



*"Investing in Africa's Future"*

**COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND  
GOVERNANCE**

**ADVANCED AUDITING MAC 405**

**END OF SECOND SEMESTER EXAMINATIONS**

**APRIL/ MAY 2017**

**LECTURER: MS N E CHIRIMA**

**DURATION: 3 HRS**

---

***INSTRUCTIONS***

Answer questions as directed in each section

---

---

---

---



## SECTION A [20 MARKS]

*Answer ALL questions on the answer grid provided. Mark the correct option with an X (in pen) filling the chosen grid. Any alterations should be clearly made. Each question is worth 2 marks.*

1. Significant conditions, events, circumstances or actions that could adversely affect the entity's ability to achieve its objectives and execute its strategies create:
  - A. Management Risk
  - B. Detection Risk
  - C. Control Risk
  - D. Business Risk
  
2. A situation where someone believes they have a favorable or promising combination of circumstances to commit an undetectable fraud is the description of:
  - A. Management Fraud
  - B. Rationalization
  - C. Perceived Pressure
  - D. Perceived Opportunity
  
3. Detection risk is:
  - A. The susceptibility of an assertion to misstatements that could be material, before consideration of any related controls.
  - B. The risk that an auditor's substantive procedures will not detect a misstatement that exists and that could be material.
  - C. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated.
  - D. The risk that a misstatement that could occur in an assertion, and that could be material, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.



4. The standards given in 'Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement' (ISA 315) emphasizes:
- A. Procedures for sampling audit tests.
  - B. Obtaining an understanding of business risks and significant risks.
  - C. Obtaining an understanding of control risk.
  - D. Management Letter contents
5. Which of the following is NOT a purpose of analytical procedures?
- A. To assist the auditors in planning the nature, timing and extent of other audit procedures.
  - B. As a test of control.
  - C. As an overall review of the financial statements in the final review stage of an audit.
  - D. As substantive procedures when their use can be more effective or efficient than tests of details
  - E. In reducing detection risk for specific financial statement assertions.
6. Which of the following statements is NOT correct about representation by management?
- A. It can take the form of a representation letter from the management.
  - B. It is a letter from the auditors outlining the auditors' understanding of management's representations, duly acknowledged and confirmed by the management.
  - C. It can take the form of relevant minutes of meetings of the board of directors.
  - D. It considers an oral representation as better evidence than a written representation.



7. An auditor should design the audit programme so that:
- A. Each account balance is tested under either tests of controls or tests of transactions.
  - B. Substantive tests prior to the balance sheet date are minimized.
  - C. All material transactions are selected for substantive testing.
  - D. The audit procedures selected achieve specific audit objectives.
8. A form of qualification normally used by external auditors where there are obvious uncertainties regarding the whole financial statements of a client is known as
- A. Adverse opinion
  - B. Except for
  - C. Material opinion
  - D. Disclaimer of opinion
  - E. Subject to
9. The first auditors of a company are usually appointed by
- A. Shareholders of the Company
  - B. Members of the audit committee
  - C. Corporate Affairs Commission
  - D. Directors of the Company
  - E. Solicitors to the Company
10. An audit procedure that involves detailed examination of assets and liabilities in the financial records at the year end is known as
- A. Depth Test
  - B. Walk Through Test
  - C. Substantive Test
  - D. Sampling Test
  - E. Compliance Test



- B. Valuation
- C. Completeness
- D. Rights and obligations

15. Your client has not written down inventory to its Net Realisable Value as required by IAS 2 "Inventories". The write down would reduce the amount disclosed under Current Assets by 15%. What type of audit opinion would you issue?

- A. Qualified
- B. Adverse
- C. Disclaimer
- D. Unqualified opinion with an emphasis of matter paragraph

16. Which one of the following statements best describes "effectiveness"?

- A. The relationship between outputs and outcomes of a program
- B. The relationship between the inputs and outputs of a program
- C. The relationship between resources used and outcomes of a program
- D. The relationship between resources used and inputs of a program.

17. A company is being sued for substantial damages for producing a faulty product. The results of the litigation will not be known for some time. The company believes the claim is unjustified and they will be successful in the case. Thus they have not included any reference to the pending lawsuit in the financial statements. The audit firm's independent legal advice suggest that the outcome of the case is not clear. What type of audit opinion should be issued?

- A. Qualified
- B. Adverse
- C. Unqualified opinion with an emphasis of matter paragraph
- D. Unqualified opinion with an other matter paragraph



18. Which of the following is NOT an audit software technique?
- Using computer programs to extract a sample for a receivables circularization
  - Running a computer program to test the addition of the cash book
  - Using a computer to perform an analytical review comparison of administration expenses against the prior year
  - Entering a sample of dummy sales orders through the computer system which takes customers over their credit limit to ensure the system rejects the orders
19. Which of the following procedures are TESTS OF CONTROL an auditor should perform in testing the inventory cycle of their client whilst attending the inventory count?
- Observe whether the client's staff is following the inventory count instructions
  - Review inventory present in the warehouse for evidence of damage or obsolescence
  - Obtain a sample of the last goods received notes and goods dispatched notes and follow through to ensure inclusion in the correct accounting period
  - Inspect and review management's inventory count instructions
- 2 and 3
  - 1 and 4
  - 1 and 2
  - 3 and 4
20. Luwa Ltd is in the retail business selling agricultural product. Its sales have averaged \$10 million annually for the past three years (2013 – 2015). The company's total assets at the end of 2015 amounted to \$9 million. You have been appointed as Luwa Ltd's auditors for the 31 year ended December 2016. As part of your planning on this new client you have acquired, you have computed the following ratios for the 3 year period:

