

EXAMINATION NO. _____

THE PUBLIC ACCOUNTANTS EXAMINATION
COUNCIL OF MALAWI

2014 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 7: AUDITING

FRIDAY 30 MAY 2014

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. You are about to complete the audit of your client company and your audit manager has recommended that a conclusion cannot be reached until analytical procedures and general audit reviews have been carried out to satisfy yourselves that adequate work has been carried out and sufficient and appropriate evidence has been obtained as a basis for a consolidated conclusion and expression of opinion on the client's financial statements.

Your analytical procedures have revealed the following results:

- (1) While sales revenue has increased by 55% over the previous year, the gross profit margin has only increased from 46% to 48%, and the net profit margin has actually decreased from an average of 40% to 25%.
- (2) Gearing, that is equity capital as a percentage of the total capital employed, has increased from 60% to 80%, because some convertible debentures were converted to equity during the year.
- (3) The cash operating cycle, that is inventory days plus receivables days minus payables days, increased during the year unlike the previous year, from 30 to 38 days. The current ratio was 3:1 compared to 2:1 in the previous year, while the acid test ratio was 0.5:1 against 1:1 in the previous year. This was due to the substantial increase in inventory levels held during the year.

Required:

- (a) State any **four** purposes of analytical procedures. **4 Marks**
- (b) For each of the findings 1,2,3 listed above, state any **three** types of additional audit work that you would carry out to satisfy yourself of the completeness of the evidence over those issues. **9 Marks**
- (c) State any **four** factors that you would consider when reviewing the overall evidence before making any conclusion on the financial statements. **4 Marks**
- (d) State the **three** necessary procedures that you would follow to conclude an audit in order to form an overall opinion on the financial statements. **3 Marks**

(TOTAL: 20 MARKS)

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2. Chikuluti Stadium is a newly constructed multipurpose stadium, but predominantly used to host football matches between major teams in the country's Super League and major cup competitions. Fans pay three fixed rates to watch the matches: K5,000, K1,000 and K500 each for the VIP stand, covered stand and open stand, respectively.

Ticket Sales

Fans buy tickets to get into the stadium from the ticket offices through three separate gates for each stand. Tickets are only available and valid on the day of the match, with adults and children paying the same rate to enter into the stadium. Tickets are pre-printed and stored in each ticket office, and are purchased using either cash or visa cards. Each ticket has a number comprising two elements, two digits relating to the ticket office and four digits, numbered in sequence in order to identify the ticket source.

Cash sales

- (1) All ticket sales are recorded on a computer showing the amount of each sale and the number of tickets issued. This information is transferred electronically to the accounts office.
- (2) Cash is collected regularly from the ticket offices by a supervisor. The cash is then counted by two accounts clerks in the presence of the supervisor and banked on a daily basis.
- (3) The total cash from each ticket office is agreed to the sales information that has been transferred from each office.
- (4) The total cash received is then recorded into the cash book, and then into the general ledger.

Visa card payments:

Card holders swipe their cards through the EPS machine and enter their card personal identification number (PIN) codes and the ticket value for their preferred stands and are issued a ticket. The amounts are electronically deducted from the customers' accounts or card balances and debited into Chikuluti's account instantly, and the information is also transferred electronically to the accounts office.

You are a member of the audit team carrying out the annual audit of Chikuluti for the year ended 31 December 2013.

Required:

- (a) State any **eight** audit tests that you would carry out to verify the cash and bank balances in the books. **8 Marks**
- (b) State **twelve** audit tests that will confirm the audit completeness with regard to the sales or collections for the period. **12 Marks**

(TOTAL: 20 MARKS)

Continued/.....

3. You are the auditor of Takondwa Traders Limited whose year-end receivables balance, as verified by you in the ledgers, was K4,319,400. You have also requested for and have been provided with the debt age analysis given below. The chief accountant has informed you that receivable days have increased from 40 to 55. As a source of additional evidence you intend to obtain a direct confirmation from some of the balances through a circularization.

