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| **FACULTY:** | FACULTY OF COMMERCE, MANAGEMENT AND LAW |
| **SCHOOL:** | SCHOOL OF ACCOUNTING |
| **SUBJECT:** | AUDITING 1A |
| **SUBJECT CODE:** | AUA 3751 |
| **DATE:** | JUNE/JULY EXAMS |
| **MARKS:** | 100 |
| **TIME ALLOWED:** | 180 MINUTES |

## 1ST OPPORTUNITY EXAMINATIONS

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| **EXAMINER:** | **MRS. B DHLAMINI** |
| **MODERATOR:** | **MR E. BEUKES** |
| | |

**INSTRUCTION TO STUDENTS:**

1. **ANSWER *ALL* THE QUESTIONS**
2. **THIS EXAM CONSISTS OF SIX(6) QUESTIONS**
3. **THIS QUESTION PAPER CONSISTS OF SEVEN (7) PAGES INCLUDING THE FRONT COVER**

# UNIVERSITY OF NAMIBIA

# EXAMINATIONS

## Question 1 (10 marks)

Listed below under "A", are the first parts of ten sentences. Listed under "B" are the second parts of each sentence. *When the parts (A and B) are combined, a complete and correct sentence is made*

**List A**

A1 Events or conditions that indicate an incentive or pressure to commit fraud are referred to as.....

A2 The element or characteristic which distinguishes fraud from error, is.....

A3 Intentionally using an inappropriate policy for revenue recognition to inflate profits is an example of.....

A4 The auditor does not simply accept everything he is told by the client; this attitude is referred to as.....

A5 The auditor should consider the risk of fraudulent financial reporting in terms of management's attitude, opportunity and.....

A6 Embezzlement of cash sales by a cashier would be classified as.....

A7 To state that the auditor has a responsibility to prevent fraud is.....

A8 Where the auditor considers that there is a risk of fraudulent financial reporting, the risk would be a.....

A9 To state that an increased risk of fraudulent financial reporting would generally result in stricter performance materiality, is.....

A10 Authorizing a journal entry designed to manipulate an account balance is a form of.....

**List B**

B1 .....professional skepticism

B2 .....incentive/pressure

B3 .....misappropriation of assets and employee fraud

B4 .....fraud risk factors

B5 .....significant risk

B6 .....fraudulent financial reporting and management fraud

B7 .....true

B8 .....Management override

B9 .....Intention (of the perpetrator)

B10 .....false

## Question 2 (15 marks)

According to ISA 240 - *The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements*, the auditor is required to recognise situations which may result in misstatement in the financial statements arising out of the misappropriation of assets.

ISA 240 classifies the factors which could lead to the risk of misstatement arising from misappropriation as follows:

Classification a - incentives/pressures to misappropriate assets

Classification b - opportunities to misappropriate assets

Classification c - attitudes/or rationalization which suggest that misappropriation may take place.

**YOU ARE REQUIRED TO:**

Consider the following risk factors **(a. to h.).** Indicate into which classification each of the above risk factors falls, and to give a brief explanation as to why each of the factors increases the risk of misappropriation.

a. A client company which holds large quantities of inventory does not keep perpetual inventory records. Relations between the warehouse manager and the warehouse personnel are very poor as the warehouse manager does not treat his staff with respect.

b. A company which has a centralized accounting department makes all its payments (e.g. wages, salaries, creditors) by electronic funds transfer. 10 employees are provided with the facilities on their computers to authorize and effect electronic transfers for their various sections.

c. The company reconciles its creditors ledger with creditors statements only at year-end.

d. The company pays salaries well below the industry norm and adopts the attitude that "If staff don't like it, they can leave".

e. Employees caught stealing from the company or making unauthorised use of company assets are dismissed immediately and prosecuted.

f. The company makes a significant number of cash sales.

g. Management and other employees constantly complain about the company (many of the complaints being unfounded). Company morale is low.

h. There is inadequate authorisation of expenditure incurred by management and employees on behalf of the company e.g. salesmen's expense claims, management travel claims.

## Question 3 (20 marks)

During the audit of Beegie Ltd, the audit team gathered a substantial amount of audit evidence through tests of controls, substantive procedures, and analytical reviews. At the finalisation stage, a junior auditor expressed surprise at the wording of the audit report:

> "Why do we give an opinion on the financial statements instead of confirming that they are completely accurate? With all the work we have done, surely, we can state that the financial statements are 100%, correct?"

