



**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 21 August 2024. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

(a) XYZ Auditors is a medium-sized audit firm that has been operating for over 15 years. The firm has a diverse client base that includes small and micro enterprises, non-profit organisations and publicly listed companies. Recently, XYZ Auditors experienced the following issues that indicate deficiencies in the quality management system:

1. The firm faced regulatory scrutiny and legal action due to a significant audit failure that involved a publicly listed client, Beta Ltd. The regulatory scrutiny revealed material misstatements in the financial statements that were not detected during the audit process.
2. Several cases were reported where auditors had close relationships with key personnel of clients' organisations, likely comprising the auditors' independence and objectivity.
3. Meanwhile, many audit staff had not received sufficient training on recent changes in auditing standards and new regulatory requirements.
4. The firm often struggled with resource allocation, resulting to audit staff being overburdened and rushed audits, which led to the quality of audits being compromised.
5. Inconsistencies in audit documentation coupled with lack of sufficient audit evidence to support conclusions reached in several audit engagements was also noted.

The above issues have prompted the firm's top management to consider implementing International Standard on Quality Management 1 (ISQM1) to enhance their quality management system and address these deficiencies.

**Required:**

Analyse **SIX** components of ISQM1 that XYZ Auditors should focus on to address the issues raised to comply with the standard. (6 marks)

(b) International Standard on Auditing (ISA) 520, "Analytical Procedures", requires auditors to perform analytical procedures at various stages of audit risk assessment.

**Required:**

- (i) Explain **FIVE** objectives of performing analytical procedures as part of audit risk assessment. (5 marks)
- (ii) Highlight **THREE** limitations of performing analytical procedures at the planning stage of the final audit. (3 marks)

(c) You are a senior auditor in the audit of Bayeti Ltd., a medium-sized company which sells a limited range of industrial products. While performing reviews on Bayeti Ltd.'s audit files, you have noted that a number of creditors have withdrawn their financial support to your client and that your client has defaulted on a number of loans. The working papers conclude that the going concern assumption is inappropriate and recommends that a note explaining the cash flow challenges your client is facing be included in the financial statements. However, the directors are reluctant to include the note in the financial statements.

**Required:**

In each case, discuss **THREE** implications on the audit report if:

- (i) The directors refuse to disclose the note. (3 marks)
- (ii) The directors agree to disclose the note. (3 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Tech Innovators Ltd. is a 2-year-old startup seeking to attract significant venture capital investment. Your firm has been appointed by Tech Innovators Ltd. to conduct a due diligence investigation. You are the partner responsible for the audit of Tech Innovators Ltd. The due diligence process involves reviewing the prospective financial information provided by the client and also a social and environmental audit to assess the company's compliance with sustainability practices.

**Required:**

- (i) Describe **FIVE** areas of interest you could consider in evaluating the prospective financial information relevant while conducting the due diligence process. (5 marks)
- (ii) Analyse **FIVE** factors you might consider while undertaking the social and environmental audit. (5 marks)

- (b) You are the Audit Manager of Maharabu and Maharabu Associates, a firm of Certified Public Accountants, responsible for the audit of Madeni Ltd. You are currently reviewing the working papers of the audit for the year ended 31 December 2023. While reviewing the working papers on the payroll with the audit junior, he mentioned the following:

“A number of new employees were hired during the year, with Sh.1.35 million being paid to them. No documentation is available to show that the board had authorised the hiring of additional members of staff. When I questioned the payroll supervisor, she mentioned that she made the additions. She said that no authorisation was required from the board, because the new employees were hired on a temporary basis. Conversely, when making enquiries about the staffing levels from the management, it was stated that no new employees had been taken on board for the year under review”.

Other than the tests of controls planned, no other audit work has been performed.

**Required:**

- (i) Explain the meaning of the term "professional skepticism". (2 marks)
- (ii) In relation to the audit of Madeni Ltd.'s payroll, recommend **FOUR** actions that should be taken by the auditor. (8 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) You are the Audit Manager of Mateo and Associates, a firm of Certified Public Accountants who are the auditors of Miradi Group of Companies Ltd. for the year ended 31 December 2023. Miradi Group of Companies Ltd. is a financial services company. The group has three subsidiaries namely; Kasi Ltd. which provides capital markets services, Taurus Ltd. which provides brokerage, investment and wealth management services and Gold Crowns Ltd. which undertakes asset management and other related services. The year-end is almost complete and the following matters have been raised by the audit senior for your attention:

1. Kasi Ltd. is experiencing going concern problems as noted during this year's audit. Unless it secures the prospected loan from the bank to finance a contract already won, Kasi Ltd. will be unable to continue in operation in the foreseeable future. No disclosure of the going concern problems have been made.

The audit senior has suggested that, due to the seriousness of the situation, the audit opinion should be qualified 'except for'.

2. Taurus Ltd. has changed its accounting policy on buildings from cost model to revaluation model. No disclosure of this change has been given in the financial statements. The carrying amount of the premises in the statement of financial position as at 31 December 2023 is the same as at 31 December 2022. The buildings figure is material in the context of the financial statements. The audit senior is satisfied with the carrying value of the buildings in the statement of financial position.

The audit senior has concluded that a qualification is not required but suggests that attention can be drawn to the change in accounting policy by way of an emphasis of matter paragraph.

3. The directors' report of Gold Crowns Ltd. states that the company's revenues have grown from 1.2 % to 4% in the last one year. However, analytical review procedures revealed that revenues had only grown by 1.65 %. The audit senior is satisfied that the revenue figures are correct.

The audit senior has noted that an unmodified opinion should be given as the audit opinion does not extend to the directors' report.

**Required:**

For each case mentioned above:

- (i) Comment on the appropriateness or otherwise of the audit senior's proposals regarding the auditors' reports. (3 marks)
- (ii) Where you disagree, indicate what audit modification (if any) should be given instead. (6 marks)
- (b) You are the audit engagement partner in the audit of Alina Ltd. An audit trainee assigned to you is considering ending his internship programme after he learnt that auditors are potentially liable for both criminal and civil offences in the conduct of an audit.

**Required:**

- (i) Citing relevant examples in each case, distinguish between auditors "criminal liability" and "civil liability". (6 marks)
- (ii) Highlight **FOUR** conditions that the company must prove under criminal liability in order to succeed against the auditor in damages. (5 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Auditor independence is part of the foundation of the auditing profession. An independent, reliable and ethically sound audit gives a company credibility and allows the public to trust in the accuracy of the results and the integrity of the accounting profession.

