



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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