



**AUE202M
AUI2028
AUI310B
RAE202P
RAI202A**

May/June 2009

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

Duration : 2 Hours

100 Marks

EXAMINERS :

FIRST :

MRS L GREBE

SECOND :

PROF HJ THERON

Use of a non-programmable pocket calculator is permissible.

This paper consists of **SEVEN (7)** pages.

This paper consists of the following questions and main topics:

| QUESTION | MAIN SUBJECT | MARKS |
|----------|-----------------------------------|-----------------|
| 1 | Multiple-choice questions | 15 |
| 2 | The audit of credit sales | 20 |
| 3 | The audit of inventory | 25 |
| 4 | The audit of bank and cash | 20 |
| 5 | The audit of long term borrowings | 20 |
| | | <hr/> 100 <hr/> |

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.

[TURN OVER]

QUESTION 1

15 marks

REQUIRED

For each sub-section of this question select only **one** alternative that you consider to be appropriate and then to write down as your answer the number of the sub-section and the letter that precedes the selected alternative. Answer the sub-sections of this question in numerical sequence, for example

1.1 A

1.2 B

1½ marks per question

1.1 Select the alternative which **best** completes the following sentence

A general ledger account which influences the audit of several transaction cycles, is the

- A bank account
- B inventory (stock) account
- C wages account
- D sundry income account

1.2 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

[TURN OVER]

1.3 Select the assertion which **correctly** completes the following sentence

The designing of substantive procedures whereby source documents are selected and the information compared to entries in the accounting records provides assurance about the objective

- A valuation
- B existence
- C completeness
- D presentation

1.4 Which one of the following substantive procedures will provide the auditor with the **most** assurance that newly purchased land and buildings are correctly valued?

- A Inspect the deed of transfer indicating the buyer is the new owner
- B Agree the cost price per the notes to the financial statements to the purchase price stated in the signed purchase contract
- C Inspect the minutes of the directors' meeting at which the purchase was authorised
- D Re-perform the posting of the journal entry to the proper accounts in the general ledger

1.5 Which one of the following general internal control measures is **not** an appropriate internal control measure with regard to authorisation?

- A A senior person should be responsible for authorising, by way of a signature, high value credit sales transactions which may be entered into
- B A senior person should be responsible for authorising access to the inventory store
- C A senior person should be responsible for checking the accuracy of the information on the source documents and the authorisation for the recording thereof
- D General authority is sufficient for authorising any routine transaction below a certain rand value

[TURN OVER]

1.6 Which one of the following alternatives is **not** one of the seven characteristics of a good internal control system?

- A The use of audit sampling
- B Competent, trustworthy staff
- C Segregation of duties
- D Isolation of responsibility

1.7 Going concern is a fundamental accounting principle when preparing annual financial statements

Which one of the following is the **best** indication to the auditor that an entity might not be able to continue trade in the future?

- A A large client of the entity missed a monthly payment on its account for the purchase of goods
- B The entity has sold all its investment property in order to rather invest the funds on the stock market
- C The trade receivables figure at year-end has decreased although sales for the year have increased
- D The liabilities of the entity exceed its assets

1.8 Which one of the following documents is **not** associated with the administration and payment of wages?

- A Invoices
- B Clock cards
- C Unclaimed wages register
- D Pay slips

[TURN OVER]

1.9 Which assertion is being addressed when the auditor poses the following question to an auditee?

"Are credit purchases of trading stock properly authorised?"

- A Completeness
- B Occurrence
- C Accuracy
- D Disclosure

1.10 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 whether the financial manager's signature of approval appears on the monthly salaries reconciliation

QUESTION 2

20 marks

You are currently auditing the revenue and receipts cycle of The Hardware Store (Pty) Ltd. Sales are mainly on credit as the client of the business are big building contractors who prefer to keep an account which they settle on a monthly basis. During your audit you become aware of the fact that the management of the company wants to pay as little income tax as possible. You realise the risk of understatement of sales is high as management wants to keep profits low.