With reference to the Institute of Certified Public Accountants of Kenya (ICPAK) ethical guidelines, justify **FIVE** reasons why professional independence is considered important to the auditor. (5 marks)

- (b) You are a senior auditor in the audit of Jasiri Ltd., a medium sized manufacturing company. The audit of the financial statements for the year ended 30 June 2024 is almost complete and you are reviewing the audit files for the period. The following issues have prompted the senior auditor to call for a meeting with the client's top management to be held in a weeks' time:
1. There were questions concerning the accuracy of the depreciation charged in the financial statements and a preliminary investigation revealed that the computerised accounting system had failed to compute depreciation of equipment correctly resulting to an overstatement of the depreciation value by Sh.780,975. The book value of the equipment had been overstated by Sh.1,128,340. The equipment value for the year ended 30 June 2024 was Sh.7,135,725.
  2. At the beginning of the year 2024, the company had issued a loan to Sarah Hagoi, one of the members of the top management, amounting to Sh.500,000. On further examination of the records, it was discovered that the loan had not been disclosed in the financial statements because it was considered immaterial.
  3. During the year ended 30 June 2024, the company made a reduction on its provision for customer warranties recognised in the financial statements. During the past two years, the provision has been made at the rate of 10% of sales for three months. The management has however decided to reduce it to 5% on the claims that the quality assurance processes had improved and therefore customer warranty claims were likely to reduce. Further investigations however revealed that warranty claims have by far remained the same as in previous periods.

**Required:**

- (i) Discuss how the auditor would be expected to treat each scenario mentioned above for the purpose of reporting. (9 marks)
  - (ii) Propose how you would treat each scenario mentioned above in the auditors report assuming the management of Jasiri Ltd. does not correct the misstatements. (6 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Discuss the audit supervisor’s responsibilities in relation to supervision of the audit assistants work during the audit of financial statements. (4 marks)
- (b) In the context of audit assurance engagements, describe how “attestation engagements” differ from “direct reporting engagements”. (4 marks)
- (c) Artificial intelligence (AI) is often described as ‘an evolving technology’ that is equipping computer systems with something akin to human intelligence.

**Required:**

With reference to the above statement, argue **TWO** cases for and **TWO** cases against the use of artificial intelligence in the audit practice. (4 marks)

- (d) Evaluate **FOUR** differences between “forensic audit” and “historical audit” of financial statements. (8 marks)
- (Total: 20 marks)**
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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 24 April 2024. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

(a) You are the audit manager of Gabriel and Moses Associates, a firm of Certified Public Accountants, responsible for the audit of Saforer Ltd. The draft financial statements reported a profit of Sh.13,000,000 for the year ended 31 December 2023. The audit for the year-end is almost complete and the following matters have been raised by the audit senior for your attention:

1. On 2 November 2023, a major customer went into receivership. The balance owing from the customer was Sh.2,800,000 as at 31 December 2023. This amount has been included in the accounts receivable figure in the year-end financial statements.
2. A former employee sued Saforer Ltd. for unfair dismissal during the month of December 2023. The company's lawyers estimate that damages amounting to Sh.65,000 are probably payable. A note has been included under the notes to the accounts describing the legal claim and the estimated damages. However, no adjustment has been made to the financial statements to recognise the probable loss.

After discussing the above matters with the management of Saforer Ltd, the managers decided not to adjust their financial statements. The audit senior then drafted the audit report. The following is an extract of the audit report:

**Basis for opinion and disclaimer of opinion**

We have performed our audit based on a materiality level of Sh.1,650,000. Our audit procedures have confirmed conclusively that trade receivables are materially misstated. The Finance Director, Philip Majuto, has refused to make an adjustment to write off a material trade receivable balance. Therefore, in our opinion, the financial statements of Saforer Ltd. are materially misstated and we therefore express a disclaimer of opinion.

**Emphasis of matter paragraph**

Saforer Ltd. is facing a legal claim for Sh.65,000 from a former employee. In our opinion this amount should be recognised as a provision in the financial statements of which this has not been done. We draw our attention to this breach of International Financial Reporting Standards (IFRSs).

**Required:**

Using the proposed audit report extract for the year ended 31 December 2023, evaluate **FIVE** matters that are not correctly presented in the report. (10 marks)

(b) You are an audit manager in Koki and Kioko Associates, a firm of Certified Public Accountants with five offices and 14 partners. 70% of the clients of Koki and Kioko Associates are audit clients and 30% are clients that Koki and Kioko provides with taxation services, accounting services and business advisory services. The firm is exploring ways of expanding business to boost its revenue. The business development manager at Koki and Kioko Associates has come up with the following two proposals to increase brand visibility and attract new clients:

- (i) An advertisement can be placed in two National Newspapers to attract new clients. The draft advertisement given to you reads "Koki and Kioko Associates is the largest and the most professional accountancy and audit services provider in the country. We offer a wide range of services in addition to audit which are guaranteed to improve your business efficiency and save on tax. If you are dissatisfied with your auditor, we can offer a second opinion on the report that has been issued. For all new clients we have an introductory offer of 30% discount when both audit and other services are provided. Our rates are approved by the Institute of Certified Public Accountants of Kenya (ICPAK)".

- (ii) A new experienced partner in the banking sector has joined Koki and Kioko Associates. The business development manager has proposed that the partner should specialise in offering corporate finance services to clients. Specifically, the partner should advise the clients on how to raise finance through debt and would negotiate with the client's bank or the finance provider on behalf of the client. The fee charged for this service will depend on the client obtaining finance.

**Required:**

For each of the proposals given by the business development manager, advise the partners at Koki and Kioko Associates on **FIVE** potential ethical and professional issues that could arise. (10 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Explain **THREE** steps in the process of conducting a forensic audit. (6 marks)
- (b) Describe **EIGHT** matters highlighted by International Standard on Auditing (ISA) 210 to which an audit engagement letter might make reference. (8 marks)
- (c) According to International Standard on Auditing (ISA) 550, "Related Parties", certain relationships, such as parent and subsidiary, investor and investee may be clearly evident. However, determining the existence of other related party relationships requires the application of specific audit procedures. The auditor could also devise detailed procedures intended to provide guidance for identifying material transactions with parties known to be related and for identifying material transactions that may be indicative of the existence of previously undetermined relationships.

**Required:**

Suggest **SIX** audit procedures that could be relied upon to ascertain the existence of related parties. (6 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Thermotech Boilers is an engineering company specialising in designing, fabricating, supplying, installing and servicing of boilers, incinerators and steam systems. The company has eight production plants in different parts of the country. The production process is capital intensive and requires a broad range of plant and equipment.

The finance director is responsible for the preparation of a detailed annual budget for property, plant and equipment (PPE) which is based on a five-year budget and approved by the board of directors after consultation with the audit committee. Once the budget is approved by the board it is held in a computer file, which is the basis of any purchase order. When equipment is delivered to the company, a pre-numbered goods received note (GRN) is raised and a copy is sent to the accounting and finance department. This note is used to update the PPE budget to reflect the movement. The equipment is carefully inspected by the production personnel and tested if operating properly. An operational certificate is prepared by the production department and is used by the accounting and finance department together with the GRN to check against the purchase invoice when it is received. At the same time as the purchase invoice enters the purchases system, the computerised PPE register is updated. Access to the PPE register is restricted to the personnel in the accounting and finance department. On a regular basis throughout the year, the PPE register is compared to plant and equipment on site by the accounting personnel using identification numbers in the register and permanently marked on to each item in the factory. The internal audit department also tests on a sample basis the operation of the system from the budget preparation to entry in the PPE register. Internal audit staff also compare a sample of entries in the PPE register with the equipment in the factories.

As part of your work as external auditors, you have reviewed the PPE audit programme of the internal auditors and come to the conclusion that the basis of their testing is a representative sample of purchases invoices.

