



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTING

DEPARTMENT OF ACCOUNTING AND FINANCE

EXAMINATION PAPER

COURSE CODE : CAC404
COURSE TITLE : ADVANCED AUDITING THEORY AND PRACTICE 1
SPECIAL REQUIREMENTS :
DURATION : 3 Hours
LEVEL : 4.1
DATE : 18 NOV 2019

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue.
2. Answer any **ALL** questions.
3. Begin each question on a new page.
4. The number of marks for each question or part question is shown in brackets []

SECTION A

EACH QUESTION CARRIES 2 MARKS

Q1. For an entity's financial statements to be presented fairly in conformity with generally accepted accounting principles, the principles selected should:

- A. Be applied on a basis consistent with those followed in the prior year.
- B. Be approved by the Auditing Standards Board or the appropriate industry subcommittee.
- C. Reflect transactions in a manner that presents the financial statements within a range of acceptable limits.
- D. Match the principles used by most other entities within the entity's particular industry.

Q2. Because of the risk of material misstatement, an audit of financial statements in accordance with generally accepted auditing standards should be planned and performed with an attitude of:

- A. Objective judgment.
- B. Independent integrity.
- C. Professional scepticism.
- D. Impartial conservatism.

Q3. Which of the following is not contained in the engagement letter?

- A. Responsibilities of the auditors
- B. The objectives of the engagement
- C. Responsibilities of the management
- D. Competitors of the client

Q4. Attributes of an auditor's expert should enhance the work of the auditor. Which of the following is not one of the attributes?

- A. Performance
- B. Competence
- C. Objectivity

D. Capability

Q5. Which of the following is not a way of evaluating the significance of a service organisations?

- A. Nature of the services provided by the service organization.
- B. Qualifications of the management and organizational culture.
- C. Terms of contract and relationship between the entity and the service organization.
- D. Extent to which the entity's internal control interact with the systems at the service organization.

Q6. Which of the following is a criteria for assessing internal auditing function credibility?

- A. Salary rates.
- B. Technical competence.
- C. Location in the organisation.
- D. Number of years in existence.

Q7. Audit planning entails all of the following except

- A. Establish the audit strategy and materiality.
- B. Plan risk assessment procedures.
- C. Conduct risk assessment procedures.
- D. Planning the signing of the engagement letter.

Q8. Which of the following auditing procedures most likely would assist an auditor in identifying conditions and events that may indicate substantial doubt about an entity's ability to continue as a going concern?

- A. Inspecting title documents to verify whether any assets are pledged as collateral.
- B. Confirming with third parties the details of arrangements to maintain financial support.
- C. Reconciling the cash balance per books with the cut-off bank statement and the bank confirmation.
- D. Comparing the entity's depreciation and asset capitalization policies to other entities in the industry.

Q9. When an auditor believes there is substantial doubt about the ability of an entity to continue as a going concern, all of the following should be included in the audit documentation, except:

- A. The conditions that gave rise to the substantial doubt.
- B. The auditor's conclusion about whether substantial doubt remains or is alleviated.
- C. Management's conclusion regarding whether substantial doubt remains or is alleviated.
- D. The effect of the auditor's conclusion on the auditor's report.

Q10. After considering an entity's negative trends and financial difficulties, an auditor has substantial doubt about the entity's ability to continue as a going concern. The auditor's considerations relating to management's plans for dealing with the adverse effects of these conditions most likely would include management's plans to:

- A. Increase current dividend distributions.
- B. Reduce existing lines of credit.
- C. Increase ownership equity.
- D. Purchase assets formerly leased.

Q11. Which of the following conditions or events most likely would cause an auditor to have substantial doubt about an entity's ability to continue as a going concern?

- A. Significant related party transactions are pervasive.
- B. Usual trade credit from suppliers is denied.
- C. Arrearages in preferred stock dividends are paid.
- D. Restrictions on the disposal of principal assets are present.

Q12. Which of the following is not an example of the application of professional skepticism?

- A. Designing additional auditing procedures to obtain more reliable evidence in support of a particular financial statement assertion.
- B. Obtaining corroboration of management's Explanations through consultation with a specialist.
- C. Inquiring of prior year engagement personnel regarding their assessment of management's honesty and integrity.

D. Using third party confirmations to provide support for management's representations.

Q13. Which of the following is **not** a fundamental principle to professional behaviour

- A. Confidentiality.
- B. Objectivity.
- C. Ethics.
- D. Integrity

Q14. Which of the following is not an example of the application of professional skepticism?

