



"Investing in Africa's Future"

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

MAC 305 – AUDITING PRINCIPLES

END OF SECOND SEMESTER EXAMINATIONS

APRIL/ MAY 2018

Ms. N E CHIRIMA

DURATION: 3 (Three) HRS

INSTRUCTIONS

Answer **ALL** questions

Answers are to be presented clearly and neatly.

Answer each question on a new page when answering Section B.

SECTION A [40 Marks]

Section A has 20 questions. Each question is worth 2 marks. **Answer all** questions on the answer grid paper provided (remember to **write your student I. D.**). All working is to be made in the Africa University booklet provided.

1. Confidentiality is one of the fundamental principles. During the course of the audit, the audit has access to client's information; some of them may be highly confidential.

Which of the following statement, if any, is/are correct in relation to confidentiality?

- 1 The auditor should never disclose confidential information to third party under any circumstance.
2 Disclosure of confidential information is permitted only when it is required by laws or regulations.

- A. Neither 1 nor 2
B. Both 1 and 2
C. 1 only
D. 2 only

2. Communication between the auditor and those charged with governance may be in oral.

Is the above statement true or false?

- A. True
B. False

3. Auditor should never receive gifts and hospitality from audit client.

Is the above statement true or false?

- A. True
B. False

4. **Detection risk is an important concept in a risk-based audit.**

Which of the following statements, if any, is/are incorrect?

- 1 It is a component of risk of material misstatement.
- 2 It affects the nature, time and extent of audit procedures.

- A. Neither 1 nor 2
- B. Both 1 and 2
- C. 1 only
- D. 2 only

5. **Which of the following statement, if any, is/are incorrect in relation to audit planning?**

- 1. The auditor should develop an audit plan that guides the development of the overall audit strategy.
- 2. In consideration of audit experience, audit juniors should not be involved in audit planning.
- 3. Once determined, the audit plan and overall audit strategy should not be changed.

- A. 2
- B. 2 and 3
- C. 1, 2 and 3
- D. None of the above

6. **Which TWO of the following are fundamental principles as stated in the ACCA's Code of Ethics and Conduct?**

- i. Objectivity
- ii. Independence
- iii. Confidentiality
- iv. Professional skepticism

- A. i and iv
- B. i and ii
- C. ii and iii
- D. i and iii

7. During the planning stages of the final audit, the auditor believes that the probability of giving an inappropriate audit opinion is too high. How should the auditor amend the audit plan to resolve this issue?
- A. Increase the materiality level
 - B. Decrease the inherent risk
 - C. Decrease the detection risk
8. ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment sets out the five components of internal control. Which of the following is NOT set out as a component of internal control within ISA 315?
- A. Control environment
 - B. The information system relevant to financial reporting
 - C. Human resource policies and practices
9. Which of the following would not be considered an analytical procedure?
- A. Converting dollar amounts of income statement account balances to percentages of net sales for comparison with industry averages.
 - B. Developing the current year's expected net sales based on the sales trend of similar entities within the same industry.
 - C. Projecting a deviation rate by comparing the results of a statistical sample with the actual population characteristics.
 - D. Estimating the current year's expected expenses based on the prior year's expenses and the current year's budget.

10. A basic premise underlying the application of analytical procedures is that
- A. The study of financial ratios is an acceptable alternative to the investigation of unusual fluctuations.
 - B. Statistical tests of financial information may lead to the discovery of material errors in the financial statements.
 - C. Plausible relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary.
 - D. These procedures cannot replace tests of balances and transactions.
11. If, before considering the internal controls at the audited entity, there is a high probability of certain errors in the financial statements, we particularly speak of:
- A. a high sampling risk
 - B. a high inherent risk
 - C. a high control risk
 - D. a high detection risk
12. The risk that errors in the financial statements may not be detected or corrected by the internal control system of the audited entity is:
- A. the audit risk
 - B. the inherent risk
 - C. the control risk
 - D. the detection risk
13. Materiality threshold is defined as the maximum tolerance level of errors identified after verification of a sample. Audit risk is the probability of existing errors not being identified by the auditors. Which of the following statements is not correct?
- A. The higher the materiality threshold, the lower the audit risk
 - B. Materiality and audit risk are inversely proportional
 - C. The lower the materiality threshold, the higher the audit risk
 - D. Materiality and audit risk are not related

14. **Audit information is usually considered relevant when it is:**

- A. derived from valid statistical sampling
- B. objective and unbiased
- C. factual, adequate and convincing
- D. consistent with the audit objectives

15. **Which of the following is not an objective of the audit planning procedure?**

- A. To set out the way in which the objectives and other priorities will be achieved
- B. To define how the audit evidence necessary to achieve the objectives will be obtained
- C. To perform data analysis to identify major weaknesses
- D. To identify the resources that will be needed and actually employed in audits

16. **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. Reports to government regulators.
- C. Obtaining an understanding of business risks and significant risks
- D. Obtaining an understanding of control risk.