**Required:**

- (i) Identify **THREE** strengths in Thermotech Boilers control environment in the area of PPE and explain how each of the strengths reduces the control risk. (6 marks)
- (ii) Citing **FOUR** reasons, explain why testing of a representative sample of purchases invoices to prove completeness of PPE records is not sufficient. (4 marks)
- (b) When auditing consolidated financial statements, the auditor pays close attention to accounting policies as they have a significant impact on the presentation and disclosure of financial information.

**Required:**

Discuss **FIVE** areas of interest by an auditor in relation to the accounting policies related to consolidated financial statements. (10 marks)

**(Total: 20 marks)**

#### QUESTION FOUR

- (a) You are the audit engagement partner in the audit of Cologne Ltd. You have an audit trainee assigned to you who has read the notes taken at your meeting with the managing director of Cologne Ltd. The audit trainee is seeking to know from you the implications of corporate social responsibility (CSR) expenditure being disclosed as a different figure in the financial statements compared with other information published in the annual report.

**Required:**

Describe **FOUR** actions that the auditor could take if the figure relating to the CSR expenditure disclosed in the financial statements is different from the other information published in the annual report and the management has not amended this even after the matter having been highlighted to them. (4 marks)

- (b) Discuss **FIVE** factors that might have led to increased litigation against auditors. (10 marks)
- (c) International Standard on Auditing (ISA) 570, “Going Concern”, provides examples of events that individually or collectively might cast significant doubt on the going concern assumption.

**Required:**

Summarise **SIX** events that individually or collectively might cast significant doubt on the going concern of an organisation. (6 marks)

**(Total: 20 marks)**

#### QUESTION FIVE

- (a) The anti-money laundering responsibility of accountants has become more significant in recent years. This is due to increased organised crime activities, making it necessary for governments around the world to initiate and implement actions aimed at preventing money laundering activities.

**Required:**

- (i) Explain the term “money laundering”. (2 marks)
- (ii) Using illustrations, describe **FOUR** money laundering offences, including those which could be committed by an accountant. (4 marks)
- (b) Bizmogul Ltd., a manufacturer of tyres, is an audit client of Weste and Associates, a firm of Certified Public Accountants. The financial year of Bizmogul Ltd. ended on 30 June 2023. The audit report and the financial statements were to be signed on 14 September 2023. The following additional information on two material events were brought to the attention of the auditor:

**Event 1 – Occurred on 15 July 2023**

A new type of tyre innovated by Bizmogul was found to be defective and hence unsafe for use. No sales had been made as the product was scheduled to be launched towards the end of September 2023. The company had an insurance cover for inventories. The affected inventory was estimated to be worth Sh.1,500,000 and was included in the finished goods as at 30 June 2023. The insurers estimated the affected inventory to be worth Sh.500,000. The insurance company did not want to pay for the loss in the value of inventory as the company’s inventory was under insured.

**Event 2 – Occurred on 8 August 2023**

The equipment used for vulcanisation of rubber got damaged. Leakage of harmful gas into the atmosphere occurred. The environmental agency is investigating the extent of the emission and the breach of environmental legislation arising thereof.

**Required:**

For each of the events, Event 1 and Event 2:

- (i) Explain whether the event is adjusting or non-adjusting according to International Accounting Standard (IAS) 10, “Events after the Reporting Period”. (4 marks)
- (ii) Discuss the auditor’s responsibility and the audit procedures that should be carried out. (6 marks)

- (iii) Assume that the date is 30 September 2023, and the financial statements and the audit report have been signed. The annual general meeting is to take place on 25 October 2023. The environmental agency has issued a report stating that Bizmogul Ltd. is in breach of environment regulations and a fine of Sh.2,000,000 will be imposed on the company. The amount is material to the financial statements.

**Required:**

Discuss **FOUR** additional audit procedures that might need to be performed with respect to the fine.

(4 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 6 December 2023. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

- (a) You are the Audit Manager of Baraka and Company LLP, who are the auditors of Miradi Ltd. for the year ended 30 June 2023. The company has net assets of Sh.150 million. The audit has been completed but there is a matter that has not yet been resolved on depreciation of buildings. The directors of Miradi Ltd. have resolved that depreciation on buildings will not be provided for in the financial statements. The buildings were acquired in the year 2020 and no depreciation has been provided since.

**Required:**

- (i) Describe **SIX** additional audit procedures and actions that you could take with respect to the above matter. (6 marks)
- (ii) Assume that, according to your workings, the depreciation charge on the buildings for the year ended 30 June 2023 should be Sh.4,200,000 based on the straight line method of depreciation at an annual rate of 5%.

**Required:**

Discuss the implications of the above on the financial statements, clearly indicating its effect on the audit report. (8 marks)

- (b) Explain **SIX** audit risks associated with the audit of financial instruments. (6 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) The following is an extract from a speech presented in a recent professional forum:

“In the private sector, going concern is an area of interest to users of financial statements. Shareholders and lenders wish to know that a business will continue into the foreseeable future before they can make investment or lending decisions.

The going concern concept in the public sector differs from that in the private sector. This is because most public bodies, whether government departments, devolved administrations, local public bodies or national funds have a statutory existence that makes technical insolvency almost impossible.

Despite that, stakeholders in the public sector still have an interest in knowing whether these institutions are financially sustainable.”

**Required:**

In the context of the above statement, discuss **EIGHT** factors that an auditor would consider in determining the going concern assumption of a public entity. (8 marks)

- (b) Describe **FOUR** procedures that an auditor might perform to identify subsequent events occurring after the financial year end in a company. (4 marks)
- (c) Your audit firm, KKCO LLP, has been the auditor of Express Ltd., a leading online retailer that was established a few years ago. At inception, the company had an average delivery time of a week, but has since grown to an average delivery time of between one and five days. The company started with three employees and has grown to 1,000 employees including a 150 customer service team who are available 7 days a week.

It has emerged that an employee stole Sh.20 million by manipulating vendor payment records pointing to the risk of fraud facing their trading platforms.

**Required:**

Prepare a proposal to the directors of Express Ltd. explaining:

- (i) The need for an internal audit function in the company. (4 marks)
- (ii) The benefits of outsourcing the internal audit function. (4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Compumax Ltd. is one of your audit clients for the year ended 30 June 2023. The company has followed generally accepted accounting principles and had a conservative approach to recognising revenue from its software application sales. Revenue was recognised only when the product was delivered to the customer.

Due to increased competition leading to a declining market share, the Chief Executive Officer (CEO) of the company has put pressure on the Chief Finance Officer (CFO) to find ways to improve the company's financial performance and boost revenue numbers. In reacting to the pressure, the CFO decided that the new policy will be that revenue from software application sales could be recognised as soon as the contract was signed, regardless of the product's actual delivery to the customer. The CFO did not disclose the change in policy. With the new policy, the company started recognising revenue from software application sales immediately after contract signing, artificially inflating the company's revenue figures. This allowed the company to present a more favourable financial status, potentially increasing the share price and attracting new investors.