- A. Designing additional auditing procedures to obtain more reliable evidence in support of a particular financial statement assertion.
- B. Obtaining corroboration of management's Explanations through consultation with a specialist.
- C. Inquiring of prior year engagement personnel regarding their assessment of management's honesty and integrity.
- D. Using third party confirmations to provide support for management's representations.

Q15. When is an engagement letter sent?

- A. During the internal control tests.
- B. When the auditor finalizes the audit work.
- C. When there is major restructuring in the client.
- D. When there are disagreements between the auditors and the client.

[Total: 30 marks]

SECTION B

QUESTION 1

You are an audit supervisor of NYAKU & Co and you are planning the audit of Bvanyangu Co, a listed company, for the year ending 31 March 2019. The company manufacture computer components and forecast profit before tax is \$33.6m and total assets are \$79.3m. Bvanyangu Co distributes its products through wholesalers as well as via its own website. The website was upgraded during the year at a cost of \$1.1m. Additionally, the company entered into a transaction in February to purchase a new warehouse which will cost \$3.2m.

Bvanyangu Co.'s legal advisers are working to ensure that the legal process will be completed by the year end. The company issued \$5m of irredeemable preference shares to finance the warehouse purchase.

During the year the finance director has increased the useful economic lives of fixtures and fittings from three to four years as he felt this was a more appropriate period. The finance director has informed the engagement partner that a revised credit period has been agreed with one of its wholesale customers, as they have been experiencing difficulties with repaying the balance of \$1.2m owing to Bvanyangu Co. In January 2019, Bvanyangu Co introduced a new bonus based on sales targets for its sales staff. This has resulted in a significant number of new wholesale customer accounts being opened by sales staff. The new customers have been given favourable credit terms as an introductory offer, provided goods are purchased within a two month period. As a result, revenue has increased by 5% on the prior year.

The company has launched several new products this year and all but one of these new launches have been successful. Feedback on product Luge, launched four months ago, has been mixed, and the company has just received notice from one of their customers, Petanque Co, of intended legal action. They are alleging the product sold to them was faulty, resulting in a significant loss of information and an ongoing detrimental impact on profits. As a precaution, sales of the Luge product have been halted and a product recall has been initiated for any Luge products sold in the last four months.

The finance director is keen to announce the company's financial results to the stock market earlier than last year and in order to facilitate this, he has asked if the audit could be completed in a shorter timescale. In addition, the company is intending to propose a final dividend once the financial statements are finalised. Bvanyangu Co.'s finance director has informed the audit engagement partner that one of the company's non-executive directors (NEDs) has just resigned, and he has enquired if the partners at NYAKU & Co can help Bvanyangu Co in recruiting a new NED. Specifically he has requested the engagement quality control reviewer, who was until last year the audit engagement partner on Bvanyangu Co, to assist the company in this recruitment. NYAKU & Co also provides taxation services for Bvanyangu Co in the form of tax return preparation along with some tax planning advice. The finance director has recommended to the audit committee of Bvanyangu Co that this year's audit fee should be based on the company's profit before tax. At today's date, 20% of last year's audit fee is still outstanding and was due to be paid three months ago.

(a) Describe EIGHT audit risks, and explain the auditor's response to each risk, in planning the audit of Bvanyangu Co. **(16 Marks)**

(b) Identify and explain SEVEN ethical threats which may affect the independence of NYAKU & Co.'s audit of Bvanyangu Co; and for each threat, suggest a safeguard to reduce the risk to an acceptable level. **(14 marks)**

[TOTAL 30 MARKS]

QUESTION 2

You are an audit manager in an audit firm with 250 staff. Your firm is the auditor of Sunrise, a chain of Supermarkets. Your firm has been the auditor of this client for many years.

All of the planning work and tests of control have been completed for Sunrise for the year ended 31 December 2019. Staff are still working on substantive procedures. The company operates a continuous inventory checking system with good records and you have tested this system and will be relying on the records for the year-end balance. The company is intending to invest a substantial amount in opening new stores during the next year and it has been negotiating with both banks and property companies in relation to leases.

Required:

(a) Describe the objectives of the following and how these objectives will be met in the audit of Sunrise:

(i) Overall review of financial statements; **(4 marks)**

(ii) Review of working papers. **(6 marks)**

(b) Describe the:

(i) Auditor's responsibilities with regard to subsequent events; **(6 marks)**

(ii) Procedures that should be applied during the subsequent events review at Sunrise.

(4 marks)

[TOTAL 20 MARKS]

QUESTION 3

The digital era has brought about significant changes in the accounting profession particularly on the skills set and technological side. The occurrence of contemporary scandals in the "big firms" can attest to this effect.

