

AUE3702

May/June 2016

SUBSTANTIVE PROCEDURES AND FINALISING AN AUDIT

Duration 3 Hours

100 Marks

EXAMINATION PANEL AS APPOINTED BY THE DEPARTMENT**Closed book examination**

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THIS EXAMINATION PAPER CONSISTS OF SIX (6) PAGES

This paper consists of **TWO (2)** questions dealing with the following main topics

PART	MAIN TOPIC	MARKS
1	Opening balances, Substantive audit procedures – property, plant and equipment, Substantive audit procedures including those performed with the assistance of data CAATs – inventory, Audit opinion	59
2	Analytical procedures – sales, Subsequent events, Management expert, Going concern, Audit opinion	<u>41</u>
		<u>100</u>

NOTE

The main objective of the examination is to test a candidate's knowledge and ability to apply the study material, although the examiners will also take into account the candidate's ability to organise and present that knowledge in writing and according to an acceptable standard

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QUESTION 1

59 marks

You are a member of the audit team performing the 31 March 2016 year-end audit of a new client, GlamGirl (Pty) Ltd (GlamGirl). GlamGirl was previously audited by GreenTick Incorporated. GlamGirl is a wholesaler of women's clothing and handbags. The company purchases its inventory from local and foreign manufacturers, where after the branded logo of the company is sewed on or imprinted on the items. GlamGirl operates its business from several branches across South Africa.

Final materiality has been set at R2 7 million.

Property, plant and equipment

The following working paper on property, plant and equipment was prepared by the audit senior on the audit of GlamGirl.

Client: GlamGirl		A1										
Year end: 31 March 2016	Prepared by: D Versace											
Date: 30 April 2016	Reviewed by: G Armani											
Subject: Property, plant and equipment												
<p>Property, plant and equipment are carried at cost, less accumulated depreciation and impairment losses. Depreciation is charged on a straight-line basis over the estimated useful lives of the items of property, plant and equipment. There were no changes to the accounting policy during the financial year and there were no impairments during the year ended 31 March 2016.</p> <p>Property, plant and equipment is a material figure in the financial statements of GlamGirl and comprise the following categories:</p> <table border="1"><thead><tr><th>Property, plant and equipment category</th><th>Useful lives</th></tr></thead><tbody><tr><td>Delivery trucks</td><td>5 years</td></tr><tr><td>Computer equipment</td><td>3 years</td></tr><tr><td>Furniture and fittings</td><td>5 years</td></tr><tr><td>Machinery</td><td>5 years</td></tr></tbody></table> <p>All property, plant and equipment are purchased from local suppliers. There were no disposals of property, plant and equipment during the financial year. The useful lives were already audited, and no material variances were identified.</p> <p>The fixed asset register of GlamGirl contains the following information of each item of property, plant and equipment:</p>			Property, plant and equipment category	Useful lives	Delivery trucks	5 years	Computer equipment	3 years	Furniture and fittings	5 years	Machinery	5 years
Property, plant and equipment category	Useful lives											
Delivery trucks	5 years											
Computer equipment	3 years											
Furniture and fittings	5 years											
Machinery	5 years											

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(continued)

Client: GlamGirl		A1
Year-end: 31 March 2016	Prepared by: D Versace	
Date: 30 April 2016	Reviewed by: G Armani	
Subject: Property, plant and equipment		
<ul style="list-style-type: none"> • Asset number • Asset description • Date of acquisition • Cost price • Depreciation rate • Book value - 1 April 2015 <ul style="list-style-type: none"> - Opening balance - cost - Opening balance - accumulated depreciation • Depreciation for the current financial year • Book value - 31 March 2016 <ul style="list-style-type: none"> - Closing balance - cost - Closing balance - accumulated depreciation 		

Inventory

The following information relating to the company's inventory is available to you

Client: GlamGirl		B2
Year-end: 31 March 2016	Prepared by: D Versace	
Date: 30 April 2016	Reviewed by: G Armani	
Subject: Inventory		
<ol style="list-style-type: none"> 1. GlamGirl uses an automated inventory system 2. An accurate and efficient inventory count took place on 31 March 2016 and all the necessary amendments were made to the inventory masterfile 3. GlamGirl measures inventory at the lower of cost or net realisable value. The cost of inventory is determined on the first-in-first-out (FIFO) basis 4. The inventory masterfile contains the following fields <ul style="list-style-type: none"> - Item description - Supplier (field indicates whether it is a local or foreign supplier) - Item code - Unit cost in rand - Selling price - Quantity on hand at year-end - Date of last sale - Quantity sold year to date 		

