



# National University of Science and Technology

**FACULTY OF COMMERCE**

**DEPARTMENT OF ACCOUNTING**

**FIRST SEMESTER FINAL EXAMINATION PAPER: 2012/2013**

**DATE: JANUARY 2013**

**SUBJECT: AUDIT SKILLS CAC 2103**

**TIME ALLOWED: THREE HOURS, THIRTY MINUTES (3 ½ HOURS)**

**TOTAL MARKS: 100**

## **INSTRUCTIONS TO CANDIDATES**

1. Answer **all** questions
2. Use the answer book provided
3. Use black or blue pen
4. Begin each question on a new page and
5. Submit all answer books

## QUESTION 1

[25 MARKS]

You are an audit senior at Storm Incorporated a medium-sized audit firm in Zimbabwe. Storm has offices in Kwekwe, Mutare and Bulawayo, and its head office is situated in Harare. Storm has a workforce of 400 employees, including 12 partners.

In March 2012, the Board of Directors of Whatsapp (Pvt) Ltd awarded a tender to Storm for the audit of its financial statements. Whatsapp (Pvt) Ltd is one of the largest mobile communication companies providing voice and data services in Zimbabwe. Whatsapp (Pvt) Ltd will be the largest client of Storm in terms of fee revenue.

After completing the preliminary engagement activities, the audit partner requested one of the trainee accountants assigned to the audit, to prepare a draft engagement letter to be issued to Whatsapp (Pvt) Ltd. The draft engagement letter is shown below;

Storm  
P.O Box 777  
Harare

26 March 2012

The Accountant  
Whatsapp (Pvt) Ltd  
PO Box 333  
Harare

Dear Sir/Madam

### AUDIT ENGAGEMENT LETTER

We have been requested to audit the annual financial statements of Whatsapp (Pvt) Ltd, which comprises the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Cash Flows for the year then ended, the summary of significant accounting policies, other explanatory notes as well as

**Draft**

the certificate issued by the company's directors. Our audit will be undertaken with the objective of expressing an opinion on the correct presentation of the financial statements.

We will conduct our audit in accordance with International Standards on Auditing, the Code of Professional Conduct of the Institute of Chartered Accountants of Zimbabwe (ICAZ) and the Companies Act Chapter 24:03. The standards require that we plan and perform the audit to obtain assurance about whether the financial statements are free of material misstatements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements, evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management and also evaluating the overall presentation of the financial statements.

In making our risk assessments, we consider internal controls relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances.

Our statutory audit will include the expression of an opinion on the effectiveness of the entity's internal control. We remind you that the responsibility for the preparation of financial statements and their fair presentation is that of the management of the company. This responsibility includes the maintenance of adequate accounting records and internal controls that management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

We confirm our agreement to accept a management representation letter signed by the financial director as sufficient appropriate audit evidence on the revenue and inventory accounts.

We look forward to full cooperation with your staff, as the daughter of the financial director is included in the audit team. We trust that your staff will make available to us whatever

records, documentation and other information we may request in connection with the audit.

Our audit fees, which will be billed as work progresses, will be US\$16 000 (including VAT and excluding disbursements) and will not be adjusted for a period of five years. You should note that the audit fee to be charged is 15% lower than the fee charged by the previous auditors.

In addition to the statutory audit we will prepare calculations of current and deferred tax liabilities (or assets) for Whatsapp (Pvt) Ltd. The fee for these calculations will be charged at 10% of the resulting tax refund. The maximum liability of Storm Incorporated for any claims resulting from any services rendered in terms of this engagement letter shall be limited to an amount equal to twice the fees billed.

This letter will be effective for future years unless the agreement is terminated or amended with our consent.

