

EXAMINATION NO. \_\_\_\_\_



**2015 EXAMINATIONS**

**ACCOUNTING TECHNICIAN PROGRAMME**

**PAPER TC7: AUDITING**

**WEDNESDAY 3 JUNE 2015**

**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. **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. Lobi Ltd runs a chain of small grocery shops in one of the cities of the country and uses computers in a relatively small computer environment for its accounting process. The computer maintains all stock records and also processes sales invoices on-line.

Your firm has been appointed to audit Lobi's financial statements for the year ended 31 December 2014.

**Required:**

- (a) Mention **two** control problems that are likely to exist within Lobi Ltd and for each problem, recommend a remedy that may be put in an on-line computer system. **5 Marks**
- (b) Mention **three** security and confidentiality problems that are likely to be encountered in a small computer environment. **5 Marks**
- (c) Describe any **three** special control issues that should be considered when an auditor uses audit software. **5 Marks**
- (d) Mention **five** support services that may be offered by a mini-computer supplier. **5 Marks**
- (TOTAL: 20 MARKS)**

2. International Standards on Audit (ISA) apply equally to the audit of all entities irrespective of their sizes. However, the audit of small companies may pose particular challenges for auditors and clients alike.

**Required:**

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

**Continued/.....**

3. The IFAC's Code of Ethics for Professional Accountants contains ethical principles which are mandatory for all those involved in the profession, be it members, aspiring members, in practice or in business, or students under whichever professional accountancy body worldwide. One such important principle is that of professional independence.

**Required:**

- (a) Define the term 'professional independence'. **2 Marks**
- (b) Explain why a member or a firm engaged in an assurance service such as an audit should not only be, but also be seen to be independent of their clients in all material respects. **3 Marks**
- (c) One of your audit clients Makwangwala Ltd, has recently not complied with the tax authorities' requirement to submit its tax returns for the just ended accounting period within the prescribed dates. The tax authorities have therefore, imposed an estimated tax, as empowered by the Taxation Act, which Makwangwala must pay having failed to declare it themselves. Management believes this tax is much higher than what they should pay.

They have asked you to prepare a tax return to contest the imposed tax, or even go as far as fighting the case in the Tax Arbitration Court, if necessary. In return, they have promised that your additional remuneration from the tax work will be composed of the first part based on the time spent on the work plus 50% of the tax saved.

**Required:**

As a public accountant and auditor, state what you would tell management in the above circumstances. **6 Marks**

- (d) Mtangatanga Wood Industries (MWI) Ltd supplies wood products to Chinsapo Furniture and Coffin Workshop (CFCW). You audit both companies.

Your audit of CFCW's accounts reveals that the company is insolvent and will probably be unable to pay MWI Ltd. In Mtangatanga's accounts, Chinsapo appears as one of the major receivable account balances at the year end.

**Required:**

As auditor of both companies, state whether or not you could use your knowledge of both companies to advise the management of MWI to increase in their accounts the provision for doubtful debts. **6 Marks**

- (e) State **three** possible actions that a professional accountancy body can take against its members or students who are in breach of their requirements or the IFAC Code. **3 Marks**

**(TOTAL : 20 MARKS)**

**Continued/.....**

4. ISA 315 requires an auditor to understand the environment of a client's entity in order to properly plan and determine the appropriate audit program.

**Required:**

- (a) Give **four** reasons why audit planning is important. **4 Marks**
- (b) Explain **four** issues concerned with audit planning. **4 Marks**
- (c) Mention any **four** matters that an auditor should assess when understanding the client's environment. **4 Marks**
- (d) Kunong'a Foods Ltd (KFL) operates a chain of 30 restaurants and takeaways in the main cities of the country. Its headquarters is at its largest outlet in Blantyre. The daily takings from each outlet are mainly cash. It has an account at the National Bank and cashiers in all outlets individually deposit their daily takings at their nearest National Bank branch. The company's cashbook is maintained and regularly reconciled with the bank statement by the company's accountant at the head office.

Each outlet buys materials from local suppliers using some of the money from the daily takings. Most of the materials are perishable, and only appropriate amounts need to be bought and stored in a proper environment.

