



# National University of Science and Technology

## FACULTY OF COMMERCE

### DEPARTMENT OF ACCOUNTING

**SECOND SEMESTER EXAMINATION PAPER: 2011/2012**

**DATE: MAY 2012**

**SUBJECT: AUDIT PROCESS: CAC 2203**

**TIME ALLOWED: THREE (3) HOURS**

**MARKS: 100**

### **INSTRUCTIONS TO CANDIDATES**

1. Answer any four(4) questions
2. Use the examination book provided
3. Use black or blue pen
4. Begin each question on a new page and
5. Submit all answer books
6. Maths tables are provided

## **SECTION A**

### **Question 1 Compulsory (25 Marks)**

You are the senior in charge of the audit of Brampton Co for the year ending 31 January 2010 and are currently planning the year-end audit. Brampton specialises 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 has suffered as its costs are increasing and its prices have been higher than its competitors because of lower production runs. One indicator of the problems facing the company is that it has consistently used a bank overdraft facility to finance its activities. At the time of the interim audit you had discussed with company management what actions were being taken to improve the liquidity of the company and you were informed that the company plans to expand its facilities for producing white bread as this line had maintained its market share. The company has 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 it would like a report from the external auditors to confirm the accuracy of the forecast. Following this request the company has asked you to examine the cash flow forecast and then to report to the bank.

#### **Required:**

- a) Explain the difference between the interim audit and the final audit. **(7)**
- b) Explain whether you would be able to rely on the work of the internal auditors. **(6)**
- c) Describe THREE procedures you would adopt in your examination of the cash flow forecast. **(6)**
- d) Explain the kind of assurance you could give in the context of the request by the bank. **(6)**

## **SECTION B**

### **Answer any 3 Questions**

#### **Question 2**

Redburn Co, a publisher and producer of books of poetry, has been a client of your firm of Chartered Certified Accountants for a number of years. The manager in overall charge of the audit has been discussing the audit plan with the audit team, of which you are a member, prior to commencement of the work. The audit manager has informed the team, among other things, that there has been a growing interest in poetry generally and that the company has acquired a reputation for publishing poets who are still relatively unknown.

**During your audit you determine:**

- i. Contracts with the poets state that they are given a royalty of 10% on sales. Free copies of the books are provided to the poets and to some organisations such as copyright libraries and to others, such as reviewers and university lecturers. No royalties are given on these free copies.
- ii. The computerised customer master file contains a code indicating whether a dispatch is to earn a royalty for the author. This code is shown on the sales invoice and dispatch note when they are prepared.
- iii. A computerised royalty's file is held, all entries therein bearing the invoice number and date.
- iv. The company keeps detailed statistics of sales made, including trends of monthly sales by type of customer, and of colleges where its books are recommended as part of course material, based on reports from sales staff.
- v. Bookshops have the right to return books which are not selling well, but about 10% of these are slightly damaged when returned. The company keeps similar records of returns as it does for sales.

**Required:**

- a) Describe TWO procedures used to ensure that the sales statistics kept by the company may be relied upon. **(10)**
- b) Describe SIX substantive tests you should perform to ensure that the royalties charge is accurate and complete, stating the objective of each test. **(15)**

**Question 3**

Greystone Co is a retailer of ladies clothing and accessories. It operates in many countries around the world and has expanded steadily from its base in Europe. Its main market is aimed at 15 to 35 year olds and its prices are mid to low range. The company's yearend was 30 September 2010. In the past the company has bulk ordered its clothing and accessories twice a year. However, if their goods failed to meet the key fashion trends then this resulted in significant inventory write downs. As a result of this the company has recently introduced a just in time ordering system. The fashion buyers make an assessment nine months in advance as to what the key trends are likely to be, these goods are sourced from their suppliers but only limited numbers are initially ordered. Greystone Co has an internal audit department but at present their only role is to perform regular inventory counts at the stores.

