

**BINDURA UNIVERSITY OF SCIENCE EDUCATION**

**FACULTY OF COMMERCE**

**DEPARTMENT OF ACCOUNTANCY**

**PROGRAMMES**

**BACHELOR OF ACCOUNTANCY (HONOURS) DEGREE**

**BBA POLICE AND SECURITY STUDIES**

**BCHRLOR OF COMMERCE DEGREE IN FINANCIAL INTELLIGENCE**

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**COURSE: AUDITING PRINCIPLES AND PROCEDURES 1 EXAMINATION PAPER (AC205)**

**DURATION: 3 HOURS**

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**INSTRUCTIONS TO CANDIDATES**

1. Answer all questions
  2. Cell phones are not allowed in the examination
  3. Start each question on a fresh page
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## SECTION A (30 MARKS)

The following scenario relates to questions 1 – 2.

You are an audit senior of YHT & Co and have worked on the external audit of BJM Co (BJM), an unlisted company, since your firm was appointed external auditor two years ago. BJM owns a chain of nine restaurants and is a successful company.

BJM has always been subject to national hygiene regulations, especially in relation to the food preparation process. Non-compliance can result in a large fine or closure of the restaurant concerned. Despite running a successful company, BJM's Board have often needed to be reminded of some fundamental principles and you often have to explain key concepts.

### QUESTION 1

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 external audit is performed by management 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

### QUESTION 2

The audit partner has told you that the independence threats arising from YHT & Co performing the review engagement should be monitored carefully. Which of the following is likely to cause the audit partner most concern?

- A According to the ACCA Code of Ethics, YHT & Co 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 YHT & Co's fee income from BJM to exceed 15% of the firm's total fees, the ACCA Code of Ethics states that the new engagement must be turned down.

The following scenario relates to questions 3 - 5.

You are an audit manager of Ali & Co and have just been assigned the audit of Stark Co (Stark). Stark, a listed company, provides investment advice to individuals, and is regulated by the relevant financial conduct authority. Mr. Day, a partner in Ali & Co, has been the audit engagement partner for Stark for the previous nine years and has excellent knowledge of the client.

Mr. Day has informed you that he would like his daughter Zoe to be part of the audit team this year; Zoe is currently studying for her first set of fundamentals papers for her ACCA qualification. In an initial meeting with the finance director of Stark, you learn that the audit team will not be entertained on Stark's yacht this year, instead, he has arranged a balloon flight costing less than one-tenth of the expense of using the yacht and hopes this will be acceptable.

Ali & Co has always carried out tax advisory work for Stark. The tax advisory services do not have an impact on the figures reported in the financial statements. The finance director has stated that he feels strongly that the firm that offers taxation services this year should charge a fee which is based on a percentage of tax saved. He also trusts that your firm will accept a fixed fee for representing Stark in a dispute regarding the amount of sales tax payable to taxation authorities.

### QUESTION 3

In relation to the audit team being offered a balloon ride: Which of the following actions should be taken to ensure the firm complies with Code of Ethics and Conduct?

A The gift may be accepted as Stark has taken appropriate measures to reduce the value of the gift compared to previous years.

B The value of the gift should be assessed to determine whether it is of material value to the

financial statements.

C The gift should only be accepted if its value is trivial and inconsequential to the recipients.

D Only the audit partner and audit manager should accept the gift.

#### QUESTION 4

In relation to the audit engagement partner holding the role for nine years: Which of the following safeguards should be implemented in order to comply with Code of Ethics and Conduct?

A An independent review partner should be appointed to the audit.

B The audit engagement partner should be removed from the audit team but may serve as a quality control reviewer.

C Ali & Co should not audit Stark for a two-year period.

D The audit engagement partner should be removed from the audit team.

#### QUESTION 5

Zoe is also concerned that Ali & Co might breach confidentiality were the audit firm to represent Stark in its dispute with the tax authorities.

Which of the following statements best reflects the auditor's duty of confidentiality?

A Auditors must never, under any circumstances, disclose any matters of which they become aware during the course of the audit to third parties, without the permission of the client.

B Auditors may disclose any matters in relation to criminal activities to the police or taxation authorities, if requested to do so by the police or a tax inspector.