	2013	2014	2015



Quick Acid Ratio	1.09	0.99	0.88
Current Ratio	1.81	1.93	1.97
Inventory Turnover	4.72	4.31	3.41
Debtors Turnover	8.74	7.70	6.41
Total Debt/ Total Assets	48	45	42
Long Term Debt/ Total Assets	28	24	21
Sales to PPE	1.57	1.68	1.78
Gross Margin Percentage	36.1	34.8	34.7
Net Income to Sales percentage	7	7	7.2
ROE (%)	13.7	13.2	12.8
ROA (%)	7.8	7.8	7.9
Sales as a %ge of 2013 sales	1	1.03	1.05

Which of the following conclusions would be drawn regarding the company's use of financial leverage and equity during the three year period 2013 to 2015?

- A. Equity has increased
- B. Long Term Debt has increased
- C. Total Debt has remained constant
- D. Long Term Debt has become more expensive

## SECTION B [25 MARKS]

*Answer ALL questions in the Africa University Answer Booklet*

1. "An opinion expressed by the auditor is neither an assurance as to the future viability of the enterprise nor the efficiency or effectiveness with which management has conducted the affairs". [5 marks]
2. ISA 200 requires that the auditor shall and perform an audit with professional skepticism. Explain the statement. [5 marks]
3. "As per ISA 260, auditor is required to communicate with those charged with governance various matters significant to an audit" In this reference explain various forms of communication and factors affecting mode of communication. [7 marks]



4. Auditor is required to identify and assess Risk of material misstatement through understanding the entity and its environment. Explain the various matters of which auditor should obtain understanding. [8 marks]

## SECTION C [55 MARKS]

*Answer ALL questions in the Africa University Answer Booklet*

### QUESTION ONE [20 Marks]

The International Audit and Assurance Standards Board (IAASB) is authorized to issue International Standards on Auditing.

Required:

- a) Define the term "audit" [2 marks]
- b) Briefly explain the five fundamental principles to be followed by professional accountants. [5 marks]
- c) State the general principles of an audit of historic financial statements [3 marks]
- d) Describe the authority of International Standards on Auditing. [5 marks]
- e) Explain the purpose for, and the procedures, of obtaining written presentation. [5 marks]

### QUESTION TWO [20 Marks]

It is important for an auditor to consider audit and business risk when planning, carrying out and coming to an opinion on the financial statements of a company. The risk that a company is not be able to achieve its objectives mostly translates into a risk that a material error or mis statement will be in the financial statements.

The auditor should plan and perform the audit to reduce audit risk to an acceptable low level. ISA 200 *Overall Objective of the Independent Audit and the Conduct of an Auditor in Accordance With International Standards on Auditing* has categorized audit risk into Inherent risk, Control risk and Detection risk.

Required:

- a) Define the following terms:



- i. Audit Risk [1 mark]
- ii. Control Risk [1 mark]
- iii. Inherent Risk [1 mark]
- iv. Detection Risk [1 mark]
- b) Explain the factors which affect Inherent Risk in an audit [6 marks]
- c) Describe the work you will carry out to quantify the Control Risk in a purchasing system [5 marks]
- d) Explain the effect on Detection Risk of the Inherent Risk and Control Risk if the auditor requires a particular level of audit risk. [2 marks]
- e) Briefly describe the audit checks you will perform in verifying creditors and accruals, and how these tests are affected by Detection Risk. [3 marks]

### QUESTION THREE [15 Marks]

You are carrying out the audit of Richmond Engineering Limited for the year-ended 31 March 2017, and you have been asked by the partner in charge of the audit to consider the work you would perform on events after the reporting period during the audit. You expect the detailed audit work to be completed by 20 June 2017 but the directors have informed you that they will not approve the financial statements until their board meeting on 25 July 2017 - your partner will sign the audit report on the same day. In your audit of trade debtors you found that one customer, Nasser Manufacturing Limited, had a receiver appointed on 25 May 2017. The following amounts, relating to that customer, have been included in the Statement of Financial Position at the year-end:

- i. A balance on the sales ledger amounting to \$300,000;
- ii. Goods included in inventory, valued at cost, amounting to \$400,000.

These goods had been ordered by Nasser Manufacturing plc and were held in inventory by Richmond Engineering Ltd. at 31st March 2017. However, due to the appointment of the receiver, they were not shipped as planned on 31st May 2017. It appears as if these goods will now have to be sold at a material discount in order to recover some value. No provision has been made in the accounts (for the year-ended 31 March 2017) for these items - an appropriate note has been included in the notes to the accounts. In answering the question you should assume:



- i. The potential bad debt relating to Nasser Manufacturing is material in the accounts of Richmond Engineering;
- ii. Richmond Engineering continues to be a going concern.

Required:

- a) Describe the audit work you would perform to decide whether the transactions relating to Nasser Manufacturing have been correctly treated in the financial statements, and in particular whether:
  - i. The item has been correctly treated as a non-adjusting event after reporting period;
  - ii. The provision for the bad debt is correctly stated;
  - iii. Disclosure of the loss in the value of the inventory is correctly stated. [10 marks]
- b) List and briefly describe four audit procedures you would carry out immediately before the partner signs the audit report on 25 July 2017, which will cover the period from 20 June 2017 to 25 July 2017. [5 marks]

END OF PAPER