**Required:**

With reference to the above scenario:

- (i) Describe **THREE** circumstances under which a change in accounting policy is permissible. (3 marks)
  - (ii) Summarise **THREE** disclosures that could be made in the financial statements regarding the change in accounting policy. (3 marks)
  - (iii) Discuss **FIVE** audit procedures that are necessary where an entity has changed an accounting policy. (10 marks)
- (b) The question on whether a change constitutes a change in policy or a change in estimate has been a major source of discussion among accountants and auditors.

**Required:**

Distinguish between a "change in accounting estimate" and a "change in accounting policy". (4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) During the audit of the financial statements of WX Company Ltd. for the year ended 31 December 2022, the auditors realised that new information that had not been accounted for when the management prepared the financial statements had come to their notice as follows:

1. A court case in which a customer had sued the company for goods that got lost in transit from one of the company's stores was decided against the company. Although the company had made a provision for a refund of the deposit paid on the goods, the court also awarded the customer the costs of the suit and general damages. The total amount payable now exceeds the provision.
2. A customer who owed the company a substantial amount of money and had been having problems paying has had to close business after his bank, from which he had obtained a loan, petitioned for liquidation of the business. Although he had invested the bank loan in a building project, the building had stalled before completion. The materials purchased from WX Ltd. had already been used in the project which the bank has attached as a collateral for their loan. WX Ltd. may never be paid the balance on this account.
3. Due to the rapid fluctuations in the foreign exchange rate, the directors feel that some of the inventory purchased earlier would not be replaceable if sold on the basis of their initial import cost and have suggested a revaluation of the inventory as a way of safeguarding the business from possible losses.

**Required:**

In each of the situations explained above, discuss the auditor's advice to the management of WX Company Ltd. in order to minimise the risk of material misstatement resulting from these events. (6 marks)

- (b) In conducting the audit of historical financial statements, the auditor's objective is to obtain sufficient appropriate audit evidence on which he forms an opinion about the financial statements as a whole and report that opinion to the shareholders.

**Required:**

Describe the auditor's objectives when undertaking:

- (i) An examination of prospective financial information. (3 marks)
- (ii) A financial due diligence assignment. (3 marks)
- (c) To succeed in business in the modern world, every company must consider investing in some form of Information Technology (IT). The companies that do not have their own systems still have to protect themselves from cyber criminals whenever they use computer systems even for simple communication within and without the organisation. To ensure the security of this computerised information, companies have had to invest in controls that ensure protection and integrity of their data. IT general controls are the most common controls because they are capable of preventing data theft, stop unauthorised access, reduce operational disruption and stop data breaches.

**Required:**

- (i) Explain how the IT general controls protect the company and its information systems from risk. (4 marks)
- (ii) Explain the best practice for implementing IT general controls. (4 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Solar Power Limited (SPL), an international company, sells solar panels subject to a warranty of one year. Included in the statement of financial position of SPL is a warranty provision of Sh.100,000,000. The director who owns 70% of the shares in the company is the one who estimates the cost of repairing defective solar panels reported by dissatisfied customers. The estimate from the director forms the basis of the provision.

This is your first audit of SPL whose turnover in the previous year was Sh.10 billion compared to Sh.15 billion this year.

**Required:**

Explain the audit procedures that you would perform during the year in respect to the estimated warranty provision included in the statement of financial position for the current year. (8 marks)

- (b) (i) Explain **TWO** challenges that a small audit firm might face in implementing quality control procedures, recommending a measure that could be taken to overcome each challenge. (4 marks)
- (ii) Describe **FOUR** quality control procedures that are applicable to an audit engagement. (8 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 23 August 2023. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

- (a) CMP Ltd. is a production company that employs fifty workers. The company has the following payroll procedures:
1. The factory foreman interviews applicants and on the basis of the interview either hires or rejects them. When applicants are hired, they fill in an employees withholding exemption certificate (W-4 form) and forward it to the foreman. The foreman indicates the hourly rate of pay for the new employee in the W-4 form and then forwards it to a payroll clerk as notice that the worker has been employed. The foreman verbally advises the payroll department of any adjustments to the hourly rate of pay.
  2. A supply of blank time cards is kept in a box near the entrance to the factory. Each worker takes a time card on Monday morning, fills in his name and notes in pencil their daily arrival and departure times. At the end of the week, the workers drop the time cards in a box near the factory door.
  3. Each Monday morning, the completed time cards are taken from the box by a payroll clerk. One of the payroll clerks then records the payroll transactions using a computer system which captures all information for the payroll journal as calculated by the clerk and automatically updates the employees earnings records and general ledger. Employees are automatically removed from the payroll when they fail to return in a time card.
  4. The payroll cheques are manually signed by the chief accountant and given to the foreman. The foreman distributes the cheques to the employees and arranges for the delivery of the cheques to those who are absent. The payroll bank account is reconciled by the chief accountant, who also prepares the various payroll tax reports.

**Required:**

Discuss **SIX** deficiencies in CMP Ltd.'s internal controls with the associated risk for each deficiency. (12 marks)

- (b) You are the auditor of Flowermint Ltd., a company engaged in growing and exporting flowers. Assume that when you arrived at your client's office on 11 January 2023 to begin the audit for the year ended 31 December 2022, you discovered that the client had been drawing cheques as the creditors invoices became due but not necessarily mailing them. Because of a working capital shortage, some cheques may have been held for two or three weeks.

The client informs you that unmailed cheques amounting to Sh.27,600,000 were on hand as at 31 December 2022. He states that these December 2022 dated cheques had been entered in the cash disbursements book and charged to the respective creditors accounts in December because the cheques were prenumbered. Heavy sales collections permitted him to mail the cheques before your arrival.

The client wishes to adjust the cash balance and accounts payable as at 31 December 2022 by Sh.27,600,000 because the cash account had a credit balance. The client is also reluctant to reflect an overdraft in the financial statements.

**Required:**

- (i) Prepare a detailed audit program indicating the procedures you would use to satisfy yourself of the accuracy of the cash at bank balances on the client's financial statements. (5 marks)
- (ii) Discuss the propriety or otherwise of reversing the indicated amount of outstanding cheques as at 31 December 2022. (3 marks)

**(Total: 20 marks)**

## QUESTION TWO

- (a) An Audit Committee is established by a Board to provide an independent oversight of the organisation's system of internal control and financial reporting.

Describe **FIVE** specific roles and responsibilities of an Audit Committee. (10 marks)

- (b) Discuss **FIVE** types of audit opinions, specifying the circumstances under which each opinion may be ideal. (10 marks)  
(Total: 20 marks)

## QUESTION THREE

- (a) As an audit practitioner, you have been invited by your local accountancy institute to provide insights to aspiring accountants on audit engagements, review of financial statements and the distinction between these two engagements.

In the context of the above, prepare your explanatory notes on the following:

- (i) Purpose of review engagements in relation to financial statements. (3 marks)
- (ii) **THREE** features that distinguish review engagements from audit engagements in relation to financial statements. (6 marks)
- (iii) The main focus of reviews on:
- Value for money audits. (3 marks)
  - Social and environmental audits. (3 marks)
- (b) The following is an extract from a leading journal in auditing:

“The main responsibility of auditors is to report to the members on whether the financial statements of the company show a ‘true and fair view’ or ‘present fairly’ the financial position. Of course the report should consider whether management have kept proper accounting records and complied with recognised accounting framework. Responsibilities also applies when problems happen”.

