



CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

MONDAY: 30 November 2020.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) (i) Some institutions have questioned why financial auditors do not detect more fraud. The truth, however, is that the processes of financial audits are different from those of fraud audits.
- Required:**
Explain four focus areas of fraud audits that distinguish them from financial audits. (4 marks)
- (ii) Reports documenting a forensic investigation differ considerably from audit opinions.
- The investigative report is not constrained by the required language of a governing standard. Forensic investigative reports differ from one another in organisation and content depending on the client's stated needs.
- Required:**
Describe six main components of a forensic investigation report. (6 marks)
- (b) (i) Professional scepticism is fundamental to the role and performance of auditors.
- Required:**
Describe four examples of auditable areas that might require an auditor's professional scepticism. (4 marks)
- (ii) Some scholars have identified the three elements of professional scepticism as attributes, mindset and action.
- Required:**
Evaluate how each of the three elements above relate with professional scepticism. (6 marks)
- (Total: 20 marks)**

QUESTION TWO

You are the manager responsible for the audit of Food Supremo Limited and its subsidiaries. The group mainly operates a chain of national restaurants and provides vending and other catering services to corporate clients. All restaurants offer "eat-in"; "take-away" and "home delivery" services.

The draft consolidated financial statements for the year ended 30 September 2019 show revenue of Sh.422 million (2018-Sh.418 million), profit before taxation of Sh.18 million (2018-Sh.22 million) and total assets of Sh.307 million (2018-Sh.234 million).

The following issues arising during the final audit have been noted on a schedule of points for your attention:

1. In September 2019, the board announced plans to cease offering "home delivery" services from the end of that month. The sales amounted to Sh.6 million for the year to 30 September 2019 (2018-Sh.8 million). A provision of Sh.2 million has been made as at 30 September 2019 for the compensation of redundant employees (mainly drivers). Delivery vehicles have been classified as non-current assets held for sale as at 30 September 2019 and measured at fair value less cost to sell, that is, Sh.8 million (carrying amount, Sh.5 million).
2. Historically, all owned premises have been measured at net book value and depreciated over 10 to 50 years. The board has decided to revalue these premises for the year as at 30 September 2019. At the statement of financial position date, two properties had been revalued upwards by a total of Sh.17 million. Another 15 properties have since been revalued upwards by Sh.54 million and there remain a further three properties which are all expected to be revalued during year 2020. A revaluation surplus of Sh.71 million has been credited to equity.

Required:

- (a) For each of the matters listed under 1 and 2 above, discuss four factors that would influence the auditors approach to the audit and opinion, including assessment of materiality. (8 marks)
- (b) As the auditor of Food Supremo Group, describe the evidence that you would expect to find in your audit. (12 marks)
- (Total: 20 marks)**

QUESTION THREE

You are the auditor of Synergy Ltd., a medium-sized company which sells a limited range of industrial products.

The value of the company's sales orders range between Sh.5,000 and Sh.100,000 depending on the volume and mix of the orders. Recently, the company decided to transfer the sales accounting function to a computer bureau. Synergy Ltd. operates a fixed price list for customers and any changes to the price list must be approved by the sales manager. The specific functions outsourced to the computer bureau regarding the sales function were:

1. Producing invoices.
2. Updating the master file on trade receivables.
3. Analysing sales so as to produce credit entries to stock control accounts.

In order for the computer bureau to discharge its functions, Synergy Ltd. provides the bureau with the following information:

- (i) Details of quantities and type of sale transactions.
- (ii) Cash receipts.
- (iii) Price lists and alterations.
- (iv) Bad debts and special credits.

Required:

- (a) Citing ten areas of interest, describe the internal control system you would recommend to the management of Synergy Ltd. covering sales and delivery of input to the computer bureau. (10 marks)
- (b) Describe six audit procedures you would carry out to verify the sales of Synergy Ltd. (6 marks)
- (c) Explain four drawbacks of outsourcing of the payroll function by the management of Synergy Ltd. (4 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) The audit committee is created as part of the corporate governance process, which is the cornerstone of shareholder protection.

Required:

Citing three areas, discuss the role and place of the audit committee within the corporate governance structure.

- (b) In the context of environmental audits:
- (i) Illustrate, using suitable examples, three environmental matters which may affect the financial statements. (3 marks)
 - (ii) Describe three general audit procedures that an auditor may carry out when evaluating environmental matters in relation to his audit client. (3 marks)
- (c) (i) Describe four audit techniques that an auditor may employ when conducting a value-for-money audit. (4 marks)
- (ii) Discuss four challenges associated with value-for-money audits in the public sector. (4 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) You are the audit manager in charge of the audit of Mamboleo Ltd. for the year ending 31 December 2020. Currently, you are planning for the year-end audit. Mamboleo Ltd. produces various brands of high quality bread. During the interim audit, you noted that due to the present economic down-turn and the uncertainty in the wheat market, the company has suffered as its costs are increasing and its bread prices are higher than those of its competitors because of lower production runs. One indicator of the problems facing the company is that it has consistently used a bank overdraft facility to finance its activities.

When you discussed with the company management the actions being taken to improve liquidity, you were informed that the company planned to expand its facilities for producing white bread as this line had maintained its market share. The company has approached its bank for a loan to finance the expansion and also to maintain its working capital.

To support its request for a loan, the company has prepared a cash flow forecast for the next two years from the end of the reporting period. The internal audit department has reported on the forecast to the directors. However, the bank has requested for a report from the external auditors to confirm the accuracy of the forecast. Following this request, the directors have asked you to examine the cash flow forecast and then report to the bank.

Required:

- (i) Explain the kind of assurance you could give in the context of the request by the bank. (4 marks)
 - (ii) Explain why the company's apparent liquidity problems will require a focus of the audit plan on the going concern appropriateness in the preparation of the company's financial statements. (4 marks)
 - (iii) Describe eight procedures you would adopt in your examination of the cash flow forecast. (8 marks)
- (b) Explain the role of the International Organisation of Supreme Audit Institutions (INTOSAI). (4 marks)
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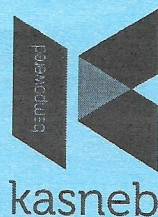
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(Total: 20 marks)

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CPA PART III SECTION 6
ADVANCED AUDITING AND ASSURANCE

THURSDAY: 28 November 2019.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) Bingo Ltd is the parent company of an expanding group of companies. The group's main business activity is the manufacture of parts for the motor vehicle industry.

All subsidiaries are wholly owned and are as summarised below:

- A Ltd., acquired in January 2008
- B Ltd., acquired in July 2011
- C Ltd., acquired in August 2019

The company now seeks to acquire a fourth subsidiary, D Ltd.

As the audit manager at Mhasibu Associates, Certified Public Accountants you are reviewing the working papers in the ongoing final audit of the Bingo Group for the year ending 31 December 2019.

Your firm has audited all current components of the group for several years, but the target company, D Ltd is audited by a different firm.

You have been provided with the following schedule of the cost of investment in D Ltd., showing that goodwill on acquisition of D Ltd. will be recognised in the consolidated statement of financial position at Sh.75 million, computed as follows:

Cost of investment	Sh. "million"
Cash consideration	250
Deferred consideration payable	
31 March 2020	150
Contingent consideration payable	
31 March 2024 of D Ltd. (revenue growth is 8% per annum)	<u>100</u>
	500
Net assets acquired	<u>(425)</u>
Goodwill on acquisition	<u>75</u>

These figures are material to the financial statements of Bingo Ltd. and the Group as a whole. The acquisition will be completed in December 2019.

Required:

- (i) Explain the matters that you would consider and the evidence you would expect to find in respect of the carrying value of the cost of investment of D Ltd. in the financial statements of Bingo Ltd. (8 marks)
- (ii) Outline the principal audit procedures to be performed on the consolidation schedule of the Bingo Group. (4 marks)
- (b) Shanzu Ltd. is audited by Ukweli Associates. Your firm, Nawiri Associates has been asked to accept appointment as joint auditors of Shanzu Ltd. in co-operation with Ukweli Associates. The directors of Shanzu Ltd. are of the view that this would enable your firm to improve group audit efficiency, without losing the cumulative experience that Ukweli Associates has built while acting as auditors of Shanzu Ltd. Eventually your firm can be the sole auditors.

Required:

Discuss two advantages and two disadvantages of conducting a joint audit of Shanzu Ltd.

(8 marks)

(Total: 20 marks)

QUESTION TWO

Maisha Bora Services Ltd. receives funding from government health departments as well as several large non-governmental organisations (NGO's). This funding represents 30% of the company's research and development annual expenditure. The amount of funding received is dependent on three key performance indicators (KPIs) targets being met annually. All three of the targets must be met in order to secure the government funding.

