

**ZIMBABWE EZEKIEL GUTI UNIVERSITY**



**FACULTY OF COMMERCE**

**DEPARTMENT OF ACCOUNTING AND FINANCE**

**ADVANCED THEORY AND PRACTICE OF AUDITING II (CAC408)**

**PROGRAMME:**

**BACHELOR OF COMMERCE HONOURS DEGREE IN ACCOUNTING (HACC)**

**TIME: 3 HOURS**

**30 NOVEMBER 2018**

**INSTRUCTIONS**

- 1. ANSWER ALL QUESTIONS.**
  - 2. START EACH QUESTION ON A NEW PAGE OF YOUR ANSWER SHEET.**
  - 3. NO CELL PHONE IS ALLOWED IN THE EXAMINATION ROOM.**
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### Question 1

You are Charlie Bee, an audit manager in a firm of Chartered Certified Accountants. You have just received this email from Mr. Tee, the audit partner for Nash Co.:

To: Charlie Bee

From: Mr. Tee

Re: Nash Co. review assignment

Hello Charlie,

Our audit client Nash Co. has engaged us to review and report on the following prospective financial information, which it has produced. The information has been produced to support an application for a \$250,000 long-term loan from a bank. The funds from the loan will be invested, on 1 January 2019, in new plant and equipment that will be used to manufacture a new product range following a recent purchase of a patented technology.

Please produce a memorandum for me in which you:

- (a) Explain the term 'prospective financial information' ('PFI'). **(3 marks)**
- (b) Explain the matters that should be considered when planning the nature and scope of the examination of Nash Co.'s forecast statement of financial position and statement of profit or loss as prepared for the bank. **(7 marks)**
- (c) Describe the examination procedures you should use to verify Nash Co.'s prospective financial information. **(9 marks)**
- (d) Discuss the professional accountant's liability for reporting on prospective financial information and the measures that the professional accountant might take to reduce that liability. **(6 marks)**

**Note: You will need to refer to the attached information when drafting the memorandum.**

Thanks,

Tee

	<i>Actual year to</i>	<i>Actual quarter to</i>	<i>Forecast year to</i>	<i>Forecast year to</i>
	<i>31 Dec</i>	<i>31 March</i>	<i>31 Dec</i>	<i>31 Dec</i>
	<i>2017</i>	<i>2018</i>	<i>2018</i>	<i>2019</i>
	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>
<b>Non-current assets</b>				
Intangible asset – Patent	0	0	10	10
Property, plant and equipment	257	262	289	569
Accumulated depreciation	(123)	(128)	(139)	(191)
Net book value	134	134	150	378
Investments	7	6	7	7
<b>Current assets</b>				
Accounts receivable	71	65	84	100
Inventory	50	59	59	69
Cash and cash equivalents	6	7	7	0
	127	131	150	169
<b>Total assets</b>	<b>268</b>	<b>271</b>	<b>317</b>	<b>564</b>
<b>Equity</b>				
Share capital	1	1	1	1
Retained earnings	26	30	67	109
	27	31	68	109
<b>Non-current liabilities</b>				
Term borrowings	174	174	151	343
<b>Current liabilities</b>				
Accounts payable	23	21	27	32
Accrued expenses	21	22	25	28
Short-term borrowings	23	23	46	51
	67	66	98	111
<b>Total equity and liabilities</b>	<b>268</b>	<b>271</b>	<b>317</b>	<b>564</b>
<b>Statement of profit or loss</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Revenue	394	86	466	556
Cost of goods sold	(278)	(61)	(329)	(390)
Gross profit	116	25	137	166
Gross profit %	29.40%	29.10%	29.4%	29.90%
Operating expenses	(47)	(12)	(55)	(80)
Earnings before interest and tax	69	13	82	86
EBIT %	17.50%	15.10%	17.60%	15.50%
Interest expense	(21)	(4)	(18)	(44)
Earnings before tax	48	9	64	42

**Required:** Respond to the partner's email.

**[Total 25 marks]**

## Question 2

According to *ISA 570: Going Concern*, auditors are required to review evidence on which directors have based their presumption that the entity is a going concern. If the going concern assumption is inappropriate, an adverse opinion is required.

Samaringa Limited manufactures space travel craft and other communication equipment. It is now November 2010, and the audit of Samaringa for the year ended 30 September 2010 is nearing completion. You are the engagement manager of Mapara & Associates, the firm auditing Samaringa Limited. While reviewing the audit working papers, you identify several issues that may raise doubts about the ability of Samaringa Limited to continue as a going concern.