REQUIRED

Marks

- 2.1 **Describe** completeness as an assertion in financial information and explain why the completeness assertion will be the biggest at risk with the **understatement** of sales (5)
- 2.2 Describe the appropriate substantive procedures you will perform to audit the credit sales of the company at year end (15)

[TURN OVER]

QUESTION 3

25 marks

You are part of the audit team that is responsible for the audit of The Warehouse (Pty) Ltd's inventories. During the planning session by the audit team, the audit manager identified several risks with respect to inventory. The risks are as follows:

- 1 Inventories are stolen
- 2 Financial losses due to fire in the inventory warehouse
- 3 Stock is issued without it being invoiced
- 4 Recorded inventory quantities do not agree with inventory quantities on hand
- 5 Financial losses due to damaged goods returned by customers

REQUIRED

Marks

- 3.1 Describe for each of the above risks two (2) **internal controls** which should be implemented to ensure good control over inventory (15)
- 3.2 Describe the **computer access controls** which should be present to ensure proper internal control over inventory records with regard to:
- (a) Physical computer access controls (5)
 - (b) Logical computer access controls (5)

QUESTION 4

20 marks

You are a member of the audit team conducting the audit of Stricken (Pty) Ltd for the financial year ended 28 February 2009. During the planning phase of the audit, you become aware of the fact that Stricken is currently experiencing cash flow problems. You suspect that Stricken might be "window dressing" the balance sheet by overstating the bank balance. This could be achieved by:

- including deposits received after year end in the current year bank balance
- not capturing cheques mailed to creditors before year end in the current year's bank balance

Your response to this audit risk is to perform audit procedures on the bank reconciliation for the last month of the financial year.

[TURN OVER]

REQUIRED

Marks

- 4.1 Describe the substantive procedures you will perform to audit the bank reconciliation as at 28 February 2009 (10)
- 4.2 Advise the management of Stricken (Pty) Ltd on the internal controls which should be present to ensure good control over cheques and the signing of cheques (10)

QUESTION 5

20 marks

During your audit of Propco (Pty) Ltd you come across the following journal

| | | |
|---|----|--------------|
| Land and buildings (Erf 2413) | Dr | 2 680 000 00 |
| Long term loan (Mortgage bond ABC Bank) | Cr | 2 680 000 00 |

REQUIRED

Marks

- 5.1 Mention **five (5)** particulars in the loan agreement that will receive your attention, as part of your verification of the interest bearing borrowing (5)
- 5.2 Describe the substantive procedures you will perform to audit the long term loan (mortgage bond) at year end to ensure that the interest bearing borrowing is properly accounted for in the client's annual financial statements (15)

SUGGESTED SOLUTION MAY/JUN 2009

| QUESTION 1 | | 15 MARKS |
|-------------------|---------------------------------------|-----------------|
| 1.1 | A Tutorial Letter 202/1/2009 1.4 | |
| 1.2 | C Jackson & Stent (2007: 8/17) | |
| 1.3 | C Tutorial Letter 202/1/2009 1.14 | |
| 1.4 | B Study Guide P190 | |
| 1.5 | C Tutorial Letter 202/1/2009 1.6 | |
| 1.6 | A Jackson & Stent (2007: 5/7 – 5/9) | |
| 1.7 | D Study Guide P219 | |
| 1.8 | A Jackson & Stent 2007: 13/8 – 13/12 | |
| 1.9 | B Jackson & Stent 2007: 11/24 – 11/25 | |
| 1.10 | D Jackson & Stent 2007: 13/21 | |
| | | |

QUESTION 2

20 MARKS

2.1 Assertion at risk with the understatement of sales 5 marks

Reference: Jackson & Stent (2007:10/26-10/27)
Study Guide P78

COMPLETENESS AS ASSERTION

1. All sales made during the period have been recorded at the time they took place. (1.5 marks)
2. All sales have been recorded in the statement of comprehensive income / accounting records. (1.5 marks)
3. All sale adjustments during the period have been recorded, including goods returned and discount granted. (1.5 marks)

RISK OF UNDERSTATEMENT

4. The sales figure is understated by not recording all sales transactions.
5. If less sales transactions are recorded, the sales figure is low and the profit at the end of the year also lower.
6. If the profit is lower, the income tax payable will be lower.
7. So, management will have an incentive to illegally understate sales.