A review of the company's operating and financial information shows the following:

KPI target	Draft KPI 2019	Actual KPI 2018
1. Medicine and other pharmaceutical products donated free of charge to poor families in the country: 1% of revenue	0.9% of revenue	1.3% of revenue
2. Donations to and cost of involvement with local NGO's towards social responsibility: 0.5% of revenue	0.7% of revenue	0.9% of revenue
3. Accidents in the workplace: Less than 5 serious accidents per year	4 serious accidents	3 serious accidents

You are engaged to provide an assurance opinion on the KPIs disclosed in the operating and financial review.

Required:

- Discuss three reasons why it might not be possible to provide a high level of assurance over the stated key performance indicators. (6 marks)
- Describe three procedures you would use to verify the number of serious accidents in the year ending 31 December 2019. (6 marks)
- Explain the matters you would consider to determine whether capitalised development costs are appropriately recognised. (5 marks)
- Describe the evidence you would seek to support the assertion that development costs are technically feasible. (3 marks)

(Total: 20 marks)

QUESTION THREE

- You have recently been appointed as the auditor of Dania Ltd. The outgoing auditor provided no reasons as to why you should not accept appointment but nevertheless, commented that auditing the client "was a challenge".

During your planning for the new audit, you discovered that:

- The company has been experiencing a low return on assets over the last few years.
- The company has failed to meet its contractual obligations and consequently has lost several contracts to competitors.
- The production manager's package includes a substantial profit related bonus.
- Staff are unhappy and there is a huge turnover of staff.
- The managing director, a substantial shareholder is about to retire and his exit package includes a profit related bonus.
- The managing director is keen on the accounts showing a dramatic improvement in the current year due to cost savings.

Required:

- Describe how you would analyse inherent risks in planning for the audit of Dania Ltd. (4 marks)
- On analysing draft accounts, you discover that profits have improved significantly due to a decline in provisions for doubtful debtors.
Discuss how this finding would affect your audit programme. (4 marks)
- You also discover that non-current assets have been valued at prices that cannot be supported. In spite of this, the managing director is unwilling to engage an independent valuer.
Demonstrate, through a draft audit opinion, how you would reflect the above finding. (4 marks)

- (b) The preparation of financial estimates involves significant subjective judgement and opinion. Many of the provisions made fall within what are ordinarily called "accounting estimates".

Required:

Describe four audit procedures required in respect of accounting estimates.

(8 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Describe three measures that an entity might put in place to prevent incidences of hacking of financial data in its computerised systems. (3 marks)

- (b) International Standard on Auditing (ISA) 220: Quality Control for an Audit of Financial Statements requires audit firms to document and implement a system of policies and procedures to ensure audits are conducted in accordance with ISAs. International Statement on Quality Control (ISQC) 1 requires firms to establish, document and communicate to staff their quality control policies and procedures to provide reasonable assurance that the firm and its staff comply with professional standards, regulatory and legal requirements and that the firm and/or engagement partner issue reports that are appropriate in the specific instances.

Required:

Explain how a firm would address each of the five matters required to meet ISA 220 and ISQC 1 requirements.

(10 marks)

- (c) You are the audit manager in-charge of the audit of Maji Mazuri Ltd., a mineral water bottling company.

During the audit for the year ended 31 December 2018 and four months ended 30 April 2019, your audit team observed the following:

- (i) Fixed assets were not uniquely labelled and there was no fixed assets register.
- (ii) Neither the finance manager nor any of the key staff has any professional accounting qualification.
- (iii) There are no budgets against which actual financial performance may be compared.
- (iv) Though there is an accounting software that has been in use for the last ten years, you are informed that it is highly doubtful if it accurately computes cost of sales and closing stock hence misstating profits.
- (v) There are no written policies and procedure manuals to guide financial management, human resource management or procurement.
- (vi) The company does not generate monthly management accounts. Financial statements for year 2018 were availed for audit by end of March 2019.
- (vii) There was no evidence of a physical stock-take having been conducted at the year end or on a monthly basis. The company has no perpetual stock system.

Summarise how each of the above factors may impact your opinion on the truth and fairness of financial statements and the reliability of the internal control system.

(7 marks)

(Total: 20 marks)

QUESTION FIVE

ISA 580 "Management representations" recognises that management representations form an important source of audit evidence. Management ordinarily provide their representations to the auditor in the form of a letter of representation.

Required:

- (a) Explain why it is important for the auditors to discuss the contents of the letter of representation at an early stage of the audit. (4 marks)
- (b) Discuss two reasons why standard letters of representation are becoming less frequently used in the auditing profession. (4 marks)

- (c) ISA 260 (Revised) - Communication with those charged with governance, states that:

"The auditor should consider audit matters of governance interest that arise from the audit of the financial statements and communicate them with those charged with governance".

Required:

Describe four audit matters of governance interest that the auditor should consider.

(8 marks)

- (d) The auditor's communication with those charged with governance may be made orally or in writing.

Discuss two matters that influence the auditor's decision to communicate orally or in writing.

(4 marks)

(Total: 20 marks)



CPA PART III SECTION 6

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FRIDAY: 24 May 2019.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) "A disruptive technology, like cloud computing, can impact on how to audit".

The above phrase was extracted from an article featured in an international auditing journal.

Required:

Describe three auditing challenges that are associated with cloud computing environments. (6 marks)

- (b) "To an external observer, financial audits and forensic audits may look similar. Both types of audit closely examine and confirm accounting records, using fairly similar methods. However, this could be as far as the similarities go".

The above statement was extracted from a presentation made during one of the conferences held by a national professional accountancy institute.

Required:

Evaluate two key differences between "financial audits" and "forensic audits". (6 marks)

- (c) Discuss the procedures involved in applying forensic auditing in fraud investigations. (8 marks)

(Total: 20 marks)

QUESTION TWO

- (a) For the first time, the accounts of Mzalendo Ltd. have been presented as part of an integrated report. Included in the integrated report are several key indicators, one of which states that the company's profit before tax has increased by 20% from the previous year. However, in the profit and loss account, the increase is 12.5%.

Required:

Discuss the implications of the matter described above on the completion of the audit and on the auditor's report, recommending any further actions which would be taken by the auditor. (6 marks)

- (b) (i) Describe the aspects of a client's business which should be considered in order to gain an understanding of the client company and its operating environment. (8 marks)

- (ii) Recommend the procedures that an auditor should perform in order to gain business understanding of an entity. (6 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Sinendet Ltd. manufactures custom-made furniture. The company's year end is 31 May. The company purchases its raw materials from a wide range of suppliers. The company's purchasing system is described below:

- When production supervisors require raw materials, they complete a requisition form which is submitted to the purchase ordering department. Requisition forms do not require authorisation and no reference is made to the current inventory levels of the materials being requested. Staff in the purchase ordering department use the requisitions to raise sequentially numbered purchase orders based on the approved suppliers list, which was last updated 24 months ago. The purchasing director authorises the orders prior to these being sent to the suppliers.
- When goods are received, the warehouse department verifies the quantity to the suppliers despatch note and checks that the quality of the goods received is satisfactory. The department then completes a sequentially numbered goods received note (GRN) and sends a copy to the finance department.

3. Purchase invoices are sent directly to the purchases ledger clerk, who stores them in a manual file until the end of the week. He then inputs the invoices into the purchases ledger using batch controls and gives each invoice a unique number based on the supplier code. The invoices are reviewed and authorised for payment by the finance director, but the actual payment is only made 60 days after the invoice is input into the system.

Required:

With respect to the purchase ordering system described above:

- (i) Analyse four system deficiencies. (8 marks)
 - (ii) Recommend a control to address each of the deficiencies described in a (i) above. (4 marks)
- (b) Your firm is the auditor of Deluxe Tea Holdings Ltd., a company which is planning to list on the National Securities Exchange within the next six months. The listing rules of the securities exchange require compliance with corporate governance principles to which the directors are unsure as to the company's compliance status. The directors have requested for your firm's advisory on this matter.

Additional information:

1. The company's board comprises ten members; six executive directors, a non-executive chairman and three other non-executive directors (NEDs). The chairman and one of the NEDs are former executive directors of the company and on reaching the retirement age, were requested to take on non-executive roles.
2. The company has established an audit committee and all NEDs are members including the chairman of the board who chairs the committee.
3. All the four members of the audit committee were previously involved in sales or production related roles.
4. All the directors have been members of the board for at least four years.
5. As the chairman does not have an executive role, he has the sole responsibility of liaising with the shareholders and answering any of their questions. The company has not established an internal audit function to monitor internal controls.

Required:

Identify four corporate governance weaknesses faced by Deluxe Tea Holdings Ltd. and for each weakness, provide a recommendation to address it. (8 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Your audit of Wasiwasi Ltd. indicates that one or more material uncertainties exist regarding the company's ability to continue as a going concern.

