

KOLEJ UNIVERSITI TUNKU ABDUL RAHMAN
FACULTY OF ACCOUNTANCY, FINANCE AND BUSINESS
ACADEMIC YEAR 2017/2018
APRIL/MAY EXAMINATION
BBFD3023 AUDITING

SATURDAY, 28 APRIL 2018

TIME: 2.00 PM – 5.00 PM
(3 HOURS)

BACHELOR OF ACCOUNTING (HONOURS)

Instructions to Candidates:

This paper consists of **FIVE (5)** questions and you are required to answer **ALL** questions.

All questions carry equal marks.

Marks will be awarded for clarity in presentation and logical arguments.

You are required to continue with a **fresh page** when answering **new questions or parts** of the question.

BBFD3023 AUDITING

Answer **ALL FIVE (5)** questions.

Question 1

Hufix Sdn. Bhd. (Hufix) specialises in computer design, artistic consultancy and marketing images. Hufix has a small internal audit team with two internal auditors managing the company's internal control system.

Hufix found out that one of its directors had fraudulently obtained RM4 million in the last 18 months and had left the country. During the previous audit, the external auditors had issued an unqualified audit report.

The board of directors of Hufix are threatening legal action against the audit firm, accusing them of being incompetent for failing to identify and detect the fraud. The internal auditors are also being threatened with dismissal.

Required:

- (a) Explain **ANY FIVE (5)** differences between an internal audit and an external audit. (10 marks)
 - (b) Explain **ANY SIX (6)** external auditors' responsibilities towards fraud. (6 marks)
 - (c) Explain the differences between a fraud and an error and provide an example of each. (4 marks)
- [Total: 20 marks]

Question 2

You are the audit manager in Coast & Co. (Coast) and are responsible for the audit of Nippoj Sdn. Bhd. (Nippoj). Nippoj manufactures high quality snack foods. The following issues have arisen during the audit:

During the audit, the audit team was told by the finance director that they were allowed to have as much of the snack as they want for free.

The finance director, Melvin, had instructed you that he is not to be disturbed by excessive questions from the audit team. To avoid too much disruption to his working days he had requested you to have a brief meeting with him once a week and that under no circumstances should anyone other than you ask him any questions with regard to the audit.

The audit senior which had been assigned to the audit team for Nippoj did not disclose the fact that his father is one of the directors in Nippoj as he felt that he will be promoted once the audit is completed.

Due to the growth of the company, the board of directors has decided to implement best practice corporate governance principles in preparation to be listed in a few years' time. The finance director is one of the members of the company's audit committee.

BBFD3023 AUDITING**Question 2 (Continued)**

Nippoj's finance manager had informed the audit manager that several non-executive directors (NEDs) have just resigned and no immediate replacement has been made as of to date. The finance manager had requested the audit partners of Coast to help Nippoj in recruiting new NED.

Nippoj had proposed to Coast that the audit fee should be based on a percentage of their final pre-tax profit. The partners of Coast were excited about this proposal as they believe it will increase the overall audit fee.

Coast does not have an internal audit function. The board of directors has asked for your advice on how they can improve the internal controls of the company in view of the growth of the company in recent years so as to achieve good performance.

Required:

- (a) Explain **ANY SIX (6)** ethical threats which may affect the independence of Coast & Co. in the audit of Nippoj Sdn. Bhd. (9 marks)
- (b) For each threat identified in part (a) above, explain how it can be mitigated. (6 marks)
- (c) One of the ethical principles that auditors need to adhere to is the confidentiality of a client's information except in certain circumstances.

Explain **ANY FIVE (5)** circumstances where the auditors are allowed to disclose a client's confidential information. (5 marks)

[Total: 20 marks]

Question 3

Malawati Sdn. Bhd. (Malawati) supplies facial masks worldwide and they have been trading for over 25 years. Malawati's year end is 31 March 2018. Malawati sells the facial masks to customers via its website and this represents 75% of total revenue. Remaining revenue is generated by contracts to supply facial masks and supplies to facial centres. Below is a description of the sales system of Malawati:

Facial centre

The revenue for the year ended 31 March 2018 consists of sales to 30 facial centres. Malawati has a sales clerk who maintains all aspects of this revenue stream. The sales clerk will receive orders from the facial centres, follow by raise the relevant sales invoices and process payments. When raising invoices, the sales system captures the online prices for the products. However, the sales prices offered to the contract facial centres are 5% lower than the online prices. Hence the clerk has to manually amend the price in the sales invoices prior to despatching the products.

