

# 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.

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:**

- (a) 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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