In view of the above circumstance, discuss four matters that should be considered in forming your final audit opinion and the potential impact on the auditor's report. (9 marks)

- (b) You are the audit manager responsible for the audit of Mega Group of Companies. The following information has been brought to your attention regarding two of the companies in the group:

1. **Samia Foods Ltd.**

The company manufactures and distributes cakes and cake ingredients. Towards the year-end, the government paid a grant to the company to assist with costs associated with installing new environmentally friendly packing lines which are aimed at reducing energy usage by 25%. The reduction in energy usage was one of the conditions of the grant. The company began operating the new packaging line three months ago.

2. **Lindi Ltd.**

Your firm audits all companies in the group except for Lindi Ltd. which is audited by a small local firm in the company's country of operation. Audit regulations in Lindi Ltd's country of domicile are not based on International Standards on Auditing (ISAs).

Required:

- (i) Recommend five principal audit procedures that should be performed on the conditions attached to the grant received by Samia Foods Ltd. (5 marks)
- (ii) Explain three factors that should be considered and the procedures that should be performed in deciding the extent of reliance to be placed on the work of the auditors of Lindi Ltd. (6 marks)

(Total: 20 marks)

QUESTION FIVE

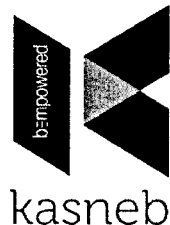
- (a) Identify four principles of ethics that are applicable to internal auditors and for each principle, explain how an internal auditor could demonstrate adherence. (8 marks)
- (b) Bawabu Ltd. seeks to obtain a loan for investment in capital assets. The directors of the company have approached River Bank Ltd. for the loan. To support their loan application, the directors have included a summary of profit forecasts for the next three years which reflect an expected growth in revenue and profits.

Required:

As an audit consultant for Bawabu Ltd., describe six examination procedures that you would use to enable you express a professional view on the profit forecasts. (12 marks)

(Total: 20 marks)

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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 30 November 2018.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

Assume that you are an audit senior in the audit of Fashion Trends Ltd., a manufacturer of fashion dresses. You have been presented with the full draft annual report and financial statements of the company for the year ended 30 September 2018.

From the Chairman's statement and the Directors' report, you discover that:

1. The Directors' report, in discussing developments, states that the company intends to close down the factory in Town X and shift production to a newly built extension in Town Y. The financial statements include Sh.48 million as the unamortised cost of the plant in Town X. The factory in Town X is on leasehold with only one year remaining of the lease contract.
2. The dividend per share is stated in the Directors' report to be Sh.0.45 against Sh.0.40 in the previous year. However, you further note that the total dividend has decreased from Sh.0.63 to Sh.0.62 per share.
3. The Chairman's statement indicates that the company is poised for a large increase in turnover and profit. However, the budgeted accounts and forecasts for the next year and further projections in a long range forecast and plan depict a short-term decline in business and profit and a very low recovery in the long term.

The company's turnover is Sh.6 billion, profit before tax Sh.450 million and net assets Sh.4 billion.

You have further discussed these items with the Board and they have refused to make any changes to the report.

The Directors have lost the confidence of institutional shareholders and fear a take-over bid.

Required:

- (a) Discuss the above scenario from an audit perspective and indicate the action (s) you would take. (12 marks)
 - (b) Draft the sections of the auditor's report that would be modified with respect to these items assuming that there were no other challenges. (8 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) You are the audit manager in Triple P Associates. One of the application files you are reviewing is that of Buru Ltd. The Managing Director of Buru Ltd. has invited your firm to quote or tender for its audit. Buru Ltd. is a small owner-managed company providing financial services such as arranging mortgages and advising on pension plans.

The company's previous auditors recently resigned. The Managing Director of Buru Ltd. states that this was due to "a disagreement on the accounting treatment of commission earned and further because they thought their controls were not very good".

You are aware that Buru Ltd. has been investigated by the Financial Services Authority for alleged non-compliance with its regulations.

As well as performing the audit, the Managing Director would like your firm to give business development advice.

Required:

Discuss six ethical and other professional issues raised in the above scenario and recommend any actions that should be taken. (12 marks)

- (b) You are the auditor of a company with branches spread throughout the region. The turnover for the year ended 30 June 2018 was Sh.3,125 million, the profit before tax was Sh.187.5 million and the net assets were Sh.1,187.5 million.

Your audit report was signed in September 2018 without qualification.

You have received a call from the finance director of the company that the sales ledger clerk in one of the branches has been caught "teeming and lading". His investigations show that during the year to 30 June 2018, the sales ledger clerk had diverted Sh.6.25 million of receipts from customers to his own bank account. The finance director has requested you to attend a meeting with him to discuss the matter.

On checking the records, you ascertain that as at 30 June 2018, the branch affected had net assets of Sh.50 million, a turnover of Sh.125 million and recorded a small loss.

Your re-examination of the audit working papers shows that your staff had visited the branch and had apparently carried out their responsibilities in the required manner.

Required:

Analyse the above scenario and prepare detailed notes to guide you in your discussions with the finance director.

(8 marks)

(Total: 20 marks)

QUESTION THREE

- (a) DD Electronics designs, develops, manufactures and markets a wide range of personal computing products including desktop computers, portable computers, network servers and peripheral products that store and manage data in network environments. The company markets its products primarily to businesses, homes, government and education customers. The company operates in one principal industry segment across geographically diverse markets.

The company is subject to legal proceedings and claims which have arisen in the ordinary course of its business. The management does not believe that the outcome of any of these matters will have a material adverse effect on the company's consolidated financial position or operating results.

Required:

With reference to the above scenario and introducing other relevant information as may be applicable, discuss four issues that an audit firm should consider before accepting to audit DD Electronics.

(8 marks)

- (b) Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. They range from simple comparisons to the use of complex models involving many relationships and elements of data. They involve comparisons of recorded amounts or ratios developed from recorded amounts to expectations developed by the auditors.

Required:

- (i) Describe four broad objectives of analytical procedures.

(8 marks)

- (ii) Describe two factors that influence the extent to which an auditor will use the results of analytical procedures to reduce detailed tests in meeting audit objectives.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Safari Logistics Ltd. is a company involved in long distance cargo transportation on behalf of its clients. The company has sixty trucks for transportation of loose cargo, containerised cargo and fuel tankers.

The finance director has identified the following as key risk areas in the company:

1. Illegal sale of fuel by drivers. The company has its own fuel station at its yard from which fuel is bought in bulk and dispensed to drivers at the start of each journey. Drivers are not expected to buy fuel.
2. Sale of clients goods by unscrupulous drivers and conductors.
3. Carriage of unauthorised cargo by drivers and conductors.
4. Claims by crew for amounts apparently spent to repair vehicles for breakdowns on the road.
5. Escalating labour costs relating to cargo loading and offloading especially for loose cargo.

Required:

Summarise two control measures that might be put in place to deal with each of the issues noted above.

(10 marks)

- (b) Discuss the objective of a review engagement contrasting the level of assurance provided with that of an audit of financial statements. (4 marks)
- (c) Discuss three reasons why the identification of related parties and material related party transactions could be difficult for auditors. (6 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) Mwanza Hotels Ltd. operates a chain of 60 hotels. This year's results show a return to profitability for the company, following several years of losses.

Required:

As the internal auditor for Mwanza Hotels Ltd., recommend seven key performance indicators (KPIs) which could be used to monitor the hotel's social and environmental performance and for each KPI, outline the nature of evidence that should be available to provide assurance on its accuracy. (14 marks)

- (b) Describe three objectives of a forensic investigation. (6 marks)
- (Total: 20 marks)**

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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 25 May 2018.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

(a) International Standard on Auditing (ISA) 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with ISAs:

- Requires an auditor to recognise that circumstances may exist that can cause financial statements to be materially misstated.
- Recognises that maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risk of overlooking unusual circumstances.

In addition, the International Auditing and Assurance Standards Board (IAASB) in one of its recent publications observes that the importance of professional skepticism to the public interest is underscored by the increasing complexity of financial reporting and changes in business models.

Required:

(i) In the context of the above brief, discuss with practical examples how you would apply professional skepticism during an audit. Your response should include the following key audit processes:

- Performing risk assessment procedures.
- Obtaining audit evidence.
- Evaluating evidence.
- Forming the audit opinion.

(8 marks)

(ii) Evaluate three possible challenges to your application of professional skepticism as discussed under (a) (i) above. (6 marks)

(b) The role of forensic accountants today is gaining momentum, catalysed by the increasing complexity and sophistication of financial crimes. According to a recent global economic crime and fraud survey published by a leading accountancy firm, 49% of organisations globally reported that they had been victims of fraud and economic crimes.

