financial statements which are free from material misstatement
- C Management's responsibility to provide the auditor with all information relevant to the preparation of the financial statements
- D Management's responsibility to prevent and detect fraud

The following scenario relates to questions 10 - 15.

Porthos, a limited liability company, is a retailer of sports equipment, specialising in racquet sports such as tennis, squash and badminton. The company purchases equipment from a variety of different suppliers and then resells this online.

The company has over 150 different types of request available in inventory, each identified via a unique product code. Customers place their orders directly on the company website.

Most orders are for one or two racquets only. The ordering/sales software automatically verifies the order details, customer address and credit card information prior to orders being verified and goods despatched. The integrity of the ordering system is checked regularly by ArcherWeb, an independent internet service company. You are the audit manager working for the external auditors of Porthos, and you have just started planning the audit of sales. You have decided to use CAATs in auditing the sales account.

You have identified the key steps to be taken in planning the application of CAATs, as follows:

- (1) Define the types of transactions to be tested
- (2) Set the objective of the CAAT application
- (3) Define the procedures to be performed on the data
- (4) Determine the content and accessibility of the entity's files

10. Which of the following identifies the correct order in which the above steps should be performed?

- A 2, 4, 1, 3
- B 1, 4, 2, 3
- C 2, 1, 3, 4
- D 4, 2, 3, 1

11 Test data will be used to test the input of details into the sales system. The audit junior has identified the following test data which can be used:

- (1) Orders for unusually large quantities
- (2) Orders with fields left blank
- (3) Orders with invalid inventory codes
- (4) Orders with complete and valid details

Which of the above should be used to confirm the completeness and accuracy of input into the sales system?

- A 2 only

B 2 and 3 only

C 1, 2 and 3 only

D 1, 2, 3 and 4

12 You are also considering using audit software as part of your substantive testing of the data files in the sales and inventory systems of Porthos Co.

Which of the following are the difficulties that the audit team may encounter in using audit software?

A Any resulting corruption of the client's data files has to be corrected, and valid controls may prevent the auditors from removing the corrupting data.

B If errors are made in the design of the audit software, audit time and costs can be wasted in investigating anomalies that have arisen because of flaws in how the software was put together rather than by errors in the client's processing.

C Audit procedures are performed on previewed files which are dependent on other software (and therefore could contain errors or could have been tampered with following export).

D Audit software only tests the operation of the system at a single point of time and therefore the results do not prove that the program was in use throughout the period under review.

13 As part of substantive audit procedures, you plan to perform a sequence check on the sales invoice numbers issued over the year.

What is the purpose of this audit procedure?

A To give assurance that cut-off has been applied accurately

B To give assurance over the occurrence of the sales transactions recorded

C To provide audit evidence over the completeness of the recording of sales

D To provide audit evidence that the sales figure has been calculated accurately

14 The audit is underway. When carrying out tests of controls on a sample of sales invoices, the audit team identified an unexpectedly high deviation rate.

Which of the following would be a satisfactory course of action?

(1) Extend the sample size

(2) Replace the sample

(3) Ignore the deviations as they only affect some of the items tested

(4) Perform alternative substantive procedures

A 1 and 3

B 1 and 4

C 2 and 3

D 2 and 4

The following scenario relates to questions 15.

You are the audit manager of Savage & Co. It is a busy time of year for you as you have several on-going audit clients at the moment, for some of these the audits are entering the review and finalisation stage of the audit, whilst others are at the stage where fieldwork is complete.

You have just received a 'phone call from on particular audit senior who is unsure about the steps to take in relation to uncorrected misstatements.

15. Which of the following statements correctly describe the auditor's responsibility in respect of misstatements?

A ISA 450 Evaluation of misstatements identified during the audit states that the auditor only has a responsibility to accumulate material misstatements identified during the audit

B Where misstatements are not material the auditor should request that management to correct the misstatements in the following accounting period

C If management refuses to correct some or all of the misstatements, the auditor should consider the implications of this for their audit opinion

D A written representation should be requested from management to confirm whether they believe that the effects of the unadjusted misstatements are immaterial, both individually and in aggregate, to the financial statements as a whole.

SECTION B: 70 MARKS

QUESTION 1

Auditors must obtain sufficient appropriate audit evidence to issue an audit opinion on the financial statements. In order to gain that evidence, auditors may use a combination of tests of controls and substantive procedures.

Required :

(a) Explain what is meant by:

(i) A test of control

(ii) A substantive procedure and give one example of each that may be used when auditing the completeness of revenue. (4 marks)

(b)

Your firm is the auditor of Springfield Nurseries, a company operating three large garden centres which sell plants, shrubs and trees, garden furniture and gardening equipment (such as lawnmowers and sprinklers) to the public.

Non-current assets

You are involved in the audit of the company's non-current assets for the year ended 31 December 2022. The main categories of non-current assets are as follows:

- (i) Land and buildings (all of which are owned outright by the company, none of which are leased)
- (ii) Computers (on which an integrated inventory control and sales system is operated)
- (iii) A number of large and small motor vehicles, mostly used for the delivery of inventory to customers
- (iv) Equipment for packaging and pricing products.