17. **Which of the following is not a fundamental principle as set out in the International Ethics Standards Board for Accountants (IESBA)?**

- A. Materiality
- B. Confidentiality
- C. Professional competence and due care
- D. Objectivity

18. International auditing standards are issued by the:

- A. International Accounting Standards Board
- B. Financial Accounting Standards Board
- C. International Audit and Assurance Standards Board
- D. Auditing Practices Board

19. According to the IESBA, compliance with fundamental principles may be threatened by a broad range of circumstances. Safeguards that may eliminate or reduce such threats to an acceptable level fall into two general categories. What are the two categories?

- A. (1) Safeguards created by professional, legislation or regulation
(2) Safeguards created by the individual
- B. (1) Safeguards created by professional, legislation or regulation
(2) Safeguards created by the work environment
- C. (1) Safeguards created by society and government
(2) Safeguards created by professional, legislation or regulation
- D. (1) Safeguards created by the work environment
(2) Safeguards created by the individual

20. For a practicing auditor, which of the following circumstances may create a self interest threat?

- A. Threat of dismissal by the client over a disagreement about the review of accounting principles
- B. Concern over employment security
- C. Review of the data after being involved in the preparation
- D. Being threatened with litigation

SECTION B [60 Marks]

Section B has 4 questions. Each question is worth 20 marks. Select and Answer THREE questions in the Africa University booklet provided.

QUESTION ONE (20 Marks)

W.W Ltd, a retail store, has utilised your services as independent auditor for several years. During the current year, the company opened a new store, and in the course of your annual audit, you verify the cost of fixtures installed in the new store by examining purchase orders, invoices and other documents. The audit brings to light an understated invoice nearly a year old, in which a clerical error by the supplier Ruva Ltd caused the total of the invoice to read \$28 893. 62 instead of \$82 893, 62. The invoice was paid immediately upon receipt and subsequent statements and communication with Ruva Ltd show that the amount had been paid in full. Assume that the amount is material in relation to the financial position of both companies.

- a. What action will you as the auditor take in this situation? [5 marks]
- b. If W. W Ltd declines to take any action on the matter, would you insist that the unpaid \$54 000 be disclosed in the financial statements under liabilities as a condition necessary to your issuance of an unqualified report. [7 marks]
- c. Assuming you are later appointed as an auditor for Ruva Ltd, would you use the information you gained in your audit of W. W Ltd to initiate the reopening of the account with that company? Justify your answer. [8 marks]

QUESTION TWO (20 Marks)

ISA 315 states: "The auditor should obtain an understanding of internal control relevant to the audit."

- a. What is internal Control? [2 marks]
- b. What are the objectives of an internal control? [3 marks]
- c. List and explain the five components of an internal control as set out by ISA 315 (Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment) [15 marks]

QUESTION THREE (20 Marks)

You have joined KK Audit firm as a junior articulated clerk. Your audit manager has assigned you to be part of a team auditing Temba Timber Manufacturing Ltd. The audit team leader has given you the task to prepare an audit program for the Cash and Bank.

Prepare a detailed Cash and Bank audit program clearly showing your audit objectives (indicating the related assertion) as well as the substantive audit tests to be performed (including the assertion satisfied by each test). [20 marks]

QUESTION FOUR (20 Marks)

You are the auditor of Kugadzira Ltd, a construction company that deals with contracts that usually last between 6 and 36 months. The head office is in Harare and site offices are erected at each big building site. The building sites are usually situated in the Mashonaland area. The following is a description of Kugadzira's accounting and internal control system in respect of creditors:

Orders are completed in three fold and approved by Mr. J the head office buyer. The approved orders are treated as follows:

- The green copy is sent to the supplier
- The pink copy is sent to the head office creditors' clerk Ms. S
- The white copy remains in the order book that is checked by the head office buyer

Ms. S attached the relevant order to the invoice when she receives the invoices from the supplier. She will only process the invoice after the delivery has been confirmed telephonically by the site supervisor. Before they are processed, the invoices are sent to the head office contract accountant Mr. B who records the relevant contract allocation codes on it. The site supervisor is authorized to receive goods and to sign the delivery note of the supplier as proof of delivery. Copies of the signed notes are kept at the site. Ms. S processes the invoices monthly on the computer. Costs are updated in the contract ledger and a creditors' list is generated. Ms. S reconciles the suppliers' monthly statements with the creditors list and the creditors list with the creditors control account. The computer also prepares a remittance advice from the invoices as well as a summary of the creditors payments that were posted to the cash book.

Although Ms. S is not authorized to sign cheques, she prepares the cheques to the creditors and sends the remittance advice, cheque and invoices to the manager, Mr. Bernard and the contract engineer, Mr. Dexter for approval and signing. The signed cheques are then returned to Ms. S who posts it to the supplier. Some suppliers opt to collect the cheques themselves in which case Ms. S keeps them.

The cash book is prepared by the cash book clerk who is responsible for the monthly bank reconciliation.

REQUIRED:

- a. List at least five (5) weaknesses in the above accounting and internal control system in respect of creditors for discussion at a meeting with Kugadzira Ltd's management. [10 marks]
- b. ISA 330 states: "Irrespective of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for each material class of transactions, account balance, and disclosure." Design appropriate substantive test programmes for the audit of Kugadzira Ltd's purchases and creditors. [10 marks]

END OF PAPER