In the context of the above statement, describe **FIVE** practical situations in which auditors may be held liable. (5 marks)  
(Total: 20 marks)

## QUESTION FOUR

- (a) According to the International Federation of Accountants (IFAC):

“Skepticism is not just at the heart of auditing, it is in the heart of most auditors, a fact that is not obvious to outsiders given the various calls for auditors to exercise more skepticism, particularly when the pressures of deadlines and budgets are brought to bear and doing the right thing becomes more of a challenge”.

Other experts have gone further to postulate that professional skepticism has three elements; attributes, mindset and action.

### Required:

- (i) Explain your understanding of each of the **THREE** elements of professional skepticism identified above. (6 marks)
- (ii) Describe any **THREE** auditable areas in which professional skepticism requires to be exercised. (3 marks)
- (b) (i) Explain the **THREE** components of audit risk. (3 marks)
- (ii) Analyse **FOUR** audit risk procedures that you would employ in a high-risk audit, identifying the sources of information under each procedure. (8 marks)  
(Total: 20 marks)

**QUESTION FIVE**

- (a) Exlink Commercial Bank is a mid-size bank with a large pool of customers seeking credit. The bank’s credit activities mainly comprise the following:
1. Origination and disbursement.
  2. Monitoring.
  3. Collection.

**Required:**

As the lead auditor of the bank, prepare a checklist of the key internal controls that you would expect under each of the three functions above. (12 marks)

- (b) The Government of your country has recently introduced performance contracting in the public sector with the objective of improving service delivery to the public. This has been largely achieved by ensuring the top-level managers are accountable for results and ensuring that resources are focused on attainment of key national policy priorities of the government.

Your audit firm has recently won a tender to audit the reliability of feedback provided by state corporations on achievement of performance contracting targets.

**Required:**

Describe the key audit procedures you would undertake to achieve the above audit objective. (8 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 26 April 2023. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

- (a) As the partner in charge of the internal quality review and control envisaged by International Standard on Quality Management (ISQCM) 1, you are required to prepare a brief for training the engagement team in your firm.

**Required:**

In light of the above statement:

- (i) Explain the difference between “assurance” and “non-assurance” services as provided by external auditors. (4 marks)
- (ii) Describe the work of the partner charged with the responsibility of driving the quality agenda in external audits. (4 marks)
- (iii) Discuss **FOUR** principal tenets of ISQM 1. (4 marks)
- (b) Describe the following audits and their relevance in modern audit practice:
- (i) Environmental audit. (4 marks)
- (ii) Forensic audits. (4 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) You are responsible for the audit of Spheres Ltd. and are currently reviewing the working papers of the audit for the year ended 31 December 2022. In the working papers dealing with payroll, the audit junior has commented as follows:

“A number of new employees have been added to the company’s payroll during the year, with combined payments of Sh.1.35 million being made to them. There does not appear to be any authorisation for these additions. When I questioned the payroll supervisor who made the additions, he said that no authorisation was needed because the new employees were hired on a temporary basis. Conversely, when making enquiries about the staffing levels from the management, it was stated that no new employees have been taken on this year. Other than the tests of controls planned, no other audit work has been performed”.

**Required:**

- (i) Explain the meaning of the term “professional skepticism”. (2 marks)
- (ii) In relation to the audit of Spheres Ltd.’s payroll, recommend further actions that should be taken by the auditor. (6 marks)
- (b) You are the manager responsible for the audit of four audit clients of M & Associates, a firm of CPAs. The year end in each case is 31 December 2022. You are currently reviewing the audit working paper files and the audit seniors’ recommendations for the auditors’ reports.

**Required:**

For each of the cases below, comment on the appropriateness or otherwise of the proposition of the audit senior regarding the auditors' reports. Where you disagree, indicate what audit modification (if any) should be given instead.

Details are as follows:

1. C Ltd. is experiencing going concern problems as noted during this year's audit. Unless it secures the prospected loan from the bank to finance a contract already won, C Ltd. will likely not continue operating in the foreseeable future. No disclosure of the going concern problems has been made.

The audit senior has suggested that, due to the seriousness of the situation, the audit opinion must at least be qualified 'except for'. (4 marks)

2. P Ltd. has changed its accounting policy on premises from cost model to revaluation model. No disclosure of this change has been given in the financial statements. The carrying amount of the premises in the statement of financial position as at 31 December 2022 is the same as at 31 December 2021. The premises figure is material in the context of the financial statements. The audit senior is satisfied with the carrying value of the premises in the statement of financial position.

The audit senior has concluded that a qualification is not required but suggests that attention should be drawn to the change by way of an emphasis of matter paragraph. (4 marks)

3. The directors' report of AC Ltd. states that the company's revenue has grown from 1.2 % to 4% in the last one year. However, analytical review procedures showed that revenues had only grown by 1.65%. The audit senior is satisfied that the revenue figures are correct.

The audit senior has noted that an unmodified opinion should be given as the audit opinion does not extend to the directors' report. (4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

You are the manager in-charge of the audit of Maridadi Fashions Ltd., a private company dealing in the import and sale of fashion wear. The company plans to seek a public quotation for its shares and is required to prepare a prospectus which must incorporate a report by the auditors of the company.

The directors intend to include a profit forecast in the prospectus. You have been approached by the securities exchange to report on the bases and calculations for the forecast.

**Required:**

- (a) Explain the preliminary considerations that you would take into account before you accept responsibility for reporting on the profit forecast. (6 marks)
- (b) Discuss the specific audit procedures that you would perform to ensure that the profit forecast is not misleading. (10 marks)
- (c) Describe the matters that you would include in your report. (4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

Lavenda Group has been a client of your Audit firm for several years. The group of companies specialises in production and sale of health food products. You are a senior audit manager responsible for the audit of the Lavenda Group. The group companies all have a financial year ended 31 December 2022. Your firm audits all components of the group with the exception of P Ltd. which was acquired during the year.

You are currently planning the final audit of the consolidated financial statements. Information about several matters relevant to the group audit is given below. These matters are all potentially material to the consolidated financial statements. None of the companies in the group is listed.



**Lavenda Ltd.**

This is a non-trading parent company, which wholly owns three subsidiaries: D Ltd., S Ltd. and P Ltd. all of which are involved with the core manufacturing and marketing operations of the group. This year, the directors decided to diversify the group's activities in order to reduce risk exposure. Non-controlling interests representing long-term investments have been made in two companies. In the consolidated statement of financial position, these investments are accounted for as associates, as Lavenda Ltd. is able to exert significant influence over the companies. As part of their remuneration, the directors of Lavenda Ltd. receive a bonus based on the profit before tax of the group. In April 2022, the group finance director resigned from office after a disagreement with the chief executive officer over changes to accounting estimates. A new group finance director is yet to be appointed.

**D Ltd.**

This company mills, blends, packages and distributes healthy flours and natural spices. During the year, the factory was extended by the self-construction of a new processing area, at a total cost of Sh.8 million which is material in the context of the company's financial statements as well as the Group. A loan of Sh.8 million with an interest rate of 5% per annum had been taken out to finance the construction. The construction took 6 months to complete and the new processing area was ready for use on 1 August 2022. The processing area began to be used on 1 November 2022. The estimated useful life of the extended factory is 15 years.