2.2 Substantive procedures to audit credit sales 15 marks

Reference: Tutorial Letter 202/1/2009 1.2

1. Draw a sample of credit sales invoices and compare each with the corresponding order and delivery note in respect of the name of the client, the description and the quantity of goods dispatched.
2. Inspect the orders selected for approval by a responsible person.
3. Select documented inventory issued in a case where reliable, continuous inventory records have been kept, and follow them up by examining the corresponding delivery notes and sales invoices.
4. Trace the sales invoices that you have checked to the credit sales journal and confirm that the particulars agree and that the transaction was correctly allocated.
5. Recalculate the totals of the sales records for selected periods to make certain that the postings totals are accurate.
6. Check the postings of total sales to the credit side of the sales account and individual sales transactions to the debit side of the accounts receivables account.
7. Select invoices directly before year end and follow through to accounting records to confirm completeness in this accounting year.
8. Calculate the gross profit percentage and compare with prior periods.
9. Reconcile the list of accounts receivables with the accounts receivable control account and confirm the correctness of the reconciling items.
10. Check the number sequence of the delivery note for missing and duplicate numbers.
11. Compare the amount of the turnover in the income statement with the total of the trial balance and the general ledger.
12. Perform analytical review procedures, for example compare current year's figure with prior year. (1.5 marks each)

QUESTION 3**25 MARKS****3.1 Internal controls over inventory****15 Marks**

Reference: Jackson & Stent (2007 : 12/4 – 12/7)

Inventories are stolen

1. Limited access to warehouse, e.g. one entrance.
2. Surveillance cameras at warehouse entrance.
3. Security guards
4. High value items stored at a higher security location, e.g. upper level of warehouse.
5. Continuous inventory counts.
6. Segregation of duties between warehouse staff and security guards.

Financial losses due to fire in the inventory warehouse

1. Fire prevention, e.g. sprinklers.
2. Insurance against fire.
3. Training of employees on fire prevention.

Stock is issued without it being invoiced

1. Segregation of duties between sales personnel and picking personnel at warehouse
2. Security guard at gate must sign off on goods leaving the premises by comparing delivery note with sales invoice.
3. Supervision of warehouse staff.
4. Regular reconciliations by management between stock issued and sales for the period.
5. Inventory issues

Recorded inventory quantities do not agree with inventory quantities on hand.

1. Continuous inventory counts.
2. Regular reconciliations by management between recorded inventory and physical inventory on hand.
3. Segregation of duties between record keeping and warehouse staff.

Financial losses due to damaged goods returned by customers.

1. Regular inspection by management for deterioration in quality of inventory / obsolete inventory.
2. Goods should be safely stored in the warehouse. High risk items should be stored separately.
3. Goods should be checked for quality before delivery to client.
4. Client should sign the delivery note as confirmation that goods were received in good order.
5. The entity must implement good return policies with regards to damaged goods returned by customers.

(1.5 marks each)

3.2. General computer access controls over inventory records 10 Marks

Reference: Jackson & Stent (2007 : 8/19 – 8/22)

3.2.1. Physical access controls over inventory records

1. Security checks on user's identity and purpose of visit by a guard at the gate of premises within which computer facilities are housed.
2. User's arrival and departure logged.
3. User to be escorted to the computer facility
4. Locked doors to the rooms containing the computer facilities.
5. Passwords must be kept secret and changed regularly.
6. Cabling shielded or built into walls.
7. Surveillance cameras at the computer facilities.
8. Users not to be allowed to the computer room which houses the central processing unit.

(1.5 marks each)

3.2.2. Logical access controls over inventory records

1. A screen prompt requires that you enter your User ID.
2. The system must require a password from the user to allow access.
3. A menu tailored specifically for the user appears on the screen, providing access only to particular applications.
4. Multiple passwords required for sensitive functions or higher level access.
5. Automatic account lock-out on access violation e.g. incorrect password.
6. "Time-out" facilities which automatically log out the user after a period of time during which there has been no activity.
7. Automatic logging, review and follow up of access and access violations.
8. Encryption of confidential and critical information.
9. Firewalls to implement logical access control.

