



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 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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