**S Ltd.**

This company's operations involve the manufacture and distribution of peanut butter and other bread spreads. S Ltd. is involved in a court case with a competitor, F Foods Ltd., which alleges that a design used in S Ltd. printed material copies one of F Foods Ltd.'s designs which are protected under copyright. A verbal confirmation was made from S Ltd. lawyers that a claim of Sh.2.5 million has been made against S Ltd., which is probable to be paid. S Ltd. has not made a provision.

**P Ltd.**

This company is a new and significant acquisition, purchased in June 2022. It is located in North Africa and has been purchased to supply peanuts and other ingredients for the goods produced by S Ltd. It is now supplying approximately half of the ingredients used in S Ltd. The country in which P Ltd. is situated has not adopted International Financial Reporting Standards, meaning that P Ltd.'s financial statements are prepared using local accounting rules. The company uses local currency to measure and present its financial statements.

P Ltd. is audited by a small local firm, ABC & Co, also based in North Africa. Assume that Audit regulations in that country are not based on International Standards on Auditing.

**Required:**

- (a) Evaluate the principal audit risks to be considered in your planning of the final audit of the consolidated financial statements for the year ended 31 December 2022. (6 marks)
- (b) Describe the procedures that should be performed in deciding the extent of reliance to be placed on the work of ABC & Co. (10 marks)
- (c) Recommend the principal audit procedures that should be performed on the classification of non-controlling investments made by Lavenda Ltd. (4 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

Your firm is the current auditor of Safi Limited, a renowned wholesale business. You have been asked to carry out audit checks on the cut off and verifying inventory quantities at the year end.

The company maintains the details of the inventory quantities on its computer. These inventory quantities are updated from the goods received notes and the sales invoices. The company carries out the inventory count each month when all the fast moving and high value inventory is counted, and a third of the remaining inventory is counted in rotation so that all the items are counted at least four times a year. You attended the inventory count on the second Sunday of October 2022 and a further inventory count on the first Sunday of November 2022.

The company's year-end was 31 October 2022 and the inventory quantities as at that date as shown by the computer had been used in the valuation of the inventory. No inventory was counted at the year end.

**Required:**

- (a) Describe the principal matters that you should have checked and the matters you should have recorded when you attended the company's inventory count on the second Sunday of October 2022. (8 marks)
- (b) Explain the checks you will perform in confirming the sales and purchases cut offs have been correctly carried out at the year end. (4 marks)
- (c) Discuss the work you will carry out to check that the book inventory records have been correctly updated from the inventory count. (4 marks)
- (d) Summarise the work you will carry out to satisfy yourself that the inventory quantities used in the relation of the inventory at the year end is correct. (4 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 7 December 2022. Morning Paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

- (a) The role of auditors in non-financial audits is increasingly coming under scrutiny. One such area of interest is in “green” audits, also referred to as environmental audits. A recent article in a leading accountancy journal highlighted this fact as below:

“In many jurisdictions, corporate auditors are not under any obligation to report to stakeholders of the entities on the impact of social and environmental issues. It is therefore important that regulators of the accountancy profession set prescribed and dedicated standards on social and environmental issues for auditors”.

Noting the above trends, the accountancy regulatory body in your country has engaged you to develop a discussion paper to guide policy on conduct of environmental audits by auditors.

**Required:**

Draft a discussion paper focusing on the following, clearly elaborating on each:

- (i) **FOUR** limitations of financial accounting in reflecting the social and environmental impact of organisations. (4 marks)
  - (ii) **THREE** objectives of environmental audits. (3 marks)
  - (iii) **SIX** information components that should be disclosed in an environmental status report. (6 marks)
- (b)
- (i) Describe **THREE** circumstances under which a professional auditor may reveal confidential information relating to the client. (3 marks)
  - (ii) “Independence threats” are likely to affect an auditor’s ability to comply with the fundamental principles of ethics.

**Required:**

With relevant examples, justify the above statement.

(4 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) During a recent seminar on adapting the audit approach to emerging technological changes, a presenter made the following statement:

“To ensure a successful audit of internet/mobile banking applications, the audit team must understand the business environment in which they are operating and the prevailing conditions such as regulatory requirements, business requirements and stakeholders’ needs. The audit team needs to put together a robust internet/mobile banking and electronic payment application audit program”.

**Required:**

With reference to the above statement, discuss **FOUR** areas of the internet/mobile banking applications and supporting information technology (IT) infrastructure that should be reviewed to confirm the adequacy of controls and ensure security of the applications. (8 marks)

- (b) Analyse **FOUR** ways in which auditors might reduce the risk of professional liability in their dealings with clients. (8 marks)
- (c) In the context of audit peer reviews:
- (i) Distinguish between a “systems review” and an “engagement review”. (2 marks)
- (ii) Citing reasons, explain the importance of peer review. (2 marks)
- (Total: 20 marks)**

**QUESTION THREE**

Jua Kali Motors Ltd. is a vehicle repair shop founded some years ago by Ms Faulu who owns all of the shares apart from a qualifying share held by her husband and co-director. She runs the workshop with the help of a foreman, five mechanics and a clerk cum typist. A quotation is issued for all jobs and about 80% of the work is on insurance accident claims. The insurance companies require typed, pre-numbered quotations and invoices for insurance work. For the very large claims and occasionally for smaller claims, the insurance companies bring in their own assessors to inspect the vehicles before authorising the repairs. Private work procedures are less formal and customers are required to pay before collecting their vehicles. Small stocks of parts and service material are held, but most parts are ordered as required and accounts maintained with spare parts suppliers.

Your firm of Certified Public Accountants prepares and audits the accounts and provides tax and other advice to Faulu Motors.

**Required:**

- (a) Discuss the audit procedures that you would perform to assess the internal controls operations and ultimately the reliability of financial reports. (10 marks)
- (b) (i) Citing **FOUR** reasons, justify to Ms. Faulu on why her company should continue to engage an auditor annually for audit of the business. (8 marks)
- (ii) Suggest an alternative to a full audit that Jua Kali Motors Ltd. could consider. (2 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

Achievers Holdings Ltd. is a non-trading holding company with several subsidiaries within East Africa. The company is based in Nairobi with investment holdings ranging from 75% to 100% in several subsidiary companies.

You are the audit manager responsible for the audit of the group accounts. One subsidiary company operating in Rwanda is audited by your firm through a branch office in Kigali. The other subsidiaries in Tanzania and Uganda are audited by other audit firms based in the respective countries.

Assume that the financial year end of Achievers Holdings Ltd. is 30 June, but the subsidiary companies based in Uganda and Rwanda are engaged in highly seasonal businesses, and have 31 March as their financial year end. The subsidiary company in Tanzania was acquired during the year ended 30 June 2022.

