



## AUE202M RAE202P

October/November 2010

### INTRODUCTION TO THE PERFORMING OF THE AUDIT PROCESS (AUDITING 202)

Duration 2 Hours

100 Marks

**EXAMINERS :**

FIRST

SECOND

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PROF HJ THERON

Use of a non-programmable pocket calculator is permissible.

This paper consists of **NINE (9)** pages

This paper consists of the following questions and main topics

QUESTION	MAIN SUBJECT	MARKS
1	Multiple-choice questions	15
2	Implementation of good internal controls	20
3	The audit of inventory and wages	25
4	The internal controls for purchases and the audit of sales	20
5	The audit of property, plant and equipment and long term loans	20
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**NOTE:**

Although the primary purpose of the examination is to test the student's knowledge and application of the subject matter, the student's ability to organise and present such knowledge in written language of an acceptable standard will be taken into consideration by the examiners

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## QUESTION 1

15 marks

### REQUIRED

For every subsection of this question, you have to choose **one** alternative that you consider to be the most appropriate answer. Answer the subsections of this question in numerical order, for example, as follows

1.1 A

1.2 B

(1½ marks per question)

1.1 Select the statement which **best** indicates that a company has good segregation of duties

- A The people who handle or have access to assets may only also be responsible for the recording or security of the assets and may not be responsible for anything else relating to those assets
- B There should be segregation of duties between functions of authorisation, execution and recording of the transactions or associated transactions
- C Reliable and adequately trained people should be appointed if they are to have control over both the recording and execution of transactions
- D An authorised person should be responsible for authorising, by means of a signature, any routine transaction above a certain rand value. Transactions below that value need not be authorised

1.2 Which one of the following alternatives is a risk related to completeness of input transactions?

- A Classification errors
- B Controls override
- C The risk of fictitious transactions
- D Incorrect cut-off

[TURN OVER]

- 1.3** Which **one** of the following audit procedures is a valid **test of control** during the audit of salaries?
- A Inspect employee contracts and agree the details to the salary payslips and the recording thereof in the accounting records.
  - B By re-performance, agree the accuracy of salaries journals to the general ledger.
  - C Compare salaries on a month to month basis and investigate material deviations
  - D Observe the financial manager's signature on the monthly salaries' reconciliation
- 1.4** Select the alternative which **best** describes a substantive audit procedure on transactions
- A The completion of the relevant transaction.
  - B Incomplete documents and the comparison of various documents
  - C Selection of entries in the subsidiary books and the comparison thereof with the information on source documents
  - D Postings to the cashbook only
- 1.5** Which **one** of the following alternatives represent the best formulation of an audit procedure?
- A Check the property, plant and equipment register for . .
  - B See whether the cashier
  - C Look at whether the financial director .
  - D Recalculate the depreciation on

- 1.6 Which **one** of the following best describes the **completeness** financial statement assertion in relation to accounts receivable?
- A Accounts receivable, as reflected at year end, do exist
  - B Accounts receivable represent the sum of the balance owing by individual debtors at the balance sheet date
  - C Accounts receivable represent all the amounts owing by customers at the balance sheet date
  - D Accounts receivable has been properly disclosed and classified in the financial statements
- 1.7 Which **one** of the following is the **best** internal control that management should put in place to protect a company's assets?
- A Management should prohibit authorised access to the premises and buildings and the unauthorised use of computers
  - B Passwords for accessing the computer should only be allocated to certain people and these passwords may only be shared with certain authorised people
  - C A designated person should be responsible for authorising access to the enterprise's fixed and other assets.
  - D Regular backups of all computer data should be made and the backups must be stored in a safe place at the company's place of business.

- 1.8** Which **one** of the following alternatives is **not** a control which should be in place when a computerised information system programme is modified to meet changes in user requirements?
- A Changes should be made to a development programme and not to the live production programme.
  - B The information technology manager should review the log of programme changes.
  - C Changes should be effected by operators and not programmers.
  - D Requests for programme changes should be documented on change control forms
- 1.9** Which **one** of the following is **not** a control that management should perform to ensure the effective and continuing operation of the other general and application controls?
- A The internal controls that are in place should be regularly monitored and studied by management to ensure that they are being applied as they were designed
  - B Internal control weaknesses detected by internal audit staff in the course of their audit work in particular departments of the entity should be reported only to the external auditors during the performance of the external audit.
  - C Management should compare physical assets with the accounting records. Corrective measures should be applied if any shortfalls or weaknesses are detected.
  - D The management team must compare forecasts and budgets with actual performance. An analysis of variances could expose errors and weaknesses. If any errors are detected, management should take corrective action

**1.10** One of the following alternatives gives an inappropriate financial statement assertion in relation to accounts receivable. Select that alternative.