Required:

With reference to the above statement, describe the role of a forensic accountant in:

(i) Criminal investigations. (2 marks)

(ii) Litigation support. (2 marks)

(iii) Insurance claims. (2 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Madawa Limited has been manufacturing herbicides for the past ten years. Your firm, Mawingo and Associates, have been the auditors of Madawa Limited for the last three years. Recently, the following extract on Madawa Limited appeared in a national newspaper:

"It appears that Madawa Limited has breached the local planning regulations by building an extension to its research and development unit for which no approval was sought from the County Government. The land on which the premises are situated is protected as riparian land which means that approval by the County Government is necessary for any modification to commercial buildings".

In addition, a representative of the County Government's planning office was recently quoted as saying "We feel that this is a serious breach of regulations. This is not the first time that Madawa Limited has deliberately ignored established planning rules in the County. The same company was successfully sued in 2013 for constructing an access road to their factory without receiving prior approval from the County. We are considering taking further legal action for this breach".

Required:

- (i) Discuss the relationship between the concepts of "business risk" and "financial statements risk" in a company drawing references from the above scenario. (6 marks)
- (ii) Evaluate four potential financial statements risks from the breach by Madawa Limited of County Government's planning regulations. (8 marks)
- (b) Contrast the scope of due diligence investigations with that of an audit of financial statements. (6 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) You are the engagement partner responsible for the audit of the financial statements of Malezi Ltd. for the year ended 30 April 2018. Your preliminary evaluation of the accounting and internal control systems indicated that the systems were reliable. However, subsequent tests of controls revealed that the systems were not operating effectively. This situation has necessitated various revisions to your audit plan.

Required:

In view of the situation explained above, describe the changes that you would effect:

- (i) During the interim audit. (6 marks)
- (ii) At the final audit visit. (4 marks)
- (b) An audit of directors' remuneration at Funika Ltd., a listed company has established that the Managing Director, Mr. Anson Mweni, is the highest paid director of the company with an annual pay of Sh.36 million.

As you peruse some of the company's recent purchase invoices, you notice that part of the invoices totaling Sh.12 million relate to repair works undertaken at Mr. Mweni's house. Although Mr. Mweni authorised these payments, there were no Board minutes approving the same. You further establish that Mr. Mweni has ignored internal advice to include the Sh.12 million as part of his annual benefit and for the financial statements to be amended to reflect the proposed change in treatment of the item.

The company's profit before tax for the year before any adjustments amounted to Sh.640 million. The company's Annual General Meeting (AGM) is due to be held soon.

Required:

- (i) Assess whether the undisclosed remuneration is material in the above context. Justify your conclusion. (6 marks)
- (ii) Assume further that Funika Ltd. has an Audit and Risk Committee and that Mr. Mweni owns less than 1% of the issued shares. You have gathered hints that Mr. Mweni intends to push for replacement of your firm as auditors for the current financial year should you attempt to qualify the audit report.

Describe, indicating any other institutions that you will involve, the matters that you will consider and the actions that you will take to protect the interests of the company's shareholders and the integrity of your firm. (6 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) You are the audit manager responsible for the audit of Spark Electricals Ltd., a manufacturing company, for the financial year ended 30 September 2017. The audit work has been completed and reviewed and the audit report is due in four days.

The financial statements show revenue for the year ended 30 September 2017 of Sh.200 million, net profit Sh.50 million and total assets at the period end at Sh.1,000 million. The draft audit opinion is unmodified.

The company's finance director has just called you about an announcement made the previous day of an impending significant restructuring of the company which will take place over the next five months.

The restructuring will involve the closure of a factory and its relocation to another part of the country. It is expected that there will be some job redundancies. The estimated cost of the factory's closure is Sh.4 million. The financial statements have not been amended in respect of this matter.

Required:

- (i) Comment on the financial reporting implications of the above announcement. (2 marks)
 - (ii) Advise on any further audit procedures you would perform in view of the additional information received. (6 marks)
 - (iii) Recommend the action to take if the financial statements are not amended. (6 marks)
- (b) Discuss the auditor's consideration of materiality at the planning stage and the overall review stage of an audit. (6 marks)
- (Total: 20 marks)**

QUESTION FIVE

You are the lead auditor of Douala Holdings Limited, a large conglomerate with a number of subsidiaries. Some of the subsidiaries are audited by other firms.

Your firm is in the process of determining the extent to which the work of the auditors of the subsidiary companies can be relied upon in the audit of the accounts of the parent company and preparation of the group financial statements.

Required:

- (a) Explain three factors that you would consider in deciding on the extent to which you would rely on the work of the auditor of the subsidiary companies. (6 marks)
- (b) Analyse three matters that you would consider in deciding whether you should qualify your audit report on the parent company given that the audit report on the financial statements of one or more of the subsidiary companies was qualified. (6 marks)
- (c) Your engagement team for the audit of Douala Holdings Limited includes an audit senior and two relatively new audit assistants. One of the focus areas of the audit is the relatively high number of related party transactions among the companies in the group. You wish to brief your team on the key audit considerations for related party transactions.

Summarise four matters for inclusion in your brief to the engagement team.

(8 marks)

(Total: 20 marks)

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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 1 December 2017.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) Distinguish between “forensic accounting” and “forensic audit”. (4 marks)
- (b) Describe three challenges that an auditor might encounter in carrying out an audit in an e-commerce environment. (6 marks)
- (c) Argue three cases for and two cases against the use of global corporate governance standards. (10 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) The framework for assurance engagements does not permit an auditor to give an absolute level of assurance.
- With reference to the above statement, suggest five reasons why it is not possible to give an absolute level of assurance. (10 marks)
- (b) The International Standard on Auditing (ISA) 220: Quality Control for an Audit of Financial Statements provides that audits should be conducted in a manner that ensures the correct opinion is arrived at with due regard to time and other resource constraints. The engagement partner should be satisfied that the engagement team has the appropriate competence and capabilities.

Required:

Evaluate the importance of each of the following qualities in selecting an effective engagement team:

- (i) Independence. (2 marks)
- (ii) Scope of the assignment. (2 marks)
- (iii) Complexity of the assignment. (2 marks)
- (iv) Duration of the assignment. (2 marks)
- (v) Client expectations and requests. (2 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) You are the audit manager responsible for the audit of Kampuni Kubwa (KK) Ltd., a manufacturing company listed on the securities exchange. You are assigning staff to the final audit of KK Ltd. for the year ended 30 September 2017.

You are aware of the following matters:

- Janice Tuli, the assistant manager assigned to the interim audit of KK Ltd. recently discovered that some senior managers in the company have been defrauding the organisation. She has since received some threatening e-mails and calls from the managers.
- Alex Baricho, an audit senior has been auditing KK Ltd. for the last three years. He has confided in you that his father owns 2,000 shares in KK Ltd.

Required:

Analyse the ethical threats raised by the above matters. (4 marks)

- (b) You are the audit manager of Tausi Ltd. You are conducting a review of the financial statements and notice some transactions with the pension fund of the employees. There is no disclosure in the accounts about any related party transactions.

Required:

With reference to the above statement, suggest six procedures that an auditor might carry out in order to establish if the pension fund is a related party. (6 marks)

- (c) You are the audit manager assigned to the audit of Njema Ltd., the parent company of a group. As part of your work, in relation to the consolidated accounts, you are reviewing the work of the auditors who audit the accounts of the subsidiaries.

Required:

In the context of the above scenario, discuss five matters you should examine before relying on accounts not audited by you. (10 marks)

(Total: 20 marks)

QUESTION FOUR

You are the audit manager in charge of the audit of Vuka Mpaka Ltd., a limited liability company.

On 1 July 2000, Vuka Mpaka obtained the exclusive rights to operate car and passenger ferries across Ziwa Channel, for a period of twenty years. The company refurbished two ferries to service the route. The ferries do not meet the standards of the Environmental Regulation Authority. Each ferry makes an average of ten return crossings every day and has the capacity to carry 2,000 passengers and 400 vehicles per trip.

Vuka Mpaka Ltd. currently receives a subsidy from the local transport authority as an incentive to increase market awareness of the ferry service. The subsidy increases as the number of vehicles carried increases and is based on quarterly returns submitted to the authority.

The company employs fifty full-time crew members who are trained in daily operations, customer service as well as passenger safety in the event of personal accident or breakdown. The management of Vuka Mpaka Ltd. is planning to apply for a safety management certificate at the end of the year. This will require an audit of the ferries including a review of safety documents and evidence that activities are performed in accordance with documented procedures. A safety management certificate, valid for five years, will be issued if no major non-conformities have been found.

Your firm has been asked to provide Vuka Mpaka Ltd. with a business risk assessment as a management assurance service.

Required:

- (a) Discuss five business risks that Vuka Mpaka Ltd. might face. (10 marks)
- (b) Describe the processes by which the risks identified in (a) above could be managed by Vuka Mpaka Ltd. (10 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) You are the engagement partner of Kitabu Ltd. The financial statements for Kitabu Ltd. for the year ended 30 September 2017, show total assets of Sh.749 million and profit before tax of Sh.57.4 million.