Number of Accounts	Range of debt (K)	Current (K)	1 to 2 months (K)	More than 2 months (K)	Total (K)
3	negative	(58,250)			(58,250)
150	1 to 50,000	350,000	495,200	645,000	1,490,200
8	50,001 to 100,000	578,450	750,000	387,000	1,715,950
2	100,001 or more	875,000	-	296,800	1,171,800
163		1,745,200	1,245,200	1,328,800	4,319,400

Required:

- (a) What would you aim to discover by carrying out a circularization of the receivables' balances? **4 Marks**
- (b) State the advantages of using a positive circularization in one instance and a negative circularization in another. Can both procedures be used in the same audit? **4 Marks**
- (c) What action should you take if the management of Takondwa Traders Limited refuses to agree to the debtors' circularization being undertaken? **4 Marks**
- (d) Circularization has been undertaken, and one of the companies circularized has replied that it disputes the amount claimed by Takondwa Traders. Briefly describe the possible causes of such disputes and the action that you would take as auditor. **4 Marks**
- (e) Your audit firm intends to obtain confirmation from at least 50 accounts. Which ones, from the above, should you particularly not ignore from the selection? Give a reason for your answer. **4 Marks**

(TOTAL : 20 MARKS)

Continued/.....

4. The accounting system of Maseko Limited has been computerized and integrated such that data is captured at various terminals but centrally processed on a real time basis. You have been told that programs have been designed with a number of checks in order to eliminate erroneous input records and restrict access to the system by unauthorized users.

Required:

- (a) State **eight** effects that the adoption of a computerized system would have on Maseko Limited and on the auditor's work. **8 Marks**
- (b) Explain how an auditor may use test data and audit software to obtain evidence from a client's systems and records. **4 Marks**
- (c) Define the term "real time processing system". **2 Marks**
- (d) Identify and explain the **two** types of controls over a computerized system and give **two** examples for each. **6 Marks**
- (TOTAL: 20 MARKS)**

5. A statutory audit is an assurance service where an auditor of a limited company has the statutory duty to report whether the financial statements he/she has examined show a true and fair view or not of the state of affairs of the company over the period concerned.

Required:

- (a) Mention any **four** methods that an auditor may employ to obtain evidence. Give **two** examples of each. **8 Marks**
- (b) Mention any **four** elements of an assurance engagement such as an audit. **4 Marks**
- (c) Apart from the statutory audit, state **three** other assurance and **three** non-assurance engagements that an auditor may be contracted to do. **3 Marks**
- (d) Define the term "auditor's independence" and state how offering other services may affect the auditor's independence. **5 Marks**
- (TOTAL : 20 MARKS)**

Continued/.....

6. When deciding the course of action and procedures to adopt to obtain evidence from a client, an auditor should consider the existence and activities of an internal audit function so as to rely on some of its work or not.

Required:

- (a) Define the term “internal audit” and state its objectives. **4 Marks**
- (b) Mention **two** similarities and **four** differences between an external audit and an internal audit. **6 Marks**
- (c) State and briefly explain the factors that an external auditor should consider in order to rely on internal auditors’ work or not. **5 Marks**
- (d) Explain the implications and course of action that an external auditor should take if an internal auditor refuses to provide him/her with the information requested. **5 Marks**

(TOTAL : 20 MARKS)

7. ISA 200 requires auditors to demonstrate competence in their professional engagement by not only adhering to standards but also using professional judgment throughout their work. Some such areas where the auditor uses judgment is to assess audit risk, determine materiality and decide appropriate methods of sampling to use and the sample size to draw in the audit of a client.

Required:

- (a) Define the term “professional judgment”. **3 Marks**
- (b) (i) Define the term “audit risk”. **1 Mark**
(ii) Explain the **three** components of the audit risk model and how the auditor may reduce the risk. **4 Marks**
- (c) (i) Define the term “audit sampling”. **2 Marks**
(ii) Explain any **four** methods used to select a sample. **6 Marks**
- (d) (i) Define the term “sampling risk”. **1 Mark**
(ii) Give **three** examples of where audit risk may arise. **3 Marks**

(TOTAL: 20 MARKS)

END