The depreciation rates used are as follows:

- (i) Buildings 5% each year on cost
- (ii) Computers and motor vehicles 20% each year on the reducing balance basis
- (iii) Equipment 15% each year on cost,

Although an inventory control system is operated and up-to-date inventory records are maintained, the year end inventory quantities that are used in determining the year-end inventory value are arrived at by carrying out full inventory counts at each of the garden centres. The same set of inventory count instructions are provided at each centre and an extract from these is shown below:

(1) The inventory count will be supervised by the inventory controller for the site and will take place on 1 January 2023. The count will commence at 6:00am. The centre will be closed on the day of the count. No sales of inventory will take place on 1 January 2023, but transfer of inventory between garden centres is permitted in order to distribute it to where it will be needed most when the centres are re-opened.

(2) Staff allocated to the count (one member of staff per count area) will be provided with inventory counting sheets that are produced by the computerised system showing the

quantity per the system. These will be distributed and re-collected by the site inventory controller. Where the amount observed is different to the amount on the sheet, it should be crossed out and the new quantity written down.

(3) The inventory controller will then carry out one test count in each area that has been counted. Where an error is found, the area will be re-counted.

(4) The quantity for any inventory that looks damaged or unsaleable should be crossed out and allocated a quantity of zero. 48 Questions

(5) Once all the sheets have been collected up and test counts completed, the inventory controller will manually update the computerised system to reflect the counted quantities. Once the system is updated the count sheets can be discarded.

Required:

- (i) List and explain the main financial statements assertions tested for in the audit of non-current assets. (5 marks)
- (ii) List the sources of evidence available to you to verify the ownership and cost of the land and buildings. (2marks)
- (ii) Describe the audit procedures you would perform to check the appropriateness of the depreciation rates on each of the three categories of non-current asset. (5 marks)
- (iii) Identify and explain SEVEN deficiencies in the inventory counting system highlighted by the extract from Springfield's instructions for inventory counting. For each deficiency suggest how it could be overcome.

(14 marks)

[Total = 30 marks]

QUESTION 2

- (a) Explain the five elements of an audit engagement. (5 marks)
- (b) Panda Co manufactures chemicals and has a factory and four offsite storage

locations for finished goods. Panda Co's year end was 30 April 2022. The final audit is almost complete and the financial statements and audit report are due to be signed next week.

Revenue for the year is \$55 million and profit before taxation is \$5.6 million. The following two events have occurred subsequent to the year end. No amendments or disclosures have been made in the financial statements.

Event 1 - Defective chemicals Panda Co undertakes extensive quality control checks prior to the despatch of any chemicals. Testing on 3 May 2022 found that a batch of chemicals produced in April was defective.

The cost of this batch was \$0.85 million. In its current condition it can be sold at a scrap value of \$0.1 million. The costs of correcting the defect are too significant for Panda Co's management to consider this an alternative option.

Event 2 - Explosion An explosion occurred at the smallest of the four offsite storage locations on 20 May 2022.

This resulted in some damage to inventory and property, plant and equipment. Panda Co's management have investigated the cause of the explosion and believe that they are unlikely to be able to claim on their insurance. Management of Panda Co has estimated that the value of damaged inventory and property, plant and equipment was \$0.9 million and it now has no scrap value.

Required For each of the two events above:

- (i) Explain whether the financial statements require amendment; and
- (ii) Describe audit procedures that should be performed in order to form a conclusion on any required amendment. Note: The total marks will be split equally between each event. (12 marks)
- (iii) The directors do not wish to make any amendments or disclosures to the financial statements for the explosion (event 2).

Required

Explain the impact on the auditor's report should this issue remain unresolved.

(3 marks)

[Total 20 marks]

QUESTION 3

You are the audit manager in the firm of DeCe & Co, an audit firm with ten national offices.

You are planning the audit of Rocks Forever, one of your clients.

Rocks Forever purchases diamond jewellery from three manufacturers. The jewellery is then sold from Rocks Forever's four shops. This is the only client your firm has in the diamond industry. They have also said they will not depreciate the revalued amount allocated to the store's building because they maintain the building to a high standard. You are planning to attend the physical inventory count for Rocks Forever.

Inventory is the largest account on the statement of financial position with each of the four shops holding material amounts. Due to the high value of the inventory, all shops will be visited and test counts performed. With the permission of the directors of Rocks Forever, you have employed UJ, a firm of specialist diamond valuers who will also be in attendance.

UJ will verify that the jewellery is, in fact, made from diamonds and that the jewellery is saleable with respect to current trends in fashion. UJ will also suggest, on a sample basis, the value of specific items of jewellery. Counting will be carried out by shop staff in teams of two using pre-numbered count sheets.

Required

- (a) Briefly describe the main risks associated with inventory in a company such as Rocks Forever.
(3 marks)
- (b) Describe four audit procedures that should be used in obtaining evidence in relation to the count of inventory held in the shops. For each procedure, explain the reason for the procedure.
(8 marks)
- (c) Explain the factors you should consider when placing reliance on the work of UJ.
(5 marks)
- (d) Describe the audit procedures you should perform to ensure that jewellery inventory is valued correctly.
(4 marks)

[Total 20 marks]

END OF QUESTION PAPER