Yours faithfully

Alwyn Mbudzi CA (Zim) Registered Auditor  
Storm Incorporated

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**Required:**

Critically discuss your concerns with regards to the draft engagement letter prepared by the trainee accountant. Your answer should comprise the following:

- i. The requirements in terms of *ISA 210: Terms of audit engagements*. **(15)**
- ii. The requirements in terms of the International Federation of Accountancy (IFAC) Code of Professional Conduct **(10)**

## QUESTION 2

[25 MARKS]

- a) **ISA 700: *Forming an opinion and reporting on financial statements*** explains the form and content of external audit reports. List the main elements/contents of the external audit report. **(8)**

You are the audit manager in Tarlac & Co. One of your new clients this year is Avaeut Pvt (Ltd), a company having net assets of \$15 million. The audit work has been completed, but there is one outstanding matter you are currently investigating; the directors have decided not to provide depreciation on buildings in the financial statements, although International Accounting Standards suggest that depreciation should be provided. Unfortunately, you have been unable to resolve the matter regarding depreciation of buildings; the directors insist on not providing depreciation. You have therefore drafted the following extracts for your proposed audit report.

- i. '.....We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement (.....remaining words are the same as a normal unmodified report).
- ii. As discussed in Note 15 to the Financial Statements, no depreciation has been provided in the Financial Statements, the practice, in our opinion, is not in accordance with International Accounting Standards.
- iii. The provision for the year ended 31 September 20X7, should be \$420,000 based on the straight-line method of depreciation using an annual rate of 5% for the buildings.
- iv. Accordingly, the non-current assets should be reduced by accumulated depreciation of \$1,200,000 and the profit for the year and accumulated reserve should be decreased by \$420,000 and \$1,200,000, respectively.

- v. In our opinion, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the financial statements present fairly, in all material respects ... (remaining words are the same as for an unmodified opinion paragraph).'

**The extracts have been numbered to help you refer to them in your answer.**

**Required:**

- b) Explain the meaning and purpose of each of the above extracts in your draft audit report. **(10)**
- c) **ISRE 2400: *Engagements to review financial statements*** provides guidance on reports for review engagements. Define the term '**limited assurance**' and explain how this differs from the assurance provided by an audit report on statutory financial statements. **(7)**

### QUESTION 3

[25 MARKS]

You are a manager in the audit firm of Alpha & Omega; and this is the first time you have worked on one of the firm's established clients contributing 20% to the gross fee revenue, Beta PLC. The main activity of Beta PLC is providing investment advice to individuals regarding saving for retirement, purchase of shares and securities and investing in tax efficient savings schemes.

You have been asked to start the audit planning for Beta PLC by Mr Ben, a partner in Alpha & Omega. Mr Ben has been the engagement partner for Beta PLC for the previous nine (9) years and so has excellent knowledge of the client. Mr Ben has informed you that he would like his daughter Zoe to be part of the audit team this year; Zoe is currently studying for her first set of fundamentals papers for her CA qualification.

Mr Ben also informs you that Mr Far, the audit senior, received investment advice from Beta PLC during the year and intends to do the same next year. In an initial meeting with the Finance Director of Beta PLC, you learn that;

- Due to the long association with the client, there is a standing agreement to have a fixed fee for the audit service.
- The audit team will not be entertained on Beta PLCs' boat cruise this year as this could appear to be an attempt to influence the opinion of the audit. Instead, he has arranged a balloon flight costing less than one-tenth of the expense of using the boat cruise and hopes this will be acceptable.
- The director also states that the fee for taxation services this year should be based on a percentage of tax saved and trusts that your firm will accept a fixed fee for representing Beta PLC in a dispute regarding the amount of corporation tax payable to the taxation authorities.

#### Required:

- a) Explain the ethical threats which may affect the auditor of Beta PLC. (15)
- b) For each ethical threat, discuss how the effect of the threat can be mitigated. (10)

#### **QUESTION 4**

**[25 MARKS]**

Technim PLC was formed on 1 August 2010 in order to manufacture mini computers. The directors are unsure as to their responsibilities and the nature of their relationship with external auditors.

**Required:**

The audit partner has asked you to write a report to the directors explaining the more fundamental aspects of accountability of the company and the relationship between the auditors, the directors of Technim PLC and the shareholders of Technim PLC. The memo should cover the following areas:

- i.** Why is there a need for an audit. **(5)**
- ii.** How the auditors of a public company maybe appointed under the Company's Act Chapter 24.03. **(7)**
- iii.** The repercussions of the company failing to appoint an auditor. **(3)**
- iv.** The auditors rights under the companies Act chapter 24.03. **(5)**
- v.** The responsibilities of the directors in relation to the accounting function of the company. **(5)**

**END OF EXAMINATION PAPER!**