Required:

Discuss the potential implications of the following matters on the audit report:

- (i) The basis of accounting note states that financial statements have been prepared in compliance with International Financial Reporting Standards (IFRSs). However, the accounting policy note for development costs states that all development costs are expensed as incurred. Results of audit tests showed that of the Sh.25.9 million development costs expensed during the year, Sh.9.8 million should have been recognised as an asset, in accordance with International Accounting Standard (IAS) 38 "Intangible Assets". (4 marks)
- (ii) The management of Kitabu Ltd. has informed you that, for the first time, the company's annual report is to be published on the company's website. (2 marks)
- (b) You are auditing the financial statements of Zebra Engineering Ltd. for the year ended 30 June 2017. The partner in charge of the audit instructs you to carry out a review of the company's activities since the financial year end.

Required:

Analyse seven audit procedures which you might carry out in order to identify any material post balance sheet events. (14 marks)

(Total: 20 marks)

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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 26 May 2017.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

You are the audit manager responsible for the audit of Tamasha Ltd. for the year ended 30 June 2016. The audit fieldwork has been completed and the general manager in charge of finance is seeking to finalise the financial statements.

You are reviewing the audit file and the financial statements and have noted the following issues:

1. An investment held at the year end has since declined by Sh.1,250,000 in market value.
2. A tangible asset with a net book value of Sh.800,000 was sold on 29 June 2016. The final selling price was contingent on a valuer's report which was not received until 15 July 2016. As a result of this report, the profit recorded on this sale should be reduced by Sh.300,000.
3. A number of minor control points were noted and reported to management by way of a formal management letter.
4. Trade payables include a balance of Sh.700,000 owing to the parent company of Tamasha Ltd. The parent company has assured the general manager that it will not seek repayment of the amount for two years from the date the audit report is signed. The general manager will confirm this in the letter of representation.
5. A legal case which was ongoing at the year end has just been concluded. The case is disclosed and a provision of Sh.350,000 included in the draft financial statements. The outcome of the case was that Tamasha Ltd. should pay damages amounting to Sh.1,450,000 to the other party.

The draft financial statements, which do not contain any adjustments and some relevant disclosures relating to the above matters, show the following:

	Sh. "000"
Turnover	34,500
Profit before tax	2,900
Net current liabilities	(1,400)
Net assets	2,100

Required:

- (a) For each of the issues noted from your review, summarise the potential implications on the audit report. Treat each issue independently. (10 marks)
 - (b) Explain the overall audit opinion that you would express taking into consideration that no further adjustments or disclosures were made for the issues noted. (4 marks)
 - (c) Describe one other significant audit issue likely to arise from the above information. (3 marks)
 - (d) Outline further audit work you would perform arising from the potential audit issue identified in (c) above. (3 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Pona Hospital is a referral hospital fully owned by the Government. Two years ago, on recommendation by the hospital's internal audit department, the management reviewed all aspects of hospital operations and implemented a number of measures aimed at improving overall "value for money" for the users of the facility.

Your audit firm has been requested to perform a review of the following measures which have been implemented so far:

1. Pona Hospital has one centralised purchasing department where all purchase requisitions for medical supplies are forwarded. Upon receipt, the procuring team will research on the lowest price from suppliers and a purchase order is raised. This is then forwarded to the purchasing manager who authorises all orders. The small purchasing team receives in excess of 200 requisition forms per day.

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2. The human resource department has experienced difficulties in recruiting suitably trained staff. Overtime rates have been increased to incentivise permanent staff performing extra duties due to staffing gaps. This has been popular and reliance on expensive temporary staff has been reduced. Monitoring of staff hours had been difficult. However, the hospital has implemented time card procedures for clocking in and out. The hours clocked are used to calculate payments.
3. The hospital has invested heavily in new surgical equipment. Although the surgical equipment are very expensive, more surgeries can be performed and patient recovery rates are now faster. However, there is a shortage of appropriately trained medical staff and the equipment is underutilised. A capital expenditure committee has been established, made up of senior managers, to authorise future procurement of any significant capital expenditure items.

Required:

- (i) Analyse four strengths within Pona Hospital's internal control environment. (4 marks)
 - (ii) For each of the strengths analysed in (a)(i) above, recommend further improvements in order to provide best value for money. (8 marks)
- (b) Your firm has been invited by Mr. Abdalla Juma, the Managing Director of Msingi Bora Ltd., to accept appointment as auditors of the company. You establish that the present firm of auditors will not be reappointed when their term of office expires as Msingi Bora Ltd. is dissatisfied with their services.

Mr. Juma has further requested that:

1. An employee of your firm assumes responsibility of preparing monthly management accounts on tight deadlines. The continuation of the overdraft facility by the company's banker is dependent on the receipt of these accounts by the bank within ten days of each month end.
2. The audit partner in your firm attends the monthly board meetings, mainly to explain the management accounts to the other directors.

Required:

Describe the matters that you would consider in deciding whether to accept the above appointment as auditor and to provide the additional services as requested. (8 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Periodically, there arises debate within and outside the accountancy profession on the independence of auditors. One suggestion floated to improve auditor independence is to have compulsory rotation of audit firms after a pre-determined period.

Required:

- (i) Discuss four ethical threats created by a long association with an audit client. (8 marks)
 - (ii) Evaluate three advantages and three disadvantages of compulsory rotation of audit firms. (6 marks)
- (b) You are a newly appointed auditor of Shida Ltd. You have recently ascertained the following about your new client:

1. The company has two major customers and a few small-sized customers.
2. The company recently purchased a very large and complex computer system as part of its automation process. The administration staff do not have adequate competence to run the system properly.
3. The Chief Executive Officer of the company, Albert Amingi, has a dominating personality and is overbearing on his subordinates.
4. The company has no formal management accounting system. The new computer system is supposed to remedy this gap.

Required:

Justifying your answer, suggest an appropriate audit strategy for the first audit of Shida Ltd.

(6 marks)

(Total: 20 marks)

QUESTION FOUR

Kenya Construction Ltd. (KCL), a company involved in construction of residential houses for sale, has sued their outgoing general manager over matters of financial impropriety. Kelly Limited, which owns 70% of the shares in KCL is also a complainant against the general manager of KCL on the basis that Sh.60 million advanced by the company to KCL was not refunded. The High Court has ordered the lawyers representing the parties in the above case to liaise with their clients and appoint an independent auditor who would scrutinise the documents submitted by the general manager as ordered by the Court. Thereafter, the independent auditor is to file a report to the Court.

The main issues being raised between Kelly Limited and KCL are as follows:

1. All the houses planned to be constructed and sold were actually constructed and sold.
2. All the buyers had paid KCL all monies due.
3. The general manager kept changing contractors and the terms of contract for personal gain.
4. The general manager engaged in excessive overseas travels for personal errands using company resources.
5. The general manager did not maintain proper books of account and did not retain all business vouchers as expected.
6. The general manager did not file VAT, PAYE, corporate tax and social security returns as expected thereby exposing the company to fines and penalties. Failure to file returns was aimed at concealing the general manager's malfeasance.
7. Although all houses were sold, KCL still owed Kelly Limited Sh.60 million and had a bank overdraft of Sh.80 million secured against some of the houses already disposed of.
8. The present cost was grossly overstated through unexplained and unsupported expenditure. The general manager violated all known principles of good project governance regarding execution, supervision and handing over of a project.

Required:

Assuming you have been appointed the forensic auditor in the above case:

- (a) Describe how you would deal with each of the issues numbered 1 to 8 above. (16 marks)
 - (b) Explain how you would ensure that you are effective in the provision of valuable evidence to the Court. (4 marks)
- (Total: 20 marks)**

QUESTION FIVE

A newspaper article contains the following:

"The role of statutory auditors is often misunderstood. In particular, there is confusion over the auditor's responsibilities in respect to fraud and the nature of the assurance provided by an audit. Furthermore, following a number of corporate collapses and the revelation of fraud perpetrated by management, it is the auditors who may be sued for large sums of money. This trend is threatening the future of the auditing profession. The majority of auditors would prefer the current legislation to be changed to enable auditors agree on a contractual cap on liability (that is, a limit on the monetary amount which the auditors could pay out in damages)".

Required:

- (a) Compare and contrast the responsibilities of auditors and directors of a company in relation to the prevention and detection of fraud. (6 marks)
 - (b) Explain why the statutory audit cannot provide absolute assurance that the financial statements are free from misstatement whether caused by fraud, error or other irregularity. (6 marks)
 - (c) Discuss in each case, four arguments for and against changing the legislation to allow auditors to agree on a contractual cap on liability in respect to the statutory audit. (8 marks)
- (Total: 20 marks)**
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KASNEB

CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 25 November 2016.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

Electronic Solutions Ltd. is a newly incorporated limited liability company. The company provides information technology services to overseas clients. The company relies heavily on information technology for operational activities. Most of the activities are captured online through a monitoring system. The company does not sell any of the systems that it has developed outright but has agreements with clients that permit the company to receive commissions based on the volume of transactions that flows through its system. The rates charged for the transactions vary with the volume of transactions.