- A To obtain satisfaction that the accounts receivable balances have been fully accounted for in the accounting records and financial statements (completeness)
- B To obtain satisfaction that the accounts receivable balances have been recorded appropriately (accuracy)
- C To obtain satisfaction that accounts receivable actually exists at year end (existence)
- D To obtain satisfaction that accounts receivable pertain to the organisation at year end (rights and obligations)

## **QUESTION 2**

**20 marks**

You are part of the audit team performing the year-end audit of Robin Hat (Pty) Limited for the year ended 30 September 2010. As part of the value added services that your firm agreed to perform for the client, the Audit Manager instructed you to advise the client on suitable internal controls that can be implemented for the effective control of the following problems that exist in the client's undertaking.

- a Invalid transactions were executed and recorded in the accounting records,
- b Transactions were recorded at incorrect rand values,
- c Transactions were not recorded in the correct accounting period

[TURN OVER]

**REQUIRED**

**Marks**

- 2.1** Advise management on suitable **internal controls** that you would recommend, to address the following problem areas:
- 2.1.1** Invalid transactions were entered into and recorded in the accounting records, (11)
  - 2.1.2** Transactions were recorded at incorrect rand values, (6)
  - 2.1.3** Transactions were not recorded in the correct accounting period. (3)

**QUESTION 3**

**25 marks**

You are part of the audit team performing the audit of ABC Manufacturers Limited for the year ended 31 August 2010. The Financial Director Lionell Mercy presented you with the draft financial statements as at year-end. The audit of inventory and wages were allocated to you

**Inventory**

The results of your analytical review procedures, where you compared inventory balance for this year to the prior year, show that there was a huge decline in the inventory balance in the current year compared to the prior year. Revenue and debtors balances have remained fairly stable. It was noted in the report of the internal auditors that inventory was stolen from the warehouses. The partner in charge of the audit decided that you should focus on auditing the existence and ownership of inventory at year-end.

**Wages**

ABC Manufacturers Limited employs a lot of farm workers in its factories. The entity has decided to move away from paying wages manually through envelopes to paying them online through the computer. This means that wages are paid online by transferring funds electronically from the entity's bank account to the individual accounts of each employee. The entity will no longer handle large amounts of cash on hand to pay to the employees. The entity made an agreement with the bank to transfer the funds on a Friday at the end of each week.

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**REQUIRED**

**Marks**

- 3.1 Describe the **substantive procedures** that you will perform to audit the **inventory** at year-end Distinguish between – (15)
- (a) procedures before the physical inventory count is performed, and
- (b) procedures during the performance of the inventory count
- 3.2 Explain **three advantages** of implementing the online system of payment of wages through electronic fund transfers. (5)

**QUESTION 4**

**20 marks**

Jordaan (Pty) Limited is the only supplier contracted by the Government's Department of Communications to supply them with corporate gifts. The entity buys these gifts from a manufacturer and brands them before selling them to customers. The entity concluded a five year contract in May 2010 with Pienaar Manufacturers (Pty) Limited in which Pienaar Manufacturers (Pty) Limited will be their sole supplier of these gifts. Jordaan (Pty) Limited also negotiated huge discounts on purchases and extended their creditor's settlement period from 30 days to 90 days. During the current year ended 30 September 2010 the entity made purchases of about R1.5 million from Pienaar Manufacturers (Pty) Limited and in turn had made sales of R6.9 million. Of the total sales, 90% were made on credit.

You are a member of the audit team performing the year-end audit of Jordaan (Pty) Limited for the year ended 30 September 2010. The audit manager decided to allocate you to the sales and the purchases section to audit.

**REQUIRED**

**Marks**

- 4.1 List the **internal controls** that should be present to ensure good internal control over the **credit purchases** of Jordaan (Pty) Limited (10)
- 4.2 Describe the **substantive procedures** that you will perform to audit **credit sales** of Jordaan (Pty) Limited for the year ended 30 September 2010 (10)

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## QUESTION 5

20 marks

Teko Mokoena is the managing director who owns 69% of the shares of Mokoena Construction (Pty) Limited. The entity specialises in construction work. Teko has been looking at many ways of expanding the entity. The 2010 Soccer World Cup that was held in South Africa presented a lot of opportunities to small and medium enterprises. The exposure and connections made during the soccer spectacle allowed Teko to meet a couple of foreign visitors and as such received a lucrative contract to construct a building in Ghana starting in August 2010. The contract is worth R500 million.

As a result of the new opportunities presented to Mokoena Constructions (Pty) Limited, the entity needed to acquire new equipment and machinery worth R10 million in the year ended 30 September 2010 to be able to meet the demands of the new contract. The entity decided to finance the acquisition of the new equipment and machinery through a loan of R9 million from Capital Loans Bank Limited, a registered financial services provider. The balance of R1 million was paid from the entity's bank account.

### REQUIRED

Marks

- |     |  |      |
|-----|--|------|
| 5.1 | Describe the <b>substantive procedures</b> you will perform to audit the <b>acquisition</b> of machinery and equipment during the financial year       | (10) |
| 5.2 | Describe the <b>substantive procedures</b> you will perform to audit the <b>long-term loan</b> from Capital Loans Bank Limited as at 30 September 2010 | (10) |