**Required:**

- (i) From the above information, identify and comment on **two** matters that would significantly affect the auditors' assessment of inherent risk of KFL. **4 Marks**
- (ii) Define the term "detection risk" and mention **three** factors that may affect the level of detection risk in the above scenario. **4 Marks**

**(TOTAL: 20 MARKS)**

**Continued/.....**

5. Chimkango Traders acquired the business of Chigwenembe Enterprises. The two combined their assets and liabilities and formed a new company known as CC Ltd. The new company recognized a goodwill of K2 million in addition to other identifiable net assets of K10 million. This goodwill is to be reviewed for impairment at the end of each accounting period.

The company has approached your firm to carry out the audit of its first year ended on 31 December 2014.

**Required:**

- (a) Explain the terms “opening balances” and “comparative figures” in a set of financial statements. **3 Marks**
- (b) What is the auditor’s responsibility with respect to opening balances and comparative figures in a set of financial statements, especially in the first audit? **3 Marks**
- (c) On the goodwill figure:
- (i) Explain the term “goodwill” and its justification when one business is acquired by another, as a going concern. **4 Marks**
- (ii) What audit procedures would you carry out to satisfy yourself of the goodwill balance at the beginning and at the end of the year for CC Ltd? **3 Marks**
- (d) What audit procedures would you carry out with respect to opening balances for CC Ltd’s set of financial statements? **3 Marks**
- (e) What other issues would you consider to assess the reasonableness of the overall set of financial statements of CC Ltd? **4 Marks**
- (TOTAL : 20 MARKS)**

6. Inventory is often a significant item in financial statements of manufacturing and retail companies. As such, auditors ensure that its verification is adequately done. As part of the procedures, auditors attend inventory count at the end of the year.

**Required:**

- (a) State the main objectives of the auditors’ attendance and observation of physical inventory count. **4 Marks**
- (b) Describe your duties, as auditor, at the planning stage of the inventory count. **6 Marks**
- (c) State what you would expect to be included in the procedures for the count. **4 Marks**
- (d) State the action that you would take in respect of the counting staff who do not follow the counting instruction prepared by your client. **4 Marks**
- (e) Explain the terms; “cost” and “net realizable value”. **2 Marks**
- (TOTAL : 20 MARKS)**

7. Chikunda CPA are auditors of Pabwalo Ltd, a company engaged in retail business based in Lilongwe.

All the cash and cheques received from customers are supposed to be banked intact. All major payments to suppliers of goods and services are made through bank cheques.

A separate petty cash float of K50,000 is maintained for payments below K1,000 each. The petty cash is kept by an accounts clerk in a lockable cash safe. An average monthly expenditure is K18,000 with individual amounts ranging from K50 to K900.

Vouchers for expenditure are authorized by an accountant before cash can be paid to beneficiaries. These are recorded in the petty cashbook by the accounts clerk. Each transaction record comprises: date, reason for expenditure, amount of expenditure and the receiver of cash.

The petty cashbook is balanced and cash is counted every month. The petty cash is then reimbursed using the imprest system, with its cheque signed by the accountant, with details of the analysis part entered into the general ledger.

As part of the standard audit procedure, your team leader has prepared a bank letter for forwarding to the client's bankers. However, the managing director feels that this requirement is not necessary because in addition to internal records, all the company's bank statements, as reconciled by his employees, will be made available for the purpose of the audit. He is thus reluctant to authorize the bank to disclose any information. He has also assured the auditors that he would provide all information requested in the bank letter, and that the company's internal controls over cheque payments are very strong.

**Required:**

- (a) In respect of petty cash:
- (i) Explain any **three** weaknesses in the above petty cash system and recommend a control measure to overcome each weakness. **6 Marks**
  - (ii) State audit tests you would carry out in the above petty cash system and transactions to confirm year end balances. **4 Marks**
- (b) In respect of banking procedures and balances:
- (i) State the control procedures that you would expect to find in a cheque payment system. **4 Marks**
  - (ii) Mention **four** reasons why it is important for an auditor to obtain confirmations direct from the bank in addition to the information provided by the company's records. **4 Marks**
  - (iii) What advice would you give the Managing Director of Pabwalo Ltd regarding his stand, and what actions would you take if he was still uncooperative? **2 Marks**

**(TOTAL: 20 MARKS)**

**E N D**