The prevailing local taxation laws grant the company an income tax exemption for five years subject to the company complying with specific conditions. One of the conditions is that 90% of the company's income received during the year should be in foreign currency.

In order to grant exemption for the year ending 31 December 2016, the Revenue Authority has requested for an assurance report from the company auditors that 90% of the company's income is received in foreign currency.

Required:

- (a) Suggest with reasons the quality control objectives which are likely to be particularly relevant in the audit of Electronic Solutions Ltd. (10 marks)
 - (b) Describe the additional audit procedures you would request the audit staff to perform in order to issue the assurance report. (10 marks)
- (Total: 20 marks)**

QUESTION TWO

Your audit firm, Makau Kilunda and Associates, are the auditors of Kikomi Manufacturing Group (KMG) Ltd. The group comprises various subsidiaries which were acquired over the last two years.

The subsidiary companies operate diverse businesses including but not limited to mining, agriculture, beauty products and steel manufacturing works. The CEO of KMG Ltd., Mr. Tim Kilonzo is very entrepreneurial and autocratic. KMG Ltd. is highly geared and recently acquired a listed company dealing in information communication technology solutions. A financial analyst had indicated in one of the respected financial magazines that the listed company was acquired at a very high price compared to the value of its assets.

Another large subsidiary which manufactures skin products has been sued by customers over some products which have allegedly adversely affected their skins. Some farmers also allege that the maize seeds supplied by one of the subsidiary companies were faulty and thus the seedlings withered one month after germination.

Required:

- (a) Assess the audit risk faced by Makau Kilunda and Associates in the course of the audit of Kikomi Manufacturing Group (KMG) Ltd. (6 marks)
 - (b) Summarise the advantages of a business risk approach to the audit of KMG Ltd. (6 marks)
 - (c)
 - (i) Undertake a business risk assessment of KMG Ltd. (4 marks)
 - (ii) Highlight how the business risk assessment in (c) (i) above might influence the audit process. (4 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) Your audit client, Informat Solutions Ltd., has requested your audit firm to undertake a forensic investigation related to a suspected payroll fraud at the company.

Analyse how the code of ethics for professional accountants would be applied in undertaking the forensic investigation of the suspected fraud in Informat Solutions Ltd. (10 marks)

- (b) Your audit senior has requested you to undertake a value for money audit during the course of your audit of a public sector organisation:

(i) Explain the importance of a value for money audit in the public sector. (4 marks)

(ii) Summarise six common areas that an auditor would consider when undertaking a value for money audit in an organisation. (6 marks)

(Total: 20 marks)

QUESTION FOUR

You are the audit manager responsible for the audit of Ixcel Group, an audit client for several years. All group companies had a financial year that ended on 31 March 2016. You are currently in the final phase of the group audit. The following matters were discussed during your review with their engagement partner:

1. Karen Ltd is a subsidiary of Ixcel Group. During the audit, the audit team observed several issues in relation to the entity's ability to continue as a going concern, as follows:
 - Karen Ltd. will not be able to continue without continuous support from Ixcel Group.
 - Ixcel Group has issued a letter of support also referred to as a "comfort letter" to Karen Ltd.
2. The directors' report for Ixcel Group stated that the group has maintained a gross profit margin of 30%. This percentage did not tally with the income statement. During your review, you observed that some "other income" items were considered when calculating the gross profit margin in the directors' report. The audit senior ignored this deviation in the directors' report observing that it was not relevant to the financial statements.
3. The audit senior has prepared a draft qualified audit opinion on the going concern issue considering the seriousness of the situation.

Required:

- (a) Describe the purpose of support letters (comfort letters) as evidence in the audit of financial statements. (8 marks)
- (b) (i) Critique the draft audit opinion by the audit senior justifying the opinion you would recommend. (6 marks)
- (ii) Suggest with justification the audit opinion you would recommend based on the misstatement of the gross profit margin in the directors' report. (6 marks)

(Total: 20 marks)

QUESTION FIVE

You are the partner responsible for providing direction to more junior members of the audit department of your firm on technical matters. Several recent recruits have asked for guidance in the area of auditor's liability. They are keen to understand how an audit firm can reduce its exposure to claims of negligence. They have also heard that in some countries, it is possible to restrict liability by making a liability limitation agreement with an audit client.

Required:

- (a) Discuss the civil liabilities of an auditor under common law. (12 marks)
- (b) Assess the potential implications to the audit profession of audit firms that sign a liability limitation agreement with their audit clients. (8 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 27 May 2016.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

You are the audit manager assigned the audit of the financial statements of Himaya Ltd. for the year ended 31 December 2015. You have come across three material items in the course of your audit which need to be concluded in order to form an audit opinion on the financial statements.

Required:

- (a) In the context of the above scenario, describe the audit work to be performed on the following matters:
- (i) The allowance for doubtful debts for the current financial year is Sh.15 million which represents 2.5% of the accounts receivable as at 31 December 2015. The allowance for doubtful debts for the three previous years was 5% of the accounts receivable. The credit controller has advised that the reduction in allowance was due to the measures undertaken to improve on debt collection and credit check procedures. (5 marks)
 - (ii) The directors' emoluments amounting to Sh.70 million during the year have not been disclosed in the financial statements. (4 marks)
 - (iii) Circularisation of a debtor owing the company Sh.68 million had not been done due to what the financial controller justified as "strained relations with the debtor". No cash has been received from the debtor and some documents regarding shipment to the customer are missing. (5 marks)
- (b) Explain how the three matters outlined in (a)(i), (ii) and (iii) above would impact on the auditors report, assuming that your best estimate of the appropriate allowance for doubtful debts is Sh.30 million and that no adjustments had been made in the financial statements in respect of the matters set out in items (a)(i), (ii) and (iii) above. (6 marks)
- (Total: 20 marks)**

QUESTION TWO

Apex Ltd. was incorporated in the year 2012. The company deals with the extraction of sand, gravel and stone materials for residential and commercial building construction as well as for road construction projects. The following information relates to the affairs of the company during its few years of operation:

1. Apex Ltd. is currently working closely with sports complexes and golf course architects to develop sand of high quality for use in the construction and top dressing of golf courses and sports complex playing fields.
2. The company's profit has been declining mainly due to intense price competition from several smaller competitors. The managing director hopes that profits would improve in the year 2017 as a significant amount of the company's long term debt is payable by the year 2016. Apex Ltd. is currently involved in discussions with the banks on refinancing.
3. In late 2015, a significant theft took place at the company's quarry facility. Security was lax because it was believed that there was only low risk of these products being stolen given their nature as high volume low value products.

Required:

- (a) Discuss the reviews that could be carried out by the internal audit function in Apex Ltd. (12 marks)
- (b) Explain the potential obligations that might accrue to Apex Ltd. arising from an environmental audit. (8 marks)
- (Total: 20 marks)**

QUESTION THREE

Bakari Ltd. acquired 75 per cent of the ordinary shares of Makali Ltd. on 30 June 2015 for Sh.20 million. The reserves of Makali Ltd. at the time of acquisition were Sh.10 million (credit).

The statements of financial position of the two companies as at 31 December 2015 were as follows:

Statements of financial position as at 31 December 2015:

	Bakari Ltd. Sh. "000"	Makali Ltd. Sh. "000"
Sundry assets	20,000	50,000
Investments in Makali Ltd.		
75,000 ordinary shares of Sh.100 each	<u>20,000</u>	<u>-</u>
	<u>40,000</u>	<u>50,000</u>
Financed by:		
Share capital	20,000	10,000
Revenue reserves	<u>20,000</u>	<u>40,000</u>
	<u>40,000</u>	<u>50,000</u>

Additional information:

The subsidiary company was audited by another auditing firm and the directors of the holding company agreed through a resolution that the audit firm would continue to audit the subsidiary company for the year ended 31 December 2015.

Required:

- (a) Describe the matters you would consider in the audit of the holding company, Bakari Ltd. (15 marks)
- (b) Summarise the information that you would require from the auditors of the subsidiary company, Makali Ltd. (5 marks)
- (Total: 20 marks)**

QUESTION FOUR

You are responsible for the audit of Superior Packaging Ltd. for the year ended 31 March 2016. The principal activity of Superior Packaging Ltd. is the provision of high quality packaging services for manufacturing companies. The company was established 3 years ago and has significantly exceeded its growth targets in each subsequent year. Historically, the packaging process was labour intensive. However in December 2015, in an effort to reduce labour costs and increase efficiency, the company invested in an enhanced automated packing system. The investment was funded by a loan repayable in monthly instalments over 4 years. The loan agreement includes a covenant specifying that the company's debt equity ratio should not exceed 1:1.