**Required:**

- (a) Describe the evidence you would expect to obtain in your review of the audit work undertaken in Rwanda, Uganda and Tanzania. (8 marks)
- (b) Following the completion of the subsidiary companies audits, discuss the matters that you would address in your review of the consolidated financial statements of Achievers Holdings Ltd. for the year ended 30 June 2022, with specific focus on:
- (i) General issues touching on consolidated accounts. (6 marks)
- (ii) Audit issues relating to subsidiaries with different year ends. (3 marks)
- (iii) Audit issues relating to the newly acquired subsidiary in Tanzania. (3 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

(a) Describe **TWO** risks that an auditor could face in the audit of each the following items:

- (i) Related party transactions. (2 marks)
- (ii) Construction contracts. (2 marks)
- (iii) Impairment. (2 marks)
- (iv) Contingent liabilities. (2 marks)

(b) You are the auditor of Saidia Development Trust (SDT), a not-for-profit entity supporting charitable activities. SDT has three major donors one of whom contributes over 80% of the entity’s budget.

The major donor has placed a condition that operating cost must not exceed 10% of the total budget. Funding from each of the donors is designated and restricted to specific projects. In some instances, donor funds have not been disbursed in time making it necessary for SDT to seek for bank overdrafts to continue meeting fixed costs and ongoing projects. The Executive Director has requested you not to mention the loans in the financial statements or management letter as the donors may raise concerns. Furthermore, the overdraft has been fully repaid by period end.

Two employees have sued SDT for wrongful dismissal and claimed Sh.10 million. In order to demonstrate to the courts that SDT does not have money to meet such a claim, Sh.11 million was withdrawn from the entity’s account and banked in the Executive Director’s personal account. The director is not ready to give you his bank statement as he claims it is personal.

In an effort to reflect that SDT is not overly reliant on the major donor, a material amount has been included as “other income”. This constitutes cash injections by the Executive Director from his own sources. In order to meet the 10% operating cost requirements, actual operating costs are understated materially by crediting them and debiting the director’s loan account.

Most expenses are paid by cash even though the SDT’s policy is that amounts beyond Sh.15,000 should be paid by cheque. To achieve this, two petty cash floats are maintained, one by the receptionist which is subject to stringent controls and general cash maintained by the Executive Director where no cash count is ever done and no independent control is exercised.

**Required:**

Prepare a memorandum to the non-executive directors of SDT detailing issues noted, their implications and how to correct them. (12 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 3 August 2022. Morning paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

The Basel Core Principles for Effective Banking Supervision, “Risk Management Processes” require that banks and banking groups must have comprehensive risk management processes, including Board and senior management oversight to identify, evaluate, monitor and control/mitigate all material risks and further to assess their overall capital adequacy in relation to their risk profile.

**Required:**

- (a) With reference to the above statements, discuss six components of an effective risk management programme for banks and similar institutions from an audit perspective. (12 marks)
- (b) Describe the specific responsibilities of the Board in overseeing an institution’s strategic risk management process. (8 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) Radar Ltd. is a large private company that organises conferences, meetings and celebrations for other companies. The company was set up ten years ago by S and J who are the majority shareholders. The company employs over 300 staff in its 25 offices.

Your firm, XYZ CPA, where you are the Manager - Business Advisory, has been hired to provide internal audit services to Radar Ltd. In discussing with S, you discover that there is a small audit team headed by W, a recently qualified accountant. Before heading the internal audit, W was a junior finance manager in the company. Members of the internal audit team at Radar Ltd. would be redeployed to the finance department once XYZ CPA starts provision of the internal audit services.

S has briefed you of many instances where management policies were ignored. In addition, J has recently discovered a fraud in one office whereby an accounts manager was authorising payments of invoices received from fictitious suppliers, with the payment being channelled to the accounts manager’s personal bank account.

**Required:**

- (i) Evaluate the benefits to Radar Ltd. from outsourcing its internal audit function. (3 marks)
- (ii) Explain the potential impact on the external audit of Radar Ltd. if the internal audit function is outsourced. (3 marks)
- (iii) Recommend procedures that could be used by XYZ CPA to quantify any financial loss suffered by Radar Ltd. due to the above fraud. (3 marks)
- (iv) Compare responsibilities of external auditors and of management in relation to the prevention and detection of fraud. (3 marks)
- (v) Assess two benefits and one limitation that may arise from setting up an audit committee in Radar Ltd. (3 marks)

- (b) You are in charge of the audit of Sawala Ltd. and are planning the audit of financial statements for the year ended 31 December 2021. Sawala Ltd. has suffered decline in sales and profits in the last two years mainly due to loss of key customers. Many of Sawala Ltd.'s non-current assets are impaired in value and substantial receivables have been written off in the last six months.

Sawala Ltd's. management have decided to restructure the business by reducing the manufacturing capacity by 75% and investing in new technology to make operations more efficient and widen the variety of components produced. Sawala Ltd. has applied for a bank loan to finance the restructuring. Without the loan, Sawala Ltd. is unlikely to restructure successfully raising doubts on its ability to continue as a going concern.

Your firm has been asked to advise on forecasts and projections that the bank would need to decide on the finance requested. Management has also requested your firm to attend a meeting with the bank during which the forecasts would be discussed.

**Required:**

Advise on ethical and other implications to guide your firm on the request to provide advice on forecasts and attend the meeting with the bank. (5 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Annalisa Keya is the financial controller of a leading church organisation in the country. Recently, the chief cashier in the church was suspended for misappropriating cash amounting to Sh.2 million over a period of six months.

The church's Board of Deacons and the Finance Committee are of the view that though Annalisa Keya was not directly responsible for the loss, she failed by not discovering the fraud in time. They have recommended her suspension and possible dismissal. There are also worries that, because of the high cash volumes transacted in the church, the risk of errors and fraud in cash management is significant.

Annalisa has suggested to the Board of Deacons and Finance Committee to engage an independent auditor to carry out an investigation.

Your audit firm has been invited to a preparatory meeting of the Board of Deacons as the potential auditor for the assignment.

**Required:**

- (i) Highlight the issues you would raise during this meeting regarding the entire investigation process. (4 marks)
- (ii) Describe the essential principles that you must observe to conduct an effective investigation. (4 marks)
- (iii) Recommend an effective internal control system for cash handled by the church. (4 marks)
- (b) Describe the factors to be considered by an auditor in assessing the inherent risk in an organisation. (4 marks)
- (c) Explain how audit files are archived and retrieved for a large organisation. (4 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Bandari Furniture Ltd. manufactures a wide range of domestic furniture. The main components of the furniture items are wood for the frames, foam filling for the cushions and fabric for the covering. The company's annual turnover is Sh.700 million while its stock at the end of the year ended 31 December 2021 was Sh.400 million. You attended the stock take and you were happy with the accuracy of the exercise.

The cost of raw materials and direct labour are calculated using the standard costing system while overheads are computed from the company's financial accounting records as a percentage of direct labour cost.

