

**ZIMBABWE EZEKIEL GUTI UNIVERSITY**



**DEPARTMENT OF ACCOUNTING AND FINANCE**

**B. COM ACCOUNTING**

**COURSE: ADVANCED THEORY AND PRACTICE OF AUDITING II**

**COURSE CODE: CAC408**

**DURATION: 3 HOURS**

**DATE 31 OCTOBER 2017**

**INSTRUCTIONS TO CANDIDATES**

1. No cell phones are allowed in the examination venue.
2. Answer 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.

## QUESTION 1

You are an Audit Manager in the practice of Mutsvairo, a five-partner practice of Registered Auditors based in Bulawayo. Your client is CHANGAMIRE Ltd. It is early April 2011 and you are planning the audit. The company will also require an Accountant's Report on the profit forecasts for 2012 in connection with an application for the continuance of its overdraft facilities from the bank.

CHANGAMIRE Ltd. is involved in the manufacture, installation and maintenance of "compact refrigeration solutions" for retail premises and other small businesses. It was set up 3 years ago, in April 2008, by three key Executives of another refrigeration manufacturer which closed down after encountering severe financial difficulties. Summarised financial information relating to the new business based on the financial statements for the previous 2 years, the management accounts for the year to March 31st 2011 and projections for the following year are given in Appendix A.

Towards the end of the year ended 31st March 2011, the Financial Controller left the company following a disagreement with the technical personnel on budgetary control related to new product development. The cost of development work on the "super compact freezer" had significantly exceeded budget. However, the technical personnel would not allow spending to be curtailed as they believed that a curtailment would seriously delay completion of the development work on this new generation of products which are expected to generate the major part of the turnover of the company from the commencement of the financial year ending 31st March 2013, onwards. The technical personnel expect the development work to be completed by the end of August 2011.

However, they had also maintained that development work would be complete by November 2010 but this estimate proved to be wildly optimistic. All development costs have been written off in the accounts of the years in which they were incurred. In 2009, the company had only just commenced business and experienced relatively little competition in building its market share. It achieved substantial increases in quantity terms in sales in 2010. Further increases in market share after that were much more difficult to achieve because the total market for the company's products was stagnant and the recession was biting. The market is expected to improve slightly in 2012.

Gross profits on the sale and installation of refrigeration units have been under pressure and have been declining. This trend is not expected to change until the new “super compact freezer” becomes the predominant seller in the company's range. Price increases have been implemented in line with inflation and this will continue in the future. However, manufacturing costs have been increasing faster than inflation and efficiencies have been deteriorating leading to the squeeze on gross profits. Gross profits on the maintenance business have been steady at about 33% of billings and this is not expected to change.

Maintenance contracts are entered into by every customer for whom the company installs a refrigeration unit. Maintenance is free for the year of installation and thereafter charges are quite high relative to the sale and installation cost. This is due to the low price charged for the refrigeration unit itself in anticipation of profitable maintenance business. In the second year, the annual maintenance fee is 25% of the price paid for the purchase and installation of the refrigeration unit in the previous year and, in subsequent years, this annual fee is increased in line with increases in the price of new refrigeration units.

Selling, general and administrative costs include a licence fee of 18% of total turnover which is payable to the owners of certain technology used in the present range of refrigeration systems supplied by the company. By careful control of all other expenses and constant attention to cost saving and efficiency measures, management have succeeded in the year ended 31st March 2011, in avoiding any increase over the 2010 level, even that due to inflation, in the selling, general and administrative costs other than the licence fee, and they plan to repeat this feat again in the year ending 31st March 2012. This is expected to be somewhat easier because of an anticipated fall in the rate of inflation.

Receivables have remained constant at 3 months on sales and installation turnover and 5.5 months on maintenance turnover and efforts by management to improve these statistics have not succeeded to date. The number of days inventory (this relates only to sales and installation business - there are no material inventories relating to the maintenance business) has reduced steadily over the years. Further reductions in these statistics are not achievable without major expenditure on computerised systems and no such expenditure is planned for the foreseeable future. Trade payable days, expressed in terms of cost of new sales and installations, have fluctuated over the 3 years. Plans for 2012 are to meet a target of 90 days.

Perpetual inventory records are not maintained. Knowing that the company would be subjected to a full audit in year ended 31st March 2011, you attended the company's inventory count for the first time on 31st March 2011 and judged it to be entirely satisfactory.

The table in Appendix B sets out relevant facts about the matters referred to in the paragraphs above (all days calculations are based on 360 day year):

**REQUIREMENT:**

In early April 2011, you are planning the audit of CHANGAMIRE Ltd. for the year ended 31st March 2011.

(a) Using all the available information, analyse the significant matters which would cause you, as Audit Manager, to question whether it was appropriate for the company to prepare its accounts on the going concern basis and explain briefly why each aspect would concern you; and

**(20 marks)**

(b) Indicate what adjustments, if any, you consider it might be necessary for the Directors to make to the accounts of CHANGAMIRE Ltd. for the year ended 31st March 2011, if the going concern basis is not appropriate.