C Auditors may disclose matters to third parties without their client's consent if it is in the public interest, and they must do so if there is a statutory duty to do so.

D Auditors may only disclose matters to third parties without their client's consent if the public interest or national security is involved.

The following scenario relates to questions 6– 8 Cherry Blossom Co (Cherry) manufactures custom made furniture and its year end is 30 April. You are the audit supervisor of Poplar & Co and are developing the audit programmes for Cherry's forthcoming audit.

#### QUESTION 6

As part of audit planning, the audit team needs to obtain an understanding of the company's system of internal control. Peter, the audit junior, is unsure what a company's internal control comprises. Which of the following is not a component of an entity's internal control?

- A The control environment
- B Control activities relevant to the audit
- C The selection and application of accounting policies
- D The information system relevant to financial reporting

Cherry purchases its raw materials from a wide range of approved suppliers. When production supervisors require raw materials, they complete a requisition form and this is submitted to the purchase ordering department. Requisition forms do not require authorisation and no reference is made to the current inventory levels of the materials being requested.

#### QUESTION 7

Which of the following are the most likely consequences of the internal control deficiency described here?

- 1 Fraudulent purchases may be made, leading to funds being diverted to third parties for illegal purposes
- 2 Stock-outs may occur, resulting in the company being unable to meet orders and lost revenue
- 3 Unnecessary purchases may be made, resulting in excess obsolescent raw materials accumulating in inventory requiring to be written down
- 4 Raw materials of poor quality may be purchased, resulting in low-quality products being produced, customer goodwill being lost and going concern risks.

A 1 and 3

B 2 and 3

C 1 and 4

D 2 and 4

#### QUESTION 8

While reviewing Cherry's purchases cycle, you identified that goods received notes for raw material purchases are not sequentially numbered. Which of the following areas would you consider to be most at risk of material misstatement, as a result of this internal control deficiency?

A Rights and obligations of inventory

B Valuation of payables

C Existence of inventory

D Completeness of payables

The following scenario relates to questions 9 to 12

You are the audit manager in the firm of Wright & Co, a large accountancy firm with 30 offices. It is January 2021, and a new intake of graduates and apprentices has recently started work at the Audit department after completing their first ACCA exams. Julie, one of the new recruits, has been allocated to the audit of Wilbur Co, your audit client, for the year ended 31 December 2020. You are responsible for providing guidance to her on her first audit.

After the audit planning meeting, Julie approached you with this query: 'I know that as auditors, we have to collect audit evidence in order to support our audit opinion. But how can we tell how much audit evidence we need to get?'

Question 9

Which of the below factors influence the auditor's judgement regarding the sufficiency of the evidence obtained?

- 1 The materiality of the account
- 2 The size of the account
- 3 The source and quality of the evidence available
- 4 The amount of time allocated to the audit

A 1 and 3

B 2 and 4

C 2 and 3

D 1 and 4

It was decided that analytical procedures should be used at the planning stage of the audit of Wilbur Co. Julie is unsure what analytical procedures mean.

QUESTION 10

Which of the following assertions are examples of analytical procedures?

- 1 Comparing the actual revenue for the year with the forecast revenue from the yearly budget
- 2 Cast and cross-cast the aged trial balance of accounts payable before selecting any sample to test
- 3 Comparing the gross profit margin calculated from the 2022 draft financial statements with the gross profit margin for 2021
- 4 Calculating the average salary per employee by dividing total payroll costs by the number of employees in Wilbur Co's workforce, and comparing this with the industry average

A 1, 2 and 3

B 1, 3 and 4

C 2, 3 and 4

D 1, 2, 3 and 4

#### QUESTION 11

At which of the following stages of the audit MUST analytical procedures be used?

- (1) Interim audit
- (2) Audit planning
- (3) Audit fieldwork
- (4) Final review

A 2 only

B 2 and 3

C 2 and 4

D 1, 2, 3 and 4

#### QUESTION 12

The audit team has started to perform audit fieldwork on Wilbur Co.

In order to gain assurance over the company's bank balance, you have asked Julie to arrange for a bank confirmation letter to be sent to Wilbur Co's bank.

Which of the following summarises the steps to take in preparing the bank confirmation letter?