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REQUIRED	Marks
1.1 Describe the considerations that you would take into account in order to verify the opening balances of property, plant and equipment, in light of the fact that you have just taken over from GreenTick Incorporated	(5)
1.2 With reference to the information on property, plant and equipment (Working paper A1), formulate the substantive procedures that you will perform for the year ended 31 March 2016 for the following (ignore any value-added, normal and deferred taxation implications). a) Ocurrence and accuracy of the cost of additions to property, plant and equipment	(10)
b) Existence and valuation of items of property, plant and equipment (exclude procedures related to additions and disposals from your answer)	(17)
Communication skills Clarity of expression in formulation of substantive procedures	(2)
1.3 With reference to the information on inventory (Working paper B2), formulate the substantive procedures that you will perform, including those procedures that you will perform with the assistance of data CAATs , for the year ended 31 March 2016 for the valuation of GlamGirl (Pty) Ltd's inventory (exclude any procedures related to slow moving or obsolete stock from your answer)	(19)
Communication skills Clarity of expression in formulation of substantive procedures	(2)
1.4 Assume that during the audit of GlamGirl (Pty) Ltd you found the inventory (valued at R17 million on the financial statements) to be overvalued by a material amount of R4 million The error is due to inventory being valued at cost instead of the lower of cost and net realisable value Assume that the directors refuse to correct the error Write down the opinion and the basis of opinion paragraphs that you would include in your audit report	(4)

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QUESTION 2

41 marks

Librarians Ltd's (Librarians) main business involves the sale of books to various book stores all over South Africa. You are the audit senior in charge of the audit of Librarians for the year ended 31 December 2015.

Sales

Librarians uses an automated sales system. Based on your identification and assessment of risk in the planning stage of the audit of Librarians, you decided to use a combination of tests of details and substantive analytical procedures to obtain audit evidence of Librarians' sales total during the current financial year.

The financial manager of Librarians, Mr Jenkins, provided you with the following information:

- Librarians' financial statements and trial balance for the current and prior financial year-end,
- Librarians' budget for the current financial year-end, and
- Financial statements of other enterprises in the same operating sector with a similar clientele.

Subsequent events

During the performance of the subsequent events review in March 2016, you identified the following matter that has to be considered before finalising the financial statements:

During November 2015, a fire broke out in one of Librarians' warehouses. Stock to the value of R1.2 million was lost. The stock was insured. Mr Jenkins wrote the stock off on 31 December 2015. He also recognised a small loss that was anticipated when taking into account the expected pay-out from the insurance company. The insurance claim was raised as a debtor. You were satisfied with this accounting treatment. However, late in February 2016, the insurance company notified Librarians that it would not be paying out any amount in respect of the stock as its investigation revealed that the fire was instigated by an aggrieved staff member of Librarians. The staff member, who was an employee of Librarians, resigned from the company shortly after the incident. Librarians referred the matter to its lawyers who indicated that, in terms of a strict interpretation of the insurance policy, the insurance company could be correct. They recommended that the matter be taken to court and Librarians intends doing this.

Going concern uncertainty

The financial losses resulted in Librarians' current liabilities exceeding its total assets by R700 000. Final materiality has been set at R250 000. Furthermore, Librarians was unable to pay its creditors for the last three months and it is struggling to repay the minimum monthly instalments due on its bank overdraft. This places substantial doubt on the company's ability to continue trading as a going concern.

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REQUIRED	Marks
2.1 Refer to the information under the heading “Sales” and describe the analytical procedures that you will perform during the audit of the sales of Librarians Ltd	(8)
2.2 Refer to the information under the heading “Subsequent events” and	
(a) Write an e-mail to Librarians’ Financial Manager, explaining to him whether or not you agree with his accounting treatment of the subsequent events in the financial statements	(7)
Communication skills Layout and structure of e-mail	(2)
(b) Describe the auditor’s considerations in determining the nature, timing and extent of the procedures when relying on the work of the lawyers that were appointed by the management of Librarians Ltd	(9)
2.2 Refer to the information under the heading “Going concern uncertainty ” and	
(a) Describe how management should disclose the uncertainties that affect the entity’s ability to continue as a going concern	(8)
(b) Describe the effect on your audit opinion (set out your reasoning) if management refuses to disclose these uncertainties (do not write down the opinion or basis of opinion paragraphs)	(7)