

Examination No. _____

THE PUBLIC ACCOUNTANTS EXAMINATION
COUNCIL OF MALAWI

2010 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 7: AUDITING

TUESDAY 30 NOVEMBER 2010

TIME ALLOWED : 3 HOURS
2.00 PM - 5.00 PM

INSTRUCTIONS

1. You are allowed **15 minutes** reading time **before the examination begins** during which you should read the question paper and, if you wish, make annotations on the question paper. However, you are **not** allowed, **under any circumstances**, to open the answer book and start writing or use your calculator during this reading time.
2. Number of questions on paper – 7.
3. **FIVE** questions **ONLY** to be answered.
4. Each question carries 20 marks.
5. Begin each answer on a fresh page.
6. **DO NOT OPEN THIS PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.**

This question paper contains 5 pages

This question paper must **not** be removed from the examination hall.

1. (a) In the context of a computer based accounting system, explain the following terms and give one example of each:
- (i) Application controls; **2 Marks**
- (ii) General controls. **2 Marks**
- (b) There are a number of auditing firms that use portable computers to perform audit tasks. These computers can be used even when the client's data is not computerized, or when the clients' software is compatible with the auditors. However, the controls which must be exercised by the audit firms over computers must be adequately sophisticated to prevent the corruption of data held on the computers.

Required:

- (i) State any **five** ways in which a computer may be utilized by the auditor to perform his work. **10 Marks**
- (ii) Explain the controls which must be exercised when computers are used by the auditor in his work. **6 Marks**

(TOTAL: 20 MARKS)

Continued/.....

2. Bodom Coffee Farms Limited is a medium sized coffee growing enterprise and is located in the remote highlands of the country. It employs between 700 and 900 manual workers involved in the various farm activities. Bodom Coffee Farms recently installed a clocking machine to control the time worked by the workforce. The system starts with clock cards made out by employees by putting the cards in the time recording machine when they arrive and depart from work. The time of arrival and departure are printed onto the cards. At the end of each week the cards are authorized by the Foreman or the Manager to ensure that the hours worked are reasonable, since it is not unknown for one employee to clock on or off for another employee. The authorized cards are then sent to the human resources department for the calculation of wages due for each employee. The farm uses a payroll system supplied by Quantum Solutions, a payroll system provider based in Blantyre. The payroll clerk enters the details of hours worked from the clock cards into the computer and prints out the payroll summaries which are reviewed by the Human Resources Manager and the Finance Manager. Once approved, the payroll summaries are sent to the cash office where a cashier draws a cheque for wages and is sent to the authorized signatories for signing. Thereafter one of the payroll clerks goes to the bank to cash the cheques and packs the money in wage packets in accordance with the payroll summaries. Employees are then advised to go to the wages section of the HR department to collect their pay.

You are the Audit Supervisor of Norman and Company and in charge of the audit of Bodom Coffee Farms Limited. You have been assigned a task of reviewing the control system over the payroll system of Bodom Coffee Farms Limited.

Required:

- (a) For each of the control objectives below, identify the internal controls that you would expect to find in the wages system of Bodom Coffee Farms Limited and for each control state the compliance tests that you would carry out:
- | | | |
|-------|--|-----------------|
| (i) | To ensure that payment is only made for that actual services rendered; | 2½ Marks |
| (ii) | To ensure that only bona-fide employees are paid; | 2 Marks |
| (iii) | To ensure that pay is properly calculated; | 2 Marks |
| (iv) | To ensure that wages are accurately recorded; | 2 Marks |
| (v) | To ensure that payments are adequately controlled. | 6 Marks |
- (b) Explain the following components of the internal controls:
- | | | |
|------|-----------------------------------|-----------------|
| (i) | Control environment; | 3 Marks |
| (ii) | Control activities or procedures. | 2½ Marks |

(TOTAL: 20 MARKS)

Continued/.....