- A Written on the audit firm's headed paper; information requested to be sent directly to the auditor
- B Written on the client's headed paper; information requested to be sent directly to the auditor
- C Written on the audit firm's headed paper; information requested to be sent directly to the client
- D Written on the client's headed paper; information requested to be sent directly to the client



### QUESTION13

Mason has secured a five-year contract with each of its four customers (the police force, ambulance service, fire service and the coastguard). The contracts in place are all of equal value. Under the terms of the contract Mason charges customers an annual fee to cover the maintenance, storage and testing of the aircraft and equipment. The annual fee is payable in advance each year with the first annual payment being paid on the date the contract commences.

Based on the above information, which of the following statements summarises a key audit risk?

- A Mason's assets could be undervalued if the market value of the helicopter fleet exceeds its cost
- B Mason could breach the terms of its contracts with its customers and be liable to pay penalties, so provisions may be understated
- C Revenue may be overstated if it is recognised according to the contract date rather than over the relevant accounting period
- D An expert valuer is required to value the helicopters in the financial statement

### QUESTION 14

KLE Co's management is concerned that a number of inefficiencies in the procurement system may be having a negative financial impact on the company. As a result, they have requested the internal audit department to carry out a Value for Money audit focused on the company's procurement practices.

Which of the following best summarises the meaning of 'efficiency' in the context of a Value for Money audit?

- A The lowest cost at which the appropriate quantity and quality of physical, human and financial resources can be achieved
- B Producing the required goods and services in the shortest time possible
- C The extent to which an activity is achieving its policy objectives
- D The relationship between goods and services produced and the resources used to produce them

### QUESTION 15

While reviewing Cherry's purchases cycle, you identified that goods received notes for raw material purchases are not sequentially numbered.

Which of areas would you consider to be most at risk of material misstatement, as a result of this internal control deficiency?

A Rights and obligations of inventory

B Valuation of payables

C Existence of inventory

D Completeness of payables

### SECTION B (70 marks)

#### QUESTION 1

Lily Window Glass Co (Lily) is a glass manufacturer, which operates from a large production facility, where it undertakes continuous production 24 hours a day, seven days a week. Also on this site are two warehouses, where the company's raw materials and finished goods are stored. Lily's year end is 31 December. Lily is finalising the arrangements for the year-end inventory count, which is to be undertaken on 31 December 20X2.

The finished windows are stored within 20 aisles of the first warehouse. The second warehouse is for large piles of raw materials, such as sand, used in the manufacture of glass. The following arrangements have been made for the inventory count: The warehouse manager will supervise the count as he is most familiar with the inventory. There will be ten teams of counters and each team will contain two members of staff, one from the finance and one from the manufacturing department. None of the warehouse staff, other than the manager, will be involved in the count. Each team will count an aisle of finished goods by counting up and then down each aisle.

As this process is systematic, it is not felt that the team will need to flag areas once counted. Once the team has finished counting an aisle, they will hand in their sheets and be given a set for another aisle of the warehouse. In addition to the above, to assist with the inventory counting, there will be two teams of counters from the internal audit department and they will perform inventory counts.

The count sheets are sequentially numbered, and the product codes and descriptions are printed on them but no quantities. If the counters identify any inventory which is not on their sheets, then they are to enter the item on a separate sheet, which is not numbered. Once all counting is complete, the sequence of the sheets is checked and any additional sheets are also handed in at this stage. All sheets are completed in ink. Any damaged goods identified by the counters will be too heavy to move to a central location, hence they are to be left where they are but the counter is to make a note on the inventory sheets detailing the level of damage. As Lily undertakes continuous production, there will continue to be movements of raw materials and finished goods in and out of the warehouse during the count. These will be kept to a minimum where possible.

The level of work-in-progress in the manufacturing plant is to be assessed by the warehouse manager. It is likely that this will be an immaterial balance. In addition, the raw materials quantities are to be approximated by measuring the height and width of the raw material piles. In the past this task has been undertaken by a specialist; however, the warehouse manager feels confident that he can perform this task.

**Required :**

(a) For the inventory count arrangements of Lily Window Glass Co:

- (i) (Identify and explain six deficiencies; (6 marks)
- (ii) Provide a recommendation to address each deficiency. (6 marks)

You are the audit senior of Daffodil & Co and are responsible for the audit of inventory for Lily. You will be attending the year-end inventory count on 31 December 2022. In addition, your manager wishes to utilise computer-assisted audit techniques for the first time for controls and substantive testing in auditing Lily Window Glass Co's inventory.