**Ordering process**

Each country has a purchasing manager who decides on the initial inventory levels for each store, this is not done in conjunction with store or sales managers. These quantities are communicated to the central buying department at the head office in Europe. An ordering clerk amalgamates all country orders by specified regions of

countries, such as Central Europe and North America, and passes them to the purchasing director to review and authorise. As the goods are sold, it is the store manager's responsibility to re-order the goods through the purchasing manager; they are prompted weekly to review inventory levels as although the goods are just in time, it can still take up to four weeks for goods to be received in store. It is not possible to order goods from other branches of stores as all ordering must be undertaken through the purchasing manager. If a customer requests an item of clothing, which is unavailable in a particular store, then the customer is provided with other branch telephone numbers or recommended to try the company website.

### **Goods received and invoicing**

To speed up the ordering to receipt of goods cycle, the goods are delivered directly from the suppliers to the individual stores. On receipt of goods the quantities received are checked by a sales assistant against the supplier's delivery note, and then the assistant produces a goods received note (GRN). This is done at quiet times of the day so as to maximize sales. The checked GRNs are sent to head office for matching with purchase invoices. As purchase invoices are received they are manually matched to GRNs from the stores, this can be a very time consuming process as some suppliers may have delivered to over 500 stores. Once the invoice has been agreed then it is sent to the purchasing director for authorisation. It is at this stage that the invoice is entered onto the purchase ledger.

### **Required:**

**a)** As external auditors of Greystone Co, write a report to management in respect of the purchasing system which:

- i.** Identifies and explains FOUR deficiencies in that system;
- ii.** Explains the possible implication of each deficiency;
- iii.** Provides a recommendation to address each deficiency.

A covering letter is required.

**(15)**

**b)** Describe substantive procedures the auditor should perform on the year-end trade payables of Greystone Co. **(5)**

**c)** Describe additional assignments that the internal audit department of Greystone Co could be asked to perform by those charged with governance. **(5)**

### **Question 4**

You are the audit senior responsible for the audit of Have A Bite Co, a company that runs a chain of fast food restaurants. You are aware that a major risk of their sector is that poor food quality might result in damage claims by customers. You had satisfied yourself at the interim audit that the company's control risk as regards purchases of food and its preparation in the kitchen was low. However, during your final audit it comes to your attention that one month before the year-end, a customer has sued the company for personal injury caused by food poisoning, claiming an amount of \$200,000 in compensation. This amount is material to the stated profit of the company, but management believes that it has good defenses against the claim.

**Required:**

- a) Identify and explain FOUR assertions relevant to accounts payable at the year-end date. **(12)**
- b) State TWO controls that the company should have in place to reduce the risk associated with purchases of food and its preparation in the kitchen; and State TWO audit procedures you should carry out during controls testing to satisfy yourself that control risk in this area is low. **(8)**
- c) In respect of the potential claim state THREE items of evidence you should obtain and explain how they might enable you to form a conclusion on the likelihood of the claim being successful. **(5)**

**Question 5**

You are the audit manager of Jones & Co and you are planning the audit of LV Fones Co, which has been an audit client for four years and specialises in manufacturing luxury mobile phones. During the planning stage of the audit you have obtained the following information. The employees of LV Fones Co are entitled to purchase mobile phones at a discount of 10%. The audit team has in previous years been offered the same level of staff discount. During the year the financial controller of LV Fones was ill and hence unable to work. The company had no spare staff able to fulfill the role and hence a qualified audit senior of Jones & Co was seconded to the client for three months. The audit partner has recommended that the audit senior work on the audit as he has good knowledge of the client. The fee income derived from LV Fones was boosted by this engagement and along with the audit and tax fee, now accounts for 16% of the firm's total fees.

From a review of the correspondence files you note that the partner and the finance director have known each other socially for many years and in fact went on holiday together last summer with their families. As a result of this friendship the partner has not yet spoken to the client about the fee for last year's audit, 20% of which is still outstanding.

**Required:**

- a) State the FIVE threats contained within ACCA's *Code of Ethics and Conduct* and for each threat list ONE example of a circumstance that may create the threat. **(15)**
- b) Explain the ethical threats which may affect the independence of Jones & Co's audit of LV Fones Co; and for each threat explain how it might be avoided. **(5)**
- c) Describe the steps an audit firm should perform prior to accepting a new audit engagement. **(5)**

**END OF EXAMINATION PAPER**