**YOU ARE REQUIRED TO:**

As the senior on the engagement, prepare a detailed explanation to your junior colleague covering the following:

a. The nature of audit assurance
b. Limitations of internal control
c. Limitations of an audit. **(20)**

## Question 4 (25 marks)

**YOU ARE REQUIRED TO:**

**a.** Briefly explain artificial intelligence. **(4)**
b. Provide an example for each of the following artificial intelligence categories: **(5)**

i. Machine learning

ii. Neural networks

iii. Robotics

iv. Natural language processing

v. Computer vision

c. Explain the two different types of artificial intelligence. **(4)**

d. Briefly discuss how artificial intelligence (AI) works and the six logical steps AI follows. **(12)**

## Question 5 **(10 marks)**

**YOU ARE REQUIRED TO:**

Consider each of the incorrect statements below (a-j) and correct the highlighted parts of each of the statements.

a. Inherent risk is the susceptibility of an assertion to a misstatement ***after*** consideration of any controls.
b. The auditor must obtain ***absolute*** assurance that the financial statements are free from material misstatement due to fraud and error.
c. The auditor must presume a risk of material misstatement due to fraud in ***inventory*** recognition.
d. Fraudulent financial reporting often results from ***unintentional*** actions by management.
e. When senior management is involved in fraudulent financial reporting, the external auditor should communicate the matter to the ***internal audit function.***
*f.* Misappropriation of assets always involves ***management.***
***g.*** The misuse of intangible assets is an example of ***fraudulent financial reporting.***
h. The auditor's determination of materiality is a matter of professional ***scepticism.***
i. The auditor should use ***substantive*** procedures to identify and assess fraud risks.
j. The auditor's time constraint is an example of the ***inherent risk of controls.***

**(1 mark each)**

## Question 6 **(20 marks)**

**a. YOU ARE REQUIRED TO:**

Briefly explain the terms listed below that you will come across in your auditing studies and in practices of auditing:

i. Internal auditor;
ii. Forensic auditor;
iii. Postulates of auditing;
iv. Professional scepticism; and
**v.** Applicable financial reporting framework. **(10)**

*b. For each of the questions listed below (a.to j.) select the most appropriate answer.*

**(10)**

a. Audit risk is made up of the following components:

i. inherent risk and materiality.

ii. inherent risk and significant risk.

iii. control risk, detection risk and inherent risk.

iv. control risk and materiality.

b. Audit risk is best described as:

i. the risk that the auditor will be sued for negligent performance.

ii. the risk that the auditor will fail to recover the costs of the audit due to the client refusing to pay the audit fee charged.

iii. the risk that the auditor will not adequately respond to any significant risk which has been identified.

iv. the risk that the auditor will express an inappropriate opinion when the financial statements are materially misstated.

c. Which of the following risks can be controlled by the auditor:

i. significant risks.

ii. detection risk.

iii. control risk.

iv. inherent risk.

d. Which of the following is regarded as an inherent limitation of the audit function:

i. the complexity of the international financial reporting standards.

ii. the Companies Act 2008 requirements relating to the timing of the annual general meeting at which the audited financial statements must be presented.

iii. the fact that the auditor is dependent on the client for his fees.

iv. the subjectivity of information included in the financial statements.

e. Risk assessment procedures will usually consist of:

i. a combination of further and other procedures.

ii. substantive procedures only.

iii. substantive procedures and tests of controls.

iv. inquiry, observation and inspection as well as analytical procedures.

f. Risk assessment procedures are carried out to:

i. specifically identify fraud and other significant risks.

ii. to identify and assess the risk of material misstatement at the financial statement level and assertion level.

iii. provide a basis for establishing the audit strategy.

iv. provide a basis for determining the scope of the audit.

g. The assertions are best described as:

i. the representations by management which are embedded in the financial statements.

ii. the accounting policies used in the financial statements.

iii. the principles embodied in the reporting framework adopted by the company.

iv. the disclosures made by the directors responsible for the preparation of the financial statements.

h. A significant risk is defined as:

i. the risk that there will be material misstatement in an account heading which is material to fair presentation.

ii. a risk that, in the auditor's judgement, requires special audit consideration.

iii. a risk which is a combination of control risk and inherent risk.

iv. none of the above.

i. Risks at financial statement level are best described as:

i. the risks of material misstatement in the financial statement disclosures.

ii. the risks that the relevant accounting framework adopted in the presentation of the financial statements is inappropriate.

iii. risks that relate pervasively to the financial statements as a whole.

iv. risks that are not related in any way to the assertions.

j. All other factors being equal, an increase in the assessed risk of material misstatement will:

i. increase audit risk.

ii. decrease audit risk.

iii. have no effect on audit risk.

iv. increase significant risk.