

EXAMINATION NO. _____



2014 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC7: AUDITING

TUESDAY 2 DECEMBER 2014

**TIME ALLOWED : 3 HOURS
2.00 - 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. Answer question **ONE** plus any **FOUR** others.
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 7 pages

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

COMPULSORY QUESTION

1. Njoka Limited is an international company. Your firm has been auditing its wholly owned local subsidiary, Njoka (Malawi) Ltd. Its local managing director, Mr Nsato, told you in a recent briefing meeting for the preparation of the forthcoming audit that they had rationalized and automated some of their operations. These include information management, in general, and the computerization of accounting and control systems, the organization's database and its database management system (DBMS) to manage access to the data by different users concurrently.

Your firm is aware that with these changes in the client's systems, there is need for change in your approach to auditing the company.

Required:

- (a) State any **four** problems associated with the interrogation program used in auditing. **4 Marks**
 - (b) (i) Define the term 'audit trail'. **2 Marks**
 - (ii) In a typical credit purchases scenario, trace the trail, explaining the process and documentation involved from the point management decides to purchase the goods to the point a creditor is finally paid. **3 Marks**
 - (c) Give **four** reasons why there is often loss of audit trail in most computerized systems. **4 Marks**
 - (d) State how a typical test data pack is operated. **3 Marks**
 - (e) Mention **four** security threats to standing data in a DBMS. **4 Marks**
- (TOTAL: 20 MARKS)**

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2. Mlamba and Chambo, who have been in partnership for some time, have decided to convert their partnership into a private limited company to be known as Bwato. They have invited Matemba to join the company as a minority shareholder.

The shareholders have been informed that their incorporated company will be governed by the provisions of the Companies Act (1984). One of the requirements of the Act is to submit to the Registrar of Companies copies of audited financial statements within 6 months of the reporting date of every year of trading. To meet the requirements, they have approached Ukonde & Co. Public Accountants, for clarification and possibly, eventual appointment as the company's auditors.

As one of the senior members of staff of Ukonde, you have been mandated to hold preliminary discussions with Bwato (pvt) Limited Company over a number of their concerns and provide clarification before your firm's appointment as auditors.

Required:

- (a) Who appoints an auditor and under what circumstances is an auditor appointed according to the provisions of the Companies Act (1984)? **3 Marks**
- (b) Assuming that in the course of carrying out his work, the auditor has concluded that his relationship with the client management has deteriorated so much that his position has become untenable, and the only reasonable step to take is to resign.

Required:

State the procedure to be followed when resigning as auditor, as stipulated by the Act. **3 Marks**

- (c) State **five** reasons why the statutory audit of financial statements provide reasonable assurance, and not absolute assurance, as some users would expect. **5 Marks**
- (d) The International Federation of Accountants (IFAC) has issued a Code of Ethics for Professional Accountants to all members of its recognized professional bodies, which lays down guidelines for the conduct of an accountant in public practice. The code includes integrity and confidentiality.

Required:

Explain how an auditor is expected to deal with confidentiality and conflict of interest. **6 Marks**

Continued/.....

- (e) Soche Construction Ltd is one of your clients. The company is planning to tender for a contract to construct a road. You have been asked by Soche Construction Ltd to assess the financial viability of a number of subcontractors who will be engaged by Soche to construct bridges. One such subcontractor is Kanjedza Construction Ltd who is also your audit client.

The managing partner is concerned with the above scenario because it may lead to a breach of the ethical code of conduct.

Required:

- (i) From the above scenario, identify possible problems which may arise as you assess the financial viability of Kanjedza and give appropriate recommendations and possible courses of action to be taken by the firm. **3 Marks**

- (ii) Define the term “integrity” as stipulated in the code of ethics. **2 Marks**
(TOTAL: 20 MARKS)

3. ISA 300: Planning an Audit of Financial Statements and ISA 315: Understanding an Entity and its Environment, require an auditor to obtain an understanding of an entity and its environment so as to determine the risk associated with the client and assess whether or not to rely on the work of others and determine the nature, extent and timing of audit procedures to be carried out to achieve the overall audit objective of reporting on the truth and fairness of financial statements of that entity.

Required:

- (a) Define the term ‘audit risk’ and explain **three** components in the audit risk model. **5 Marks**
- (b) (i) Define the term ‘expert’ in the audit process. **1 Mark**
(ii) What factors should an auditor consider when deciding the extent of reliance on the work of an expert? **4 Marks**
- (c) (i) Explain the nature and purpose of a letter of internal controls.
(ii) At what point in the audit process is the letter issued and to whom is it addressed? **4 Marks**
- (d) When asked to explain what a qualified audit report is, a candidate wrote: “a qualified audit report is issued when the auditor cannot give an entity’s financial statements a true and fair view because they contain material misstatements”.

Required:

- (i) Comment on the correctness of the above explanation. If you are in disagreement with the above explanation, provide the correct one. **3 Marks**
(ii) State the difference between “a disclaimer of opinion” and “an emphasis of matter”, with respect to audit reporting. **3 Marks**

(TOTAL : 20 MARKS)

4. You are part of a team that will audit Nalikukuti Ltd, whose year end is 30 June. You are currently planning the audit for the year ended 30 June 2014. You intend to incorporate procedures which will ensure that in finalizing its financial statements, the company complied with the generally accepted accounting practices with regard to IAS 10, events after the reporting date (formerly known as subsequent events or post balance sheet events), whose audit requirement is covered under ISA 560.