Online customers

New customers are required to undergo credit check by the sales manager and the credit limits will be finalised by the finance director. Customers place online orders up to their pre-set credit limits. They will receive an email confirmation and the sales order interfaces with the despatch system.

BBFD3023 AUDITING**Question 3 (Continued)**

Goods are despatched on weekly basis. The goods despatch notes are not sequentially numbered. Malawati despatches goods via an affordable local courier so that company can reduce the cost to an acceptable level and some orders have been delivered to customers late.

Apart from the above, customers' sales invoices are automatically generated by the system on the day the online orders are placed. However, when Malawati carries out a sales promotion, the master file data has to be updated to ensure that the correct prices are used on invoices. Updating of the prices is usually performed by the sales ledger clerk.

Required:

In respect of the sales system for Malawati Sdn. Bhd.:

- (a) Identify and explain **SIX (6)** deficiencies; (9 marks)
 - (b) Recommend a control each to address each of the deficiencies identified in part (a) above; (6 marks)
 - (c) Describe **ANY FIVE (5)** substantive procedures that should be performed by the external auditor to verify Malawati revenue. (5 marks)
- [Total: 20 marks]

Question 4

Maxlin Sdn. Bhd. (Maxlin) manufactures mobile accessories and sells their products worldwide. The company's year end is 31 March 2018 and your audit manager has provided you with the planning notes below:

You are the audit senior of PT & Co., and this is your first year in this audit of Maxlin. In order to have a better understanding of Maxlin, the audit manager has suggested that you perform some research on the background of Maxlin to assist in the audit planning.

Maxlin has 40 branches and the year end inventory counts will be carried out by Maxlin at the central warehouse as well as at all the 40 branches on 31 March 2018. Inventories are valued at selling price as the new finance director believes that this is reasonable.

Maxlin has computerised its accounting system from manual system to an integrated system. The company sells its products through sales agents and the company's website. Maxlin has spent RM1 million to upgrade the company's website in order to attract more customers to buy its products.

Maxlin has spent RM2 million to renovate the central warehouse as it was too old. In order to finance the renovation cost, a sum of RM2 million was borrowed from the local bank. The loan is to be repaid over seven years. In February 2018, the financial controller left due to unfair dismissal and no immediate replacement has taken place. No supplier statement reconciliations or purchase ledger control account reconciliations have been performed since then.

BBFD3023 AUDITING**Question 4 (Continued)****Required:**

- (a) Identify and explain **ANY SIX (6)** audit risks in Maxlin Sdn. Bhd. (9 marks)
- (b) Explain the auditor's response to each of the risks identified in part (a) above, in planning the audit of the company. (6 marks)
- (c) The finance director of Maxlin Sdn. Bhd. is considering establishing an internal audit department to improve the company's internal controls.

Required:

Describe **ANY FIVE (5)** factors that the finance director should consider before establishing an internal audit department. (5 marks)

[Total: 20 marks]

Question 5

(A)

Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. Financial statements are prepared on a going concern basis, unless the management intends to either liquidate the entity or cease operations, or has no realistic alternative but to do so.

When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Required:

In accordance with ISA 570 *Going concern*, explain **ANY FIVE (5)** responsibilities each of the auditor and the management respectively in relation to going concern. (10 marks)

(B)

Those charged with governance are responsible for overseeing the strategic direction of an entity. This includes overseeing the financial reporting process.

ISA 260 (Revised) *Communication with those charged with governance* provides guidance to auditors in relation to communicating the matters arising from the audit of an entity's financial statements to those charged with governance.

Required:

- (a) Explain why it is important for the external auditor to communicate with those charged with governance during the audit of an entity. (3 marks)
- (b) Explain **ANY SEVEN (7)** examples of matters that external auditors may communicate to those charged with governance of an entity. (7 marks)

[Total: 20 marks]