

EXAMINATION NO. _____

THE PUBLIC ACCOUNTANTS EXAMINATION
COUNCIL OF MALAWI

2011 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 7: AUDITING

TUESDAY 31 MAY 2011

TIME ALLOWED : 3 HOURS
2.00 PM - 5.00PM

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 6 pages

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

1. You are the auditor of Elite Supplies Limited, a company that manufactures gypsum products including boards which are used in office partitioning and construction of ceilings. At the recent Board meeting the directors approved that the accounting system be computerized. The company has acquired an Electronic Reporting Package (ERP) system which will manage its sales and debtors, purchases and creditors, nominal ledger, and the stores system. You requested your audit clerk to record the system of purchasing both spares and service and has given you the following notes:
 - (1) User department completes Desk Top Requisitions (DTRs) each time they would like to purchase goods or services.
 - (2) The requisitions are electronically sent to the Assistant Accountant – Creditors who checks the accounting codes for the items or service being purchased. He is allowed to make corrections on errors of accounting codes only.
 - (3) The requisition is then electronically sent to the user head of department for approval. The head of department has set limits of authorization.
 - (4) Once the requisition is approved, it is electronically sent to the purchasing manager who then generates an order after checking the accompanying quotations.
 - (5) The generated order is authorized electronically by the Financial Controller or the General Manager depending on limits of authorization.
 - (6) The approved order is then printed and signed by any of the two and then it is sent to the supplier with a copy to the Stores Department.
 - (7) When the goods are delivered to the stores, the Stores Controller will check the goods against the order and requests the user department concerned to check the quality of the goods.
 - (8) Once all the checks are done and the goods are accepted, the Stores Controller receives the goods in the system and awaits the supplier's invoice.
 - (9) When the suppliers' invoices arrive in the accounts department, they are sent to the user department to certify them for processing and payment.
 - (10) The certified invoices are sent back to the creditors section of the accounts department and the clerk processes the invoice in the system and matches it with the goods receipted by the stores.
 - (11) The system then posts the entries to stock and supplier's accounts in the stock module as well as nominal ledger.

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- (12) Every Monday, the creditor's clerk runs a report of the invoices due and prints this report for the Accountant to check if cash flow is adequate to pay for the list. The Accountant signs off the list and then the creditors clerk pulls out documentation for the list and prepares payment vouchers for signing.
- (13) The signed vouchers are sent to the cash management section who prepare electronic transfer payments.

Required:

- (a) State **five** advantages of a computerized accounting system against a manual accounting system. **5 Marks**
- (b) (i) Explain the term "auditing around the computer". **2 Marks**
(ii) In what circumstances can the auditor use this approach? **4 Marks**
- (c) Identify and briefly describe internal control procedures that you would expect Elite Supplies Limited to set up around its new computerized purchasing system. **9 Marks**

(TOTAL: 20 MARKS)

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2. The audit of Safari Tours Limited, a prominent company in the Tourism industry, for the year ended 30 September 2010 was completed on 2 December 2010. Safari Tours Limited was valued at K46 million. The auditors, Jeffrey & Jeffrey, performed all the required procedures and tests which yielded satisfactory results and they issued an unqualified audit opinion. The firm has quality control procedures in place and in accordance with these procedures, a partner reviewed the file in January 2011 and concluded that the audit evidence was on file to support the opinion issued.

In March 2011, the audit firm received an e-mail from Nathan Mdinga, the Managing Director of Safari Tours Limited, informing them that the Financial Controller had a very beautiful cottage in Mangochi to which he had absconded with his secretary and that K40 million cash was missing. The Managing Director had done some preliminary investigations and the findings indicate that a sum of money had been misappropriated over a number of years. The Managing Director concluded in his e-mail by asking how it was possible that Jeffrey & Jeffrey failed to detect such a fraud for a long time and asked how they could justify their unqualified audit opinion issued just months previously. He even suggested legal action against them on this matter.