You have noted the following:

- i. Competition in the industry is becoming more intense, with many customers now manufacturing their own equipment.
- ii. The review of work-in-progress (W.I.P.) indicates that all the contracts in progress at year end are due for completion within six months of the reporting date. There are no new contracts in place for the coming year. However, management has indicated that there are orders currently being negotiated.
- iii. Included in the provisions is a large redundancy provision for 200 employees who have been informed that they may be made redundant in April 2011 depending on the status of orders at that time. (Note: the total number of employees is 1000.)
- iv. The company's bank has requested cash flow forecasts for the coming year to support the company's short-term loans borrowed from the bank.
- v. Assets consist mainly of plant and equipment, some of which is specialized to the industry.
- vi. Debtors are significant, but recoverability has been reviewed and it is not considered an issue. This is because the ongoing projects are with reputable customers and management is not aware of any problems.

### **Required:**

- a) What are the indicators that the company may have going-concern problems? **(13 marks)**
- b) What additional procedures would you carry out in order to test the applicability of the going-concern basis in this case? **(12 marks)**

**[Total 25 marks]**

### Question 3

You are an audit senior of Scarlet & Co. and are in the process of reviewing the systems testing completed on the payroll cycle of Bronze Industries Co. (Bronze), as well as preparing the audit programmes for the final audit. Bronze operate several chemical processing factories across the country, it manufactures 24 hours a day, seven days a week and employees work a standard shift of eight hours and are paid for hours worked at an hourly rate. Factory employees are paid weekly, with approximately 80% being paid by bank transfer and 20% in cash; the different payment methods are due to employee preferences and Bronze has no plans to change these methods. The administration and sales teams are paid monthly by bank transfer.

Factory staff are each issued a sequentially numbered clock card which details their employee number and name. Employees swipe their cards at the beginning and end of the eight-hour shift and this process is not supervised. During the shift employees are entitled to a 30-minute paid break and employees do not need to clock out to access the dining area. Clock card data links into the payroll system, which automatically calculates gross and net pay along with any statutory deductions. The payroll supervisor for each payment run checks on a sample basis some of these calculations to ensure the system is operating effectively.

Bronze has a human resources department which is responsible for setting up new permanent employees and leavers. Appointments of temporary staff are made by factory production supervisors. Occasionally overtime is required of factory staff, usually to fill gaps caused by staff holidays. Overtime reports which detail the amount of overtime worked are sent out quarterly by the payroll department to production supervisors for their review.

To encourage staff to attend work on time for all shifts Bronze pays a discretionary bonus every six months to factory staff; the production supervisors determine the amounts to be paid. This is communicated in writing by the production supervisors to the payroll department and the bonus is input by a clerk into the system.

For employees paid by bank transfer, the payroll manager reviews the list of the payments and agrees to the payroll records prior to authorising the bank payment. If any changes are required, the payroll manager amends the records. For employees paid in cash, the pay packets are prepared

in the payroll department and a clerk distributes them to employees; as she knows most of these individuals she does not require proof of identity.

**Required:**

(a) Identify and explain **five** internal control **strengths** in Bronze Industries Co.'s payroll system. **(10 marks)**

(b) Identify and explain **five** internal control **deficiencies** in Bronze Industries Co.'s payroll system and provide a **recommendation** to address each of these deficiencies. **(10 marks)**

(c) Describe substantive **analytical procedures** you should perform to confirm Bronze Industries Co.'s payroll expense. **(5 marks)**

**[Total 25 marks]**

**Question 4**

You are senior manager in Zodzo & Co, a firm of Chartered Certified Accountants. Recently, you have been assigned specific responsibility for undertaking annual reviews of existing clients. The following situations have arisen in connection with three clients:

- i) Zodzo was appointed auditor to Kora Co last year, and has recently issued an unmodified opinion on the financial statements for the year ended 31 March 2018. To your surprise, the tax authority has just launched an investigation into the affairs of Kora on suspicion of under-declaring income. **(3 marks)**
- ii) The chief executive of Rufaro Co, an exporter of specialist equipment, has asked for advice on the accounting treatment and disclosure of payments being made for security consultancy services. The payments, which aim to ensure that consignments are not impounded in the destination country of a major customer, may be material to the financial statements for the year ending 31 December 2018. Rufaro does not treat these payments as tax deductible. **(4marks)**
- iii) Your firm has provided financial advice to the Mambara family for many years and this has sometimes involved your firm in carrying out transactions on their behalf. The eldest son, Esau, is to take up a position as a senior government official to a foreign country next month. **(3 marks)**