**N.B.** You are not expected to calculate/quantify the adjustments, merely to state their nature.

**(20marks)**

**APPENDIX A**

**CHANGAMIRE LTD**

**STATEMENT OF COMPREHENSIVE INCOME**

**31 MARCH**

**\$000**

	FORECAST UNAUDITED		AUDITED	
	2012	2011	2010	2009
<b>AUDITED</b>				
SALES	11,241	8,802	6,230	2,670
COST OF SALES	<u>(7,254)</u>	<u>(5,536)</u>	<u>(3,783)</u>	<u>(1,513)</u>
GROSS PROFIT	3,987	3,266	2,447	1,157
OPERATING COSTS	<u>(3,168)</u>	<u>(2,732)</u>	<u>(2,269)</u>	<u>(1,246)</u>
PROFIT BEFORE INT & TAX	819	534	178	(89)
INTEREST CHARGES	(98)	(223)	(134)	(45)
TAX CHARGE	<u>(285)</u>	<u>(89)</u>	-	-
PROFIT AFTER INT. & TAX	436	222	44	(134)
DIVIDENDS	<u>(134)</u>	<u>(134)</u>	-	-
<b>RETAINED PROFIT</b>	<b>302</b>	<b>88</b>	<b>44</b>	<b>(134)</b>

**CHANGAMIRE LTD**

**STATEMENT OF FINANCIAL POSITION**

**31 MARCH**

**\$000**

	FORECAST UNAUDITED		AUDITED	
	2012	2011	2010	2009
<b>ASSETS</b>				
PROPERTY, PLANT EQUIPMENT	481	561	641	721
INVENTORY	854	757	801	668
RECEIVABLES	<u>3,622</u>	<u>2,643</u>	<u>1,691</u>	<u>445</u>
<b>TOTAL ASSETS</b>	<b>4,957</b>	<b>3,961</b>	<b>3,133</b>	<b>1,834</b>

**AMOUNTS FALLING DUE WITHIN**

**1 YEAR**

PAYABLES	1,165	1,068	979	338
BANK BORROWINGS	1,380	1,006	730	338
ACCRUELS	623	597	445	223
TAX LIABILITIES	285	89	-	-
DIVIDENDS	<u>134</u>	<u>134</u>	<u>-</u>	<u>-</u>
<b>TOTAL LIABILITIES</b>	<b>3,587</b>	<b>2,894</b>	<b>2,154</b>	<b>899</b>
<b>NET WORTH</b>	<b>1,370</b>	<b>1,067</b>	<b>979</b>	<b>935</b>
<b>CAPITAL AND RESERVES</b>				
<b>CALLED UP SHARE CAPITAL</b>	1,068	1,067	1,068	1,068
RETAINED EARNINGS	<u>302</u>	<u>-</u>	<u>(89)</u>	<u>(133)</u>
<b>NET WORTH</b>	<b>1,370</b>	<b>1,067</b>	<b>979</b>	<b>935</b>

**FORECAST UNAUDITED      AUDITED**

**AUDITED**

**2012      2011      2010      2009**

**APPENDIX B**

Market Share (% of new sales)	21.82	21.82	20.00	negligible
Increase in new installations				
Increase in overall market(%)	4.76	n/a	n/a	n/a
Inflation % per annum(%)	1.50	3.50	3.50	3.50
Gross profits on sales of units and installations(%)	36.60	38.00	40.00	43.40
Gross profit on maintenance(%)	33.30	33.30	33.30	33.30
Receivables days new installments(days)	90	90	90	90
Maintenance	165	165	165	165

## Question 2

The auditing profession has been criticised recently by politicians for its role in monitoring potential corporate failure. Radical reforms have been called for in the way the audit is regulated. For example, politicians have stated that there should be a change of legislation in the following ways:

### (i) Auditing standards

Auditing standards should be set and enforced independently from the accounting profession.

### (ii) Fraud

Auditing firms should have a duty to detect and report fraud.

### (iii) Non-audit services

Non-auditing services supplied to an audit client should be stopped.

### (iv) The duration of the appointment of auditors

The appointment of auditors should be for a maximum period of seven years.

### Required:

- (a) Describe the current regulatory and professional requirements relating to each of the main headings listed above. **(12 marks)**
- (b) Discuss the reasons why you feel that the audit profession has been criticised over the current regulations in the above areas. **(8 marks)**

## Question 3

Assume that your client has produced a set of projected financial statements for the year ended 31st December 2010. These include a projected income statement, projected statements of cash flows and a projected statement of financial position as at 31st December 2010. This will be used for internal control purposes but will also be shown to financial institutions in relation to applications for finance should the need arise.

### REQUIRED:

- a) What kind of report (if any) would it be appropriate for Irvine, Welsh and Partners to provide on this document and what are the risks to them of so doing. **(8 marks)**
- b) Discuss the view that, in current economic circumstances, it is difficult enough to audit historical or current information and, therefore, Auditors should refrain from offering any kind of opinion on prospective financial information **(12 marks)**

**Question 4**

Evaluate the factors to be considered by an auditor when forming an opinion in a given situation **(20 marks)**

**\*\*\*END OF PAPER\*\*\***