A comparison of the draft financial statements for the year ended 31 March 2016 with the previous year's financial statements indicates a significant increase in the turnover (revenue) with a small increase in profitability. The company is currently trading in excess of its overdraft limit and is negotiating an increase in its facility with the bank. The management of the company has prepared, in support of its negotiations, profit and cash flow forecasts based on the assumption that the anticipated increase in efficiency and reduction in labour costs will be achieved.

The company has struggled to meet its wage bill obligations and fallen behind with PAYE, NHIF and NSSF remittances. It has also failed to comply with the terms of the lease in respect of the factory premises and has not paid the last three months' instalments.

Required;

- (a) Explain from the information provided above, factors which could indicate that Superior Packaging Ltd. might not be a going concern. (6 marks)
- (b) Describe the duties of the directors in respect of going concern basis of a company. (6 marks)
- (c) Where events have been identified which cast doubt on the appropriateness of the going concern basis, management should demonstrate to the auditors that they have identified the problem and have plans to deal with it.
- Propose the procedures the auditors must carry out on the management plans and the possible impact to the auditors report. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) Discuss the matters that a professional accountant should consider before accepting an engagement to report on prospective financial information of a company. (10 marks)
- (b) Zakayo and Associates were invited to tender for the audit of Premier Enterprises Ltd. for the financial year ended 31 December 2015. The firm was awarded the tender as it was the most competitive. The firm had used a low balling strategy when submitting their tender. During the course of the audit, the auditors have suspected the company is involved in money laundering activities.

Required:

- (i) Explain the term “low balling” citing the potential threat of low balling to the auditor’s independence. (4 marks)
- (ii) Define the term “money laundering”. (2 marks)
- (iii) With reference to the code of ethics and conduct for professional accountants, advise the action the auditors should take with respect to the suspected money laundering activities by the company. (4 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 27 November 2015.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) Your firm has been retained as the auditors of Solo Ltd., a retailer of books, music media and computer software. As part of the audit planning for the year ended 30 June 2015, your audit manager has asked you to assist with drafting of the audit programmes.

Required:

For each of the four (4) items listed below, describe the audit procedures that you would undertake in respect of the matters listed to ensure that the financial statements of Solo Ltd. are fairly stated.

- (i) On 1 June 2015, Solo Ltd. relocated from its rented warehouse to a larger property in order to accommodate growth in the business. The lease on the old warehouse, which came to an end on 31 May 2015, contains a dilapidation clause which specifies that Solo Ltd. must carry out repairs to the warehouse in order to restore the property to the same condition it was in when the lease commenced. Work on the dilapidations commenced on the day Solo Ltd. vacated the property and it is expected to take three months to complete. The directors of Solo Ltd. have included the estimated cost of these works in the financial statements for the year ended 30 June 2015 at Sh.20 million. (4 marks)
- (ii) In order to cope with its recent expansion, Solo Ltd. installed a new computer system during the year. The old computer system, which has now been disposed of, was replaced after three years, despite its initial useful life being assessed as five years. Solo Ltd. has capitalised the new system at a cost of Sh.60 million and is depreciating it at 20% per annum on a straight line basis. (4 marks)
- (iii) Solo Ltd. maintains a perpetual inventory system. Monthly inventory reports analyse the age of items in three-month periods for all inventory up to one year old and as a single figure for all inventory older than one year old. Solo Ltd. has historically included a provision in its financial statements to cover both obsolete and damaged inventory equal to 10% of the total inventory cost. (3 marks)
- (iv) Solo Ltd. pays a 5% commission to referees in return for them directing business to the company. The 5% commission is calculated using the retail price as advertised by Solo Ltd. The commission is payable at the end of the month following that in which Solo Ltd. receives payment from its customers. Solo Ltd.'s computer system generates a monthly statement of sales made on this basis together with a calculation of the commission due. However, due to a computer virus, the computer system has not calculated or paid any commission since 31 March 2015. A number of the largest referees have since contacted Solo Ltd. demanding payment of their own estimates of commission due. Solo Ltd. has not made provisions in the financial statements for unpaid commission. (3 marks)
- (b) With respect to item (a) (iv) above, justify three audit opinions you could issue in respect of the financial statements of Solo Ltd. for the year ended 30 June 2015. (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Maxwell Wamalwa is an audit manager in Ambu and Associates Certified Public Accountants. One of the audit clients, Maridadi Ltd., designs and manufactures wooden tables and chairs for the audit firm. The business of Maridadi Ltd. has expanded rapidly in the last two years after the company employed Patrick Tundo, an experienced Sales and Marketing Manager.

The directors of Maridadi Ltd. intend to obtain a loan of Sh.30 million in order to expand its operations. The directors have approached LCT Bank for the loan. The bank's lending policy requires the loan application to be accompanied by a detailed business plan including an analysis of how the funds will be used. LCT Bank Ltd. must confirm that the loan applied for is adequate for the proposed business purpose.

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Out of 3

The business plan must be supported by an assurance opinion on the adequacy of the requested funds. Maridadi Ltd. has projected that the Sh.30 million loan will be used as follows:

	Sh. "000"
Construction of a new factory	12,500
Purchase of new machinery	10,000
Initial supply of timber raw material	2,500
Advertising and marketing of new products	<u>5,000</u>
	<u>30,000</u>

Your audit firm has agreed to review the business plan and to provide assurance on the completion of the loan application. A meeting is scheduled with Maridadi Ltd. to discuss this assignment.

Required:

- (i) Appraise the matters relating to the assurance assignment that should be discussed during the meeting with Maridadi Ltd. (8 marks)
 - (ii) Summarise the enquiries you would make to the directors of Maridadi Ltd. to ascertain the adequacy of the Sh.30 million loan applied for by the company. (7 marks)
- (b) Summarise the role played by the audit committee in enhancing corporate governance in an organisation. (5 marks)
- (Total: 20 marks)**

QUESTION THREE

You are a member of the audit team assigned to audit the financial statements of Elite Trading Co. Ltd., a listed company, for the year ended 31 August 2015. The detailed audit work was completed on Friday, 30 October 2015. The audit assignment partner has requested you to consider the auditor's responsibilities for identifying subsequent events and the audit procedures for examining subsequent events.

With respect to the financial statements of Elite Trading Co. Ltd., it is tentatively proposed as follows:

1. The audit report be signed on Thursday, 12 November 2015.
2. The financial statements be sent to the shareholders on Wednesday, 2 December 2015.
3. The annual general meeting of the company be held on Wednesday, 30 December 2015, in which meeting the shareholders will vote to approve the financial statements.

Required:

- (a) Assess the responsibility of the auditors for detecting material subsequent events in the following periods:
 - (i) 31 August 2015 to 30 October 2015. (2 marks)
 - (ii) 30 October 2015 to 12 November 2015. (1 mark)
 - (iii) 12 November 2015 to 2 December 2015. (2 marks)
 - (iv) 2 December 2015 to 30 December 2015. (1 mark)
 - (b) Explain the audit procedures that you could use in the examination of subsequent events. (10 marks)
 - (c) Describe the work you would carry out for the period listed in (a) (ii) above. (4 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) Biashara Ltd. has, as a result of technological developments, adopted sophisticated information systems in its business in order to reduce its operational costs. During the year ended 31 March 2015, the company adopted e-commerce to conduct its business in various countries. The directors of Biashara Ltd. have approached you to advise on managing risks associated with e-commerce.

Required:

- Advise Biashara Ltd. on the procedures that the company should put in place to mitigate e-commerce risks. (8 marks)
- (b) Describe the audit procedures that an auditor could perform to assess whether or not a client entity is a going concern. (8 marks)
 - (c) Explain the auditor's responsibilities in relation to the prevention and detection of fraud and error. (4 marks)
- (Total: 20 marks)**

QUESTION FIVE

You are a manager in an audit firm and double up as the head of the forensic investigation department. Your audit firm has recently been appointed the auditors of Afrokeen Manufacturers Ltd. for the year ending 31 December 2015. The directors of Afrokeen Manufacturers Ltd. have contacted your audit firm regarding a suspected fraud relating to the company's payroll. You have been assigned to undertake a forensic investigation and have held preliminary discussions with the finance director of the company.

The finance director suspects that the accountant, who had been absent from work after the finance director queried the increasing costs of overtime and casual workers payments, could be involved in some fraudulent activities.

Required:

- (a) Describe three objectives of a forensic investigation. (3 marks)
- (b) Explain the procedure you would follow to gather evidence on the suspected payroll fraud. (12 marks)
- (c) Assess how the code of ethics for professional accountants should be used in the provision of the forensic investigation service to Afrokeen Manufacturers Ltd. (5 marks)

(Total: 20 marks)

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KASNEB

CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

PILOT PAPER

September 2015.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

- (a) Your audit firm has tendered for the audit of Hekima Group of Companies.