(1.5 marks each)

QUESTION 4

20 MARKS

4.1 Substantive audit procedures on the bank reconciliation of Stricken (Pty) Limited

10 Marks

Reference: Jackson & Stent (2007: 10/38 – 10/39)

1. Agree the opening balances per the cash book (receipts and payments journal) and the bank statement with the closing balances of the previous bank reconciliation.
2. Ensure that all bank statements are accounted for, by inspecting the sequence of the page numbers and the totals carried forward from one bank statement to the next.
3. Agree the bank balance according to the bank reconciliation with the balance per the bank statement, cashbook and bank confirmation, respectively.
4. Examine whether all cheques, deposits and sundry debits, (bank charges, bank interest, R/D cheques, etc.) that appear in the cash book have been ticked off against the details on the bank statements.
5. Inspect the bank reconciliation for outstanding cheques and deposits and follow the outstanding cheques and deposits through to the bank statements subsequent to year end.
6. Recalculate the arithmetical accuracy of the bank reconciliation, the cash book and the outstanding lists and at the same time inspect the reconciliation
7. Obtain the cut-off number of the last cheque used prior to year end. Inspect the post year end bank statement and confirm that any lower cheque number does also appear on the year end bank reconciliation.
8. Enquire about any long outstanding deposits and cheques which should possibly be written back.
9. Obtain a management representation letter regarding the bank balance at year end.
10. Inspect and follow up on inter bank account transfers.
11. Obtain a bank confirmation letter from the bank.

(1.5 marks each)

4.2 Internal control over cheques and the signing of cheques 10 Marks

Reference: Jackson & Stent (2007: 10/4; 10/38 – 10/40)

1. A register of cheque books received and issued should be kept and control of unissued cheque books should be in the hands of a senior official.
2. All cancelled cheques should be clearly marked as such and attached to the relevant cheque counterfoil, or separately filed.
3. All paid cheques returned by the bank should be filed in numerical order.
4. Change of the crossing on cheque forms and to who payable may only be effected by the person responsible for the signing of cheques.
5. Drawn cheques should be presented to the person(s) authorized to sign, together with the appropriate supporting documents.
6. Persons responsible for the signing of cheques should examine the supporting documents for:
 - Amounts shown on the cheques are indeed due to be paid, and any discount due has been taken.
 - Correct names of the payees.
7. Supporting documentation should be initialled or cancelled in some way as having been paid.
8. All cheques above a certain amount should require the signatures of two senior officials.
9. Cheques needing only one signature can be overprinted with the maximum amount of the clerk's authority - for example R1 000.
10. Computerized systems may be used for the printing of cheques with the manual or electronic signature of the authorised cheque signatory.
11. Use of a separate bank account for example payments to creditors.
12. Cheques must be kept locked away in a safe place.
13. No corrections or changes to be made on cheques.

(1.5 marks each)

QUESTION 5

20 MARKS

5.1 Particulars in loan agreement

5 Marks

Reference: Jackson & Stent (2007: 14/28 – 14/30)

1. Name of the borrower, which should be the client's name
2. Name of the lender – ABC Bank
3. Loan amount
4. Interest rate
5. Basis of calculation of interest
6. Terms of payment of interest and repayment of capital
7. Effective date of loan agreement
8. Security provided for the loan amount

(1 Mark each)

5.2 Substantive audit procedures on the loan balance at year-end. 15 Marks

Reference: Jackson & Stent (2007: 14/28 – 14/30)

1. Obtain a certificate directly from ABC Bank for the amount outstanding in respect of the capital sum, accrued interest and particulars of the security provided.
2. Agree the particulars of the certificate with the original contract, general ledger account and financial statements.
3. Re-perform interest calculations in conformity with the contract agreement and ensure that accrued interest is accounted for in the appropriate accounting period.
4. Inspect the endorsement on the transfer deed at the Deeds Office for registration of the mortgage bond.
5. Ensure proper disclosure in the financial statements.
6. Reperform calculations of loan amount in the general ledger.
7. Compare re-payments per cashbook with amounts recorded in the general ledger loan account.
8. Scrutinise directors' meetings minutes for additional amounts borrowed.
9. Scrutinise the general ledger loan account for unusual transactions.
10. Obtain a management representation letter with regards to the loan balance at year end.
11. Perform analytical review procedures by comparing this year's balance with prior year balances etc.
12. Compare the current year's opening loan balance with prior year's closing balance.

(1.5 marks each)