Required:

- (a) Analyse the concerns of Mr Mdinga, the Managing Director of Safari Tours Limited, with specific reference to:
- (i) The respective responsibilities of the auditor and the Directors of Safari Tours Limited with regard to the company's financial statements; **3 Marks**
- (ii) The auditor's responsibility to detect fraud. **2 Marks**
- (b) State the limitations on the audit procedures to detect fraud. **7 Marks**
- (c) Identify ways in which the Directors of Safari Tours Limited could have discharged their duty towards detection and prevention of fraud and error. **8 Marks**

(TOTAL: 20 MARKS)

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3. A proper understanding of internal controls is essential to the auditor so that he understands the business of the client and is able to effectively plan and execute tests of control. He would ensure that appropriate levels of substantive procedures are carried out.

You are the auditor of Zalewa Precious Stones Limited, a small mining company that pays its staff in cash and bank transfers. The company maintains its payroll on a small stand-alone computer.

Required:

- (a) Define the following terms:
- (i) Internal Control System. **3 Marks**
 - (ii) Segregation of duties, and give an example of how a given transaction could be segregated in a transaction of buying stores items. **5 Marks**
- (b) Describe the internal control objectives that should be in place for the payroll department of Zalewa Precious Stones Limited. **6 Marks**
- (c) Describe the internal control environment and the internal control procedures that should be in place to achieve the internal control objectives identified in (b) above. **6 Marks**
- (TOTAL : 20 MARKS)**

4. The auditor's report on the financial statements of Soche Hill Traders Limited reads in part as follows:

“To the Directors of Soche Hill Traders Limited

We have examined the books and accounts of your company and have obtained all the information and explanations which, in our opinion, were necessary for the purpose of our audit. We have not come across any matter with which we were not satisfied. We certify that the statement of the financial position shows the correct state of the affairs of the company at the end of the financial year and the comprehensive income statement shows the correct profit for the past financial year.”

Required:

- (a) Discuss the above auditor's report taking into account the provisions of the Companies Act (1984) Chapter 46:03; **8 Marks**
- (b) State any **twelve** traditional contents of an auditor's report and briefly explain each heading. **12 Marks**
- (TOTAL: 20 MARKS)**

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5. International Standards on Auditing (ISA's) apply equally to the audit of all entities whatever their size. However, the audit of small companies may pose particular challenges to the auditor.

Required:

- (a) (i) State **five** advantages for small companies to have an audit;
(ii) State **three** disadvantages for small companies to have an audit. **8 Marks**
- (b) Describe the challenges that the auditor of a small company may encounter in relation to the following:
- (i) His independence; **3 Marks**
(ii) Internal controls; **3 Marks**
(ii) Going concern and uncertainty. **6 Marks**
(TOTAL : 20 MARKS)

6. Pambalipe, a partner of David and Jake, auditors with a large client base in Malawi, has received a telephone call from the Managing Director of Tidye Restaurants and Bars Limited, which runs a chain of restaurants and bars. They wish to appoint David and Jake as auditors, as they have disagreements with the existing auditors. The audit is due to commence in about two months' time.

Required:

- (a) What should Pambalipe consider before accepting the appointment? **5 Marks**
- (b) What matters should be discussed at the meeting with potential clients? **5 Marks**
- (c) Pambalipe has advised the potential clients that they need to sign a letter of engagement before David and Jake can start the audit.
State the main purpose of the letter of engagement. **6 Marks**
- (d) State the consequences of omissions from the letter of engagement. **4 Marks**
(TOTAL : 20 MARKS)

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7. Stock and work-in-progress is often a significant item in the financial statements for companies engaged in the service industry and auditors will ensure that its verification is adequately done. As part of the audit procedures, auditors will attend stock take of the company's inventory items at the end of the financial year.

You are reviewing the stock take procedures of Liwonde Spares Centre Limited, a company stocking various spares for marine vessels, for the year ended 31 October 2010.

Required:

- (a) State what you would expect to be included in the procedures for stock-taking. **5 Marks**
- (b) Briefly describe your duties, as auditor, at the planning stage of the stock taking. **8 Marks**
- (c) Explain the term "cost and net realization value". **4 Marks**
- (d) What procedures should the auditor take to establish the existence of obsolete and slow moving stocks? **3 Marks**
- (TOTAL: 20 MARKS)**

END