**Required**

(b) Describe the procedures to be undertaken by the auditor DURING the inventory count of Lily Window Glass Co in order to gain sufficient appropriate audit evidence. (6 marks)

(c) For the audit of the inventory cycle and year-end inventory balance of Lily Window Glass Co:

- (i) Describe four audit procedures that could be carried out using computer-assisted audit techniques (CAATS); (4 marks)

(ii) Explain the potential advantages of using CAATs;

(4 marks)

(iii) Explain the potential disadvantages of using CAATs.

(4 marks)

(Total = 30 marks)

## QUESTION 2

(a) Explain the external auditors' responsibilities in relation to the prevention and detection of fraud and error. (4 marks)

(b)

You are the audit manager of Currant & Co and you are planning the audit of Orange Financials Co (Orange), who specialise in the provision of loans and financial advice to individuals and companies. Currant & Co has audited Orange for many years. The directors are planning to list Orange on a stock exchange within the next few months and have asked if the engagement partner can attend the meetings with potential investors. In addition, as the finance director of Orange is likely to be quite busy with the listing, he has asked if Currant & Co can produce the financial statements for the current year.

During the year, the assistant finance director of Orange left and joined Currant & Co as a partner. It has been suggested that due to his familiarity with Orange, he should be appointed to provide an independent partner review for the audit. Once Orange obtains its stock exchange listing it will require several assignments to be undertaken, for example, obtaining advice about corporate governance best practice.

Currant & Co is very keen to be appointed to these engagements, however, Orange has implied that in order to gain this work Currant & Co needs to complete the external audit quickly and with minimal questions/issues. The finance director has informed you that once the stock exchange listing has been completed, he would like the engagement team to attend a weekend away at a luxury hotel with his team, as a thank you for all their hard work. In addition, he has offered a senior member of the engagement team a short-term loan at a significantly reduced interest rate.

### Required:

(i) Explain six ethical threats which may affect the independence of Currant & Co's audit of Orange Financials Co; and (6 marks)

(ii) For each threat explain how it might be reduced to an acceptable level. (6 marks)

(c) Orange is aware that subsequent to the stock exchange listing it will need to establish an audit committee and has asked for some advice in relation to this. Required Explain the benefits to Orange of establishing an audit committee.

(4 marks)

(Total = 20 marks)

### QUESTION 3 (a)

Bluesberry hospital is located in a country where healthcare is free, as the taxpayers fund the hospitals which are owned by the government. Two years ago management reviewed all aspects of hospital operations and instigated a number of measures aimed at improving overall 'value for money' for the local community.

Management have asked that you, an audit manager in the hospital's internal audit department, perform a review over the measures which have been implemented. Bluesberry has one centralised buying department and all purchase requisition forms for medical supplies must be forwarded here. Upon receipt the buying team will research the lowest price from suppliers and a purchase order is raised.

This is then passed to the purchasing director, who authorises all orders. The small buying team receive in excess of 200 forms a day. The human resources department has had difficulties with recruiting suitably trained staff. Overtime rates have been increased to incentivise permanent staff to fill staffing gaps, this has been popular, and reliance on expensive temporary staff has been reduced.

Monitoring of staff hours had been difficult but the hospital has implemented time card clocking in and out procedures and these hours are used for overtime payments as well. The hospital has invested heavily in new surgical equipment, which although very expensive, has meant that more operations could be performed and patient recovery rates are faster.

However, currently there is a shortage of appropriately trained medical staff. A capital expenditure committee has been established, made up of senior managers, and they plan and authorise any significant capital expenditure items.

#### Required:

- (i) Identify and explain four strengths within Bluesberry's operating environment; and (6 marks)

- (ii) For each strength identified, describe how Bluesberry might make further improvements to provide best value for money.

(8 marks)

(b) Describe two ways the external auditor of Bluesberry should adopt to verify each of the following assertions in relation to an entity's property, plant and equipment:

(i) Valuation

(2 marks)

(ii) Completeness

(2marks)

(iii) Rights and obligations

(2 marks).

(Total 20 marks)

END OF QUESTION PAPER