



“Investing in Africa’s future”

COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE

NMAC 408: ADVANCED AUDITING, THEORY AND PRACTICE

END OF FIRST SEMESTER EXAMINATION

NOVEMBER 2022

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DURATION: 3 HOURS

INSTRUCTIONS

You are required to answer questions as instructed

Answer **all** questions

Start **each** question on a new page in your answer booklet

Credit will be awarded for logical, systematic and neat presentations

QUESTION ONE

(a) Explain the situations where an auditor may disclose confidential information about a client. (5 marks)

(b) You are an audit manager in McKay & Co, a firm of Chartered Certified Accountants. You are preparing the engagement letter for the audit of Ancients, a public limited liability company, for the year ending 30 June 2022.

Ancients has grown rapidly over the past few years, and is now one of your firm's most important clients. Ancients has been an audit client for eight years and McKay & Co has provided audit, taxation and management consultancy advice during this time. The client has been satisfied with the services provided, although the taxation fee for the period to 31 December 2021 remains unpaid.

Audit personnel available for this year's audit are most of the staff from last year, including Mr Grace, an audit partner and Mr Jones, an audit senior. Mr Grace has been the audit partner since Ancients became an audit client. You are aware that Allyson Grace, the daughter of Mr Grace, has recently been appointed the financial director at Ancients.

To celebrate her new appointment, Allyson has suggested taking all of the audit staff out to an expensive restaurant prior to the start of the audit work for this year.

Required

Identify and explain the risks to independence arising in carrying out your audit of Ancients for the year ending 30 June 2022, and suggest ways of mitigating each of the risks you identify. (20 marks)

QUESTION TWO

Discuss the events that led to the collapse of Enron and the lessons that the accounting and auditing profession should derive from the scandal. (25 marks)

QUESTION THREE

Day-to-day internal controls are important for all businesses to maximise the efficient use of resources and profitability.

Your firm has recently been appointed as auditor to Cliff, a private company that runs a chain of small supermarkets selling fresh and frozen food, and canned and dry food. Cliff has very few controls over inventory because the company trusts local managers to make good decisions regarding the purchase, sales and control of inventory, all of which is done locally. Pricing is generally performed on a cost-plus basis.

Each supermarket has a stand-alone computer system on which monthly accounts are prepared. These accounts are mailed to head office every quarter. There is no integrated inventory control, sales or purchasing system and no regular system for inventory counting. Management accounts are produced twice a year.

Trade at the supermarkets has increased in recent years and the number of supermarkets has increased. However, the quality of staff that has been recruited has fallen. Senior management at Cliff are now prepared to invest in more up-to-date systems.

Required

- (a) Describe the problems that you might expect to find at Cliff resulting from poor internal controls. (8 marks)
- (b) Make four recommendations to the senior management of Cliff for the improvement of internal controls, and explain the advantages and disadvantages of each recommendation. (12 marks)
- (c) Explain the impact that the internal control environment at Cliff is likely to have on your audit approach. (5 marks)

QUESTION FOUR

- a) ISA 700 Forming an opinion and reporting on financial statements indicates the basic elements that will ordinarily be included in the audit report.

Required

List six basic elements of an auditor's report. Briefly explain why each element is included in the report. (9 marks)

- b) You are the audit manager in charge of the audit of MSV Co for the year ended 28 February 2022. MSV Co is based in a seaside town and hires motor boats and yachts to individuals for amounts of time between one day and one week. The majority of receipts are in cash, with a few customers paying by debit card. Consequently, there

are no trade receivables on the statement of financial position. The main non-current assets are the motor boats and yachts. The company is run by four directors who are also the major shareholders. Total income for the year was about \$10 million.

The following issues have been identified during the audit.

Issue 1

Audit tests on sales indicate a deficiency in the internal control system, with a potential understatement of income in the region of \$500,000. The deficiency occurred because sales invoices are not sequentially numbered, allowing one of the directors to remove cash sales prior to recording in the sales day book. This was identified during analytical procedures of sales, when the audit senior noted that on the days when this director was working, sales were always lower than on the days when the director was not working. (8 marks)

Issue 2

During testing of non-current assets, one yacht was found to be located at the property of one of the directors. This yacht has not been hired out during the year and enquiries indicate that the director makes personal use of it. The yacht is included in the non-current assets balance in the financial statements. (8 marks)

Required

For each of the issues above:

- (i) List the audit procedures you should conduct to reach a conclusion on these issues;
- (ii) Assuming that you have performed all the audit procedures that you can, but the issues are still unresolved, explain the potential effect (if any) on the audit report.

Note. The mark allocation is shown against each of the two issues.

END OF EXAMINATION