

UNIVERSITY EXAMINATIONS



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AUE3702

October/November 2015

SUBSTANTIVE PROCEDURES AND FINALISING AN AUDIT

Duration 3 Hours

100 Marks

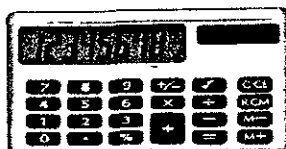
EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT

Use of a non-programmable pocket calculator is permissible

Closed book examination.

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THIS PAPER CONSISTS OF **FOUR (4)** PAGES

This paper consists of one case study and covers the following main topics:

QUESTION	MAIN TOPIC	MARKS
PART 1		
1.	Credit sales	29
2.	Going concern assumption	27
3.	Finance lease transaction	16
PART 2		
4.	Audit misstatements	14
5.	Reporting	<u>14</u>
		<u>100</u>

NOTE

Although the primary purpose of the examination is to test your knowledge and application of the subject matter, the examiner will consider your ability to organise and present such knowledge in acceptable written language and to formulate logical arguments. Therefore, **nine (9)** marks are awarded for effective communication skills

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PART 1

72 MARKS

You are the audit manager at an audit firm in Polokwane. The client for whom you have to conduct an audit is Green Growth (Pty) Ltd (GG), a medium-sized company showing growth potential. You are responsible for the audit for the financial year ending 31 December 2015.

GG manufactures and sells liquid fertilisers to wholesalers on credit. Although the manufacturing process is complex, the product is claimed to be environmentally friendly and GG has the potential of becoming an international supplier.

All sales are on credit to approved customers, and transactions are initiated once a customer order has been received. When an order is received, an invoice is prepared in triplicate consisting of white, yellow and blue copies. Before picking the goods from the store, the warehouse clerk is presented with a picking slip (which is the yellow copy of the invoice). The customer signs the delivery note on receipt of the goods (the blue copy of the invoice). Sales are accounted for in the sales journal on the invoice date.

Dr Ungerer is the head of manufacturing. The manufacturing process of the fertiliser requires a consistent temperature of 28 degrees Celsius for the fermentation process, and huge paddles in metal containers ensure that the heat is evenly distributed. The fermentation process is very sensitive to temperature fluctuations. Once the fertiliser has been bottled, temperature fluctuations have no influence on the product.

A steel container contains 10 000 litres and laboratory staff perform monitoring tests on a daily basis. The manufacturing process takes four weeks and there are 20 containers. The selling price is R300 per litre and the manufacturing costs are calculated as R110 per litre. Because load shedding occurred during July, the whole of July's production was destroyed. This incident has serious financial implications for GG.

Accordingly, you studied ISA 570 *Going concern* setting out the auditor's responsibilities in the audit of financial statements, especially concerning management's use of the going concern assumption in the preparation of the financial statements. You noticed that you had certain responsibilities during the planning and auditing of the going concern assumption. You will need to complete the additional audit procedures relating to the outcome of the load shedding and you have to conclude and report on the appropriateness of the going concern assumption.

As a result of the loss incurred due to load shedding and the unreliability of Eskom's future electricity supply, management decided to buy a generator. The machine was financed through a finance lease agreement for R6 300 000 plus VAT and it was installed on 1 September 2015.

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REQUIRED	Marks
1. Formulate the substantive audit procedures you will perform to audit credit sales for the year ending 31 December 2015	(27)
Presentation marks for properly formulated substantive procedures	(2)
2. With reference to ISA 570 <i>Going concern</i> , discuss the influence of load shedding on the audit of Green Growth, as a whole, for the year ending 31 December 2015	(25)
Presentation marks for a practical discussion and calculations	(2)
3. Formulate the substantive procedures to audit the .	
3.1 occurrence of the finance lease transaction, and	(9)
3.2 accuracy of the finance lease transaction on 1 September 2015	(6)
Presentation marks for properly formulated substantive procedures	(1)

PART 2

28 MARKS

As the audit progressed, your team recorded all the misstatements identified during the audit on a "misstatements" audit working paper. In particular, the audit procedures revealed that inventory was overstated by R12 740 000 due to a disagreement with management's estimate of obsolete inventory. After discussing the matter with management, they remained adamant not to correct the annual financial statements with an additional provision. The materiality limit set for inventory is R980 000. The revised final materiality for the financial statements as a whole is R10 000 000.

John, a junior audit trainee, joined the audit team while you were finalising the audit. He had no idea where the misstatements audit working paper fitted into in the audit process and how it is used by the auditor to make certain decisions. You explained to him that in terms of ISA 450 *Evaluation of misstatements identified during the audit*, the auditor follows certain steps or actions when evaluating misstatements.

You also explained to John that when compiling an audit report, the auditor considers various factors to assist him/her in deciding on an appropriate audit opinion and the type of modification to be effected. As mentioned, you know that the client will not adjust the annual financial statements for the identified material misstatement.

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REQUIRED	Marks
4. Describe the auditing concept "misstatement" and the steps the auditor should follow when evaluating the effect of the identified misstatement	(12)
Presentation marks for a logical description	(2)
5. Describe the aspects you would consider in forming an appropriate audit opinion and the matters you need to highlight in your audit report	(12)
Presentation marks for a logical description	(2)