Required:

Evaluate six matters that should be considered before accepting the audit engagement in the event your firm is successful in the tender. (6 marks)

- (b) You are an audit manager in Hasibu and Co. working on the audit of Safari Group (The Group), whose financial year ended on 31 March 2015. This is the first time you have worked on group audit. The draft consolidated financial statements recognise profits before tax of Sh.600 million (2014 - Sh.900 million) and total assets of Sh.900 million (2014 - Sh.820 million). The group manufactures equipment used in telecommunication industry.

Goodwill of Sh.100 million is recognised in the group statement of financial position having arisen on several business combinations over the last few years. An impairment review was conducted in March 2015 by the group finance director, from which an impairment of Sh.5,000,000 is to be recognised in respect of goodwill.

The group finance director has prepared a file documentation to support the results of the impairment review, including notes on the assumptions used, his calculations and conclusions. He made the following comment:

"I don't think you need any evidence other than that contained in my file. The assumptions used are straightforward, so you need to look into them in detail. The assumptions are consistent with how we conducted impairment reviews in previous years and your firm has always agreed with the assumptions used; so you can check that back to last year's audit file. All of the calculations have been checked by the head of group internal audit department".

The group finance director has also informed you that two members of the sales team are suspected of paying bribes in order to secure lucrative customer contracts. The internal audit team were alerted of this when they were auditing cash payments and found significant payments to several new customers being made prior to the contract being signed. The Director has asked if Hasibu & Co. could perform a forensic investigation into the alleged bribery payments.

Required:

- (i) Discuss how professional skepticism should be applied to the statement made by the group finance director. (2 marks)
- (ii) Explain the principal audit procedures to be performed on the impairment of goodwill. (6 marks)
- (iii) Recommend two procedures to be used in performing a forensic investigation on alleged bribery payments. (6 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Define the term "environmental matters" and discuss the implication environmental matters have on company's financial statements. (6 marks)
- (b) You are the audit manager of Kilimanjaro Co., a company which designs and manufactures aircraft engine parts. The audit of the financial statements for the year ended 31 December 2015 is nearing completion and you are reviewing the papers addressing the going concern section of the audit file. The draft financial statements recognise a loss of Sh.50 million (2014 - profit Sh.76 million) and total assets of Sh.138 million (2014 - Sh.144 million).

The audit senior has left the following note for your attention:

"I have performed analytical review on Kilimanjaro Co's year end financial statements. The current ratio is 0.8 (2014 - 1.2), the quick ratio is 0.5 (2014 - 1.6). The latest management accounts show that ratios have deteriorated further since the year end, and the company now has a cash balance of only Sh.2,500,000. Kilimanjaro Co. has a long-term loan outstanding of Sh.8 million with a covenant attached, which states that if the current ratio falls below 0.75, the loan can be immediately be recalled by the lender.

You are also aware that one of the Kilimanjaro Co.'s best selling product Mofire, has become technically obsolete during 2015 as customers now prefer more environmentally friendly engine parts. Historically the Mofire has generated 45% of the company's revenue. In response to customers preference, Sh.130m has been spent on designing a new product G-fire, due to launch in February 2016 which will be marketed as an environmentally friendly product.

A cash flow forecast has been prepared for the year ending 31 December 2016, indicating that based on certain assumptions, the company cash balance is predicted to increase to Sh.22 million by the end of the forecast period.

Assumptions include:

1. Successful launch of the G-fire product.
2. The sale of plant and machinery which was used to manufacture Mofire generating cash proceeds of Sh.0.5 million, forecast to take place in January 2016.
3. A reduction in payroll costs of 15%, caused by redundancies in the Mofire manufacturing plant.
4. The receipt of grant of Sh.300,000 from a government department which encourages innovation in environmentally friendly products, scheduled to be received in February 2016.

Required:

(a) Explain the matters which cast doubt on the going concern status of Kilimanjaro Co. (6 marks)

(b) Explain the audit evidence you should expect to find in your file review in respect of the cash flow forecast. (8 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Kenya Lab Instruments Ltd. is an established manufacturing company producing laboratory instruments. The following extracts are from the company's final draft statement of financial position and income statement for the year ended 30 April 2015.

Income statement:

	Year 2015 (Sh.000)	Year 2014 (Sh.000)
Sales	351,760	378,845
Gross profit	<u>243,993</u>	<u>286,505</u>
Net profit	<u>40,076</u>	<u>38,773</u>

Statement of financial position:

Fixed Assets:

Cost	183,060	176,400
Accumulated depreciation	<u>(114,993)</u>	<u>(105,840)</u>
	<u>68,067</u>	<u>70,560</u>

Current Assets:

Stock	185,336	86,111
Debtors	<u>67,627</u>	<u>63,141</u>
	<u>252,963</u>	<u>149,252</u>

Current Liabilities:

Creditors	20,691	17,379
Overdraft	<u>95,461</u>	<u>37,634</u>
	<u>116,152</u>	<u>55,013</u>
Net Assets	<u>204,878</u>	<u>164,799</u>

The following issues arose during the audit assignment of which you are the manager:

1. Sales during the second half of the year were 40% below those in the first half.
2. Kenya Lab Instruments Ltd.'s main competitor Focus Instruments Ltd. has launched a new range of specialist equipment causing Kenya Lab Instruments Ltd.'s forward orders to fall significantly.
3. The current overdraft limit is Sh.700 million.
4. Plant and machinery costing of Sh.40 million, is fully depreciated and the production director advises that new machinery must be acquired within one year to avoid incurring excessive repair costs.

Required:

A file memorandum reviewing the above results and information and raising any issues which need to be resolved prior to the signing of the audit report. (10 marks)

- (b) There are specific regulatory obligations imposed on accountants and auditors in relation to detecting and reporting money laundering activities.

You have been asked to provide a training session to the new audit juniors on the auditor's responsibilities in relation to money laundering.

Required:

- (i) Explain the term "money laundering". Illustrate your explanation with examples of money laundering offences including those which could be committed by an accountant. (5 marks)
- (ii) Explain the policies and procedures that a firm of Certified Public Accountants should establish in order to meet its responsibilities in relation to money laundering. (5 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) Your firm audits H-Pound Ltd., a recognised East Africa's premier engineering construction and infrastructure company that undertakes construction contracts which include roads, bridges, warehouses, factories and offices. H-Pound Ltd. customers include governments and businesses. Recent cut-backs in local government expenditure have resulted in fewer contracts being started this year than budgeted.

The statement of accounting policy for construction contracts in H-Pound financial statements provides as follows:

"Revenue is recognised using the percentage of completion method, calculated on the basis of costs incurred as a percentage of expected costs.

"Anticipated losses are provided for in full as soon as the possibility of loss is forecast".

Direct costs attributed to specific contracts include:

- Architect's design costs, legal fees and engineering assistance.
- Material issued to site.
- Site supervision (apportioned foreman's salaries).
- Site labour costs (allocated from the payroll and subcontractors invoices).
- Costs of hiring suitable building and leasing plant and equipment.
- Depreciation of plant, equipment and vehicles.
- Transportation costs of resources such as materials between sites.
- Insurance and telephone.

Indirect expenses incurred by H-Pound Ltd.'s head office which relates to construction activities are attributed to the project at 70% of direct costs.

Last year, your firm qualified the auditor's report due to lack of evidence to support the client's schedule of estimated costs to completion.

During the year, a quantity surveyor joined the client's management team to undertake the following:

1. Supervise monthly physical counts at the major construction sites.
2. Monitor costs to date against the monthly rolling budget.
3. Prepare year-end schedules by contract of total cost of completion (that is direct costs incurred to the balance sheet date, attributable overheads and estimated costs to completion).

You are satisfied that the quantity surveyor is appropriately qualified and experienced.

Required:

- (i) Explain the principal audit risks to be considered when placing the approach to the final audit for the year ending 30 September 2015. (10 marks)
 - (ii) Explain the nature and extent of reliance which you should seek to place on the work of the quantity surveyor. (5 marks)
 - (b) Explain the factors which have contributed to the increased number of lawsuits against auditors from third parties in recent years. (5 marks)
- (Total: 20 marks)**

QUESTION FIVE

Public sector auditing refers to the examination of and control of government receipts and payments with a view of assessing the benefits derived from the use of public property, utility or service and evaluate level of responsibility and accountability of government officers to the electorate.

The audit exercise is governed by professional norms of independence, competence and due care and it draws its mandate from the constitution. The client is in principle the government comprising the executive office, ministries, the treasury, county governments, independent departments and government executed projects.

Required:

- (a) Describe the comprehensive process in public sector audits. (4 marks)
 - (b) Briefly describe two main elements of public sector audits. (4 marks)
 - (c) Outline the status, functions and powers of the Controller and Auditor General. (12 marks)
- (Total: 20 marks)**
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