Required:

- (a) Mention the **two** types of events which are classified under ISA 10 and explain their accounting treatment. **4 Marks**
- (b) State the auditor's responsibilities under ISA 560 with respect to the events mentioned in (a), above. **4 Marks**
- (c) State the audit procedures that would be carried out in relation to the above events. **8 Marks**
- (d) Apart from getting assurance from management that they have supplied all the information requested by the auditor, including the above issue, state any **four** other matters that might be included in the management letter of representations. **4 Marks**
- (TOTAL: 20 MARKS)**

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5. You are part of a team that will audit Mkaté Bakers Ltd for the year ended 30 June 2014 and are currently planning the year-end audit. Mkaté Bakers Ltd specializes in the production of high quality bread of various kinds. During the interim audit, you noted that in the present economic down-turn, the company is experiencing difficulties as its costs are increasing and the prices of its products have been higher than those of its competitors because the competitors have lower production runs. One indicator of the problems that the company is facing is that it has consistently used a bank overdraft facility to finance its activities.

At the time of the interim audit, you discussed with the management what action they were taking to improve the company's liquidity. Management indicated that the company was planning to expand its facilities for producing white bread as this line had maintained its market share. The company had asked its bank for a loan to finance the expansion and also to maintain its working capital, generally.

To support its request for a loan, the company has prepared a cash flow forecast for the two years from the end of the reporting period and the internal audit department has reported on the forecast to the board of directors. However, the bank has said that it would like to have a report from external auditors to confirm the accuracy of the forecast. Following this request, Mkaté Bakers Ltd has asked you to examine the cash flow forecast and then to report to the bank.

Required:

- (a) (i) Define the term 'going concern'.
(ii) State the responsibilities of a company's management and those of its auditors in respect of going concern. **4 Marks**
- (b) Assess the company's ability to continue as a going concern and identify any mitigating factors to the effect of any such assessments. **6 Marks**
- (c) Describe **three** procedures that you would adopt in your examination of the cash flow forecast. **4 Marks**
- (d) Explain the kind of assurance that you could give in the context of the request by the bank. **3 Marks**
- (e) Explain why analytical procedures are an important approach in assessing the going concern status of an entity. Give two examples. **3 Marks**

(TOTAL : 20 MARKS)

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6. You are part of an audit team carrying out the audit of Lifuwu Manufacturers Ltd, which purchases various types of raw materials for manufacturing its finished products. In addition, it purchases other items for direct resale.

You have been assigned by your manager to carry out appropriate audit work to provide an assurance over the purchases system and year end purchases and payables balances for credit purchases.

Required:

- (a) Give **two** respective control objectives and control procedures that you would expect to find over the purchases and payables system, and the auditor's tests to evaluate their effectiveness with respect to:
- (i) Ordering; **4 Marks**
 - (ii) Receiving goods and invoices; **4 Marks**
 - (iii) Maintenance of accounting records. **4 Marks**
- (b) What audit tests would you carry out to assess the validity and accuracy of the year end purchases and payables balances? **4 Marks**
- (c) In the course of your audit, you discover that a number of batches of goods had not been properly recorded upon receipt from suppliers. Upon enquiry, management said that those batches had been sent directly to the departments that had requisitioned them.

Required:

State whether or not there is any problem with this arrangement, and if there is any, mention the possible implications. Finally, make your recommendation to management. **4 Marks**

(TOTAL : 20 MARKS)

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7. IAS 37, Provisions, Contingent Liabilities and Contingent Assets requires management to assess whether there exists any situation at the reporting date for which appropriate provisions should be made. By its nature, the knowledge of contingencies is usually confined to management, posing a risk of non-disclosure or understatement, especially if the contingencies have an unfavourable effect on the financial statements of an entity.

Required:

- (a) Define the following terms:
- (i) contingent liability **2 Marks**
 - (ii) provision **2 Marks**
- (b) Explain **two** typical situations which may give rise to contingent liabilities. **2 Marks**
- (c) What audit tests would you carry out to confirm the adequacy of disclosure of contingent liabilities and their related provisions in the financial statements of an entity? **4 Marks**
- (d) If the auditor believes that he/she has not obtained adequate evidence about contingencies and provisions, what implications would this have on his opinion in the report of an entity? **5 Marks**
- (e) Your client company had, within the year under consideration, sold goods to a consignee at cost-plus 25% mark-up, amounting to K900,000 on sale or return basis and recorded it as a receivable. By the reporting date, management had received a report from the consignee that K450,000 worth of the goods had not been sold. Management had not made any adjustment in the client's books with respect to this revelation because they were of the view that, since the goods had already been delivered to the consignee, they no longer belonged to the company.

Required:

- (i) Explain the meaning of the phrase "substance over form" in accounting. **2 Marks**
- (ii) What course of action should be undertaken by management of your client company in this case? **3 Marks**

(TOTAL: 20 MARKS)

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