3. (a) You are the auditor of Property Limited, a company that owns several buildings. The company's only business is to lease flats, offices and shops to tenants in the country's major cities. The company's year-end is 31 August. It is now June and you have scheduled an audit planning meeting with your client for the audit of the financial statements for the year ending 31 August 2010.

Required:

- (i) State **four** reasons why the auditor spends considerable time planning for audit assignments. **4 Marks**
- (ii) What matters would you consider in the preparatory procedures for the planning meeting with the management of Property Limited? **8 Marks**
- (b) Explain the term "materiality". **1 Mark**
- (c) How does the auditor interpret this principle in the course of auditing a client's accounts? **7 Marks**
- (TOTAL : 20 MARKS)**

4. In modern auditing, audit firms are adopting a risk based approach to the audit of their client's accounts and financial statements and strive to quantify the amount of risk associated with each particular audit.

Required:

- (a) Define the term "audit risk". **2 Marks**
- (b) SAS 300 states that audit risk has three components. Identify and describe each of the **three** components of audit risk. **12 Marks**
- (c) State **two** examples of each component of audit risk. **6 Marks**
- (TOTAL: 20 MARKS)**

5. You are approached to act as auditor of a partnership, but the partners want you to carry out an examination of their debtors and the private ledger only.

Required:

- (a) Would you accept the appointment on the conditions detailed above? Provide reasons for your answer. **10 Marks**
- (b) Suppose that a similar request comes to you from the directors of a private limited company incorporated under the Companies Act 1984, would you accept the appointment? Give reasons for your answer. **5 Marks**
- (c) (i) Explain the term "letter of engagement".
- (ii) Mention **three** items that you would find in a letter of engagement. **5 Marks**

(TOTAL : 20 MARKS)

6. (a) Vouching means that the auditor must ensure that the persons responsible for writing up the books of first entry have not entered incorrect amounts.

Required:

Evaluate this statement and, in your own words, give a complete description of vouching. **7 Marks**

- (b) Bender Bakery is a company located at the foot of Masaka Hills in the northern part of the country. Its main line of business is to make bread and other confectionaries which it distributes to various shops in the district. The company has a fleet of distribution vans operated by drivers and salesmen. Due to the large fleet of vans, the company installed its own fuel tanks at its bakery head office and orders its fuel from one of the major fuel suppliers. It has two pumps, one for diesel and the other for petrol.

Required:

Describe briefly the procedures that you would follow to verify the following items that appear in the balance sheet of Bender Bakery:

- | | | | |
|------|---|--------------|---------------------------|
| (i) | Delivery vans | K45,560,000; | 7 Marks |
| (ii) | Fuel on hand at own petrol and diesel pumps | K7,516,217. | 6 Marks |
| | | | (TOTAL : 20 MARKS) |

Continued/.....

7. (a) You are the auditor of Shoe and Boots Limited, a company that produces industrial boots which it supplies to the military, police and government institutions. The company has a case with the local revenue authority which has been unresolved for a long time. The case has now been referred to the Corporate Tax Arbitration Court.

Your client asks you to fight this case in the Income Tax Arbitration Court on the condition that you are remunerated to the extent of 50% of the tax saved.

Required:

State what you would tell your client in the circumstances above as a public accountant and auditor.

8 Marks

- (b) You are the auditor of Grain Suppliers Limited and Grain Processors Limited. Grain Processors Limited owes Grain Suppliers a large amount for the grain it purchased from them. Your audit of Grain Processors Limited accounts reveals that the company is insolvent and will probably be unable to pay Grain Suppliers Limited. In Grain Supplier's books the debt owed by Grain Processors Limited is shown as recoverable.

Required:

As auditor of both companies, state whether or not you could use your knowledge of Grain Processors' financial position to persuade Grain Suppliers Limited to increase its provision for bad debts.

6 Marks

- (c) What other services would an auditor offer to its clients beside their core services of audit?

6 Marks

(TOTAL: 20 MARKS)

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