**Required:**

- (i) Describe the audit work that you would perform to check the standard cost per unit of a line of finished stock. Comment on how accurate this standard cost has to be. (3 marks)
- (ii) Explain the work that you would perform to confirm that the variances are being determined correctly. (3 marks)

- (iii) Comment on the overheads that you would include in the value of stock and those that you would not include, citing relevant examples. (2 marks)
  - (iv) State two variances that you would include and those that you would exclude when adjusting the value of stock from standard cost to actual cost. (2 marks)
- (b) You are the auditor of Zambezi Ltd., a manufacturer of handcrafts. 40% of the sales are exported to a foreign country. You are about to commence the audit of the accounts for the year ended 31 October 2021. Account receivables are included in the statement of financial position at the year end net of Sh.3,000,000 debt provision (5%) at Sh.57 million. In the past audits, there has been a poor response to the trade receivables circularisation and a decision has been taken not to circularise or circulate them this year. In an attempt to reduce the exposure to the foreign currency, Zambezi Ltd. sells 50% of the foreign currency trade receivable forwards.

**Required:**

- (i) Explain the substantive procedures that you would perform as an auditor to verify the accuracy of account receivables. (4 marks)
  - (ii) Describe the audit tests you would carry out in order to form an opinion on the doubtful debts provision and the action you would take if you concluded that it was materially misstated. (4 marks)
  - (iii) State what adjustment, if any, you would make to the foreign currency account receivables on the basis that they have all been recorded at the actual exchange rate ruling on the date of sale. (2 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Explain each of the following concepts, clearly indicating its impact on the work of auditors:

- (i) Environmental audits. (3 marks)
- (ii) Social reporting. (3 marks)
- (iii) Audit disengagement. (3 marks)
- (iv) Value for money audits. (3 marks)

- (b) Safari Company Limited is a manufacturing company that was established five years ago. The company has attained tremendous growth despite the stiff competition from other companies engaged in the manufacture of similar products. The company's management is concerned with reducing the harm that may result from fines and the compensation in case of violation of the environmental laws and regulations. At the same time, to maintain its market share, the company intends to give support to the community through social responsibility activities.

**Required:**

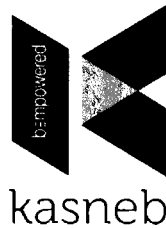
You have been appointed to evaluate the environmental aspects and social support of the company.

Describe the audit procedures that you would perform in order to advise accordingly. (8 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**ADVANCED AUDITING AND ASSURANCE**

**WEDNESDAY: 6 April 2022. Morning paper.**

**Time Allowed: 3 hours.**

**Answer ALL questions. Marks allocated to each question are shown at the end of the question. Do NOT write anything on this paper.**

**QUESTION ONE**

- (a) The regulatory body for professional accountants in your country has approached you to draft professional standards of practice in conduct and reporting on attestation engagements. These are engagements in which a professional accountant reports on the reliability of information, usually of a financial nature, presented by one party to another to assist the latter make inferences on the former.

**Required:**

With reference to International Standards on Auditing (ISAs) and any other acceptable standards of global practice, prepare a proposal paper on the required standards of professional practice. (12 marks)

- (b) In the context of international regulation of the auditing profession, discuss the role of the International Forum of Independent Audit Regulators (IFIAR). (8 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) During the last year's audit of Mila General Stores (MGS), a large retail chain of shops, you observe that commissions amount to about 25% of total sales, which is higher than in previous years. Further investigation reveals that the sector in which the shop operates on average has larger sales commissions than MGS with significant variation in rates depending on the product sold.

At the time a sale is made, the sales person records his commission rate and the total amount of the commission on the office copy of the sales invoice. When sales are keyed into the computer, a debit to sales commission expense account and a credit to accrued sales commission account are also recorded. As part of recording the sales and sales commission expense, the accounts receivable clerk verifies the prices, quantities, commission rates and all calculations on the sales invoices. Both the accounts receivable and the sales persons' commission master files are updated when the sales and sales commission are recorded. On the 15<sup>th</sup> day after the end of each month, the sales person is paid for the preceding month's sales commission.

**Required:**

- (i) An audit program to verify sales commission expense, assuming that no audit tests have been conducted in any audit area to this point. (6 marks)
- (ii) An audit program to verify accrued sales commission at the end of the year, assuming that the tests you designed in (a) (i) above resulted in no significant misstatements. (6 marks)
- (b) You are a newly appointed internal auditor of Zito Ltd., a company that is currently experiencing financial difficulties. As a condition for obtaining bank loans, the company management has agreed to maintain certain liquidity ratios, asset to liquidity ratios and gross profit margins.

The draft financial statements for the current period appear to show that the company has not succeeded in complying with some of the set targets. The profit figures are significantly affected by the calculation of bad debts and depreciation charges. There has been a suggestion to the effect that these could be changed in order to meet the bank's lending conditions.

You are informed that there is a real danger that if the bank withdraws its funding, the company would become insolvent and thus will have to cease trading. The Chief Accountant has asked you to sign certain internal records that have been altered in order to show the bank that the set targets have been met.

**Required:**

Analyse the above scenario and explain the courses of action that you would take.

(8 marks)

**(Total: 20 marks)**

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### QUESTION THREE

(a) The following information relates to Vitenge Supplies Ltd.:

1. At monthly intervals, the purchases ledger clerk of the company, Anna Mbole, lists the ledger balances. She then compares them with the file of suppliers' statements. Those statements that agree with the list of the balances are extracted and placed in the file. Those that do not agree with the listed balances are left in the original file.
2. Anna Mbole then prepares a list of the payments for all the suppliers who have sent the statements as follows:
  - (i) Where the statement agrees with the balance, the statement is attached to the list.
  - (ii) Where the statement disagrees with the balance, Anne Mbole computes a round sum amount (which is slightly less than the balance on the ledger) and enters this amount on the list of the payments. She then leaves the statement in the file.
3. The list of the payments is then passed to Peter Dawa the assistant accountant, who writes out the cheques. The cheques, lists and the statements are then sent to Lucia Kawa, the Finance Director, who signs them after checking against the statements (where these are attached) and the list of balances.
4. The cheques are then passed to the Managing Director, William Sinai, the other signatory, who signs the cheques and sends them back to Peter Dawa, who then posts them to the parties concerned.
5. The auditors of the company have previously made comments regarding the poor quality of the accounting controls.

**Required:**

- (i) Isolate the areas which could have attracted adverse comments from the auditors. (4 marks)
  - (ii) Design a programme for the substantive tests which would provide reassurance that the cheque payments are not made improperly to creditors. (5 marks)
  - (iii) Describe the controls to be instituted over the custody and authorisation of the cheque payments. (3 marks)
- (b) Discuss the procedures and nature of reporting adopted by auditors when engaged in compilation engagements of the prospective clients. (8 marks)

**(Total: 20 marks)**

### QUESTION FOUR

Jamaa Manufacturing Ltd. is planning to install an automated sales accounting system. The company's management has requested for your advice on certain matters relating to the proposed sales accounting system.

**Required:**

- (a) Describe the controls that should be incorporated in the new system before it:
  - (i) Issues an order confirmation to a customer. (3 marks)
  - (ii) Raises a dispatch note and authorises dispatch of goods to the customer. (3 marks)
- (b) Describe the controls which should be exercised over:
  - (i) Changing customer details including adding new customers, amending their details and deleting customers. (3 marks)
  - (ii) Changing customer credit limits. (2 marks)
  - (iii) Changing the selling prices of products. (3 marks)
- (c) Describe:
  - (i) The credit control criteria that the automated sales accounting system should use to decide whether to prevent dispatches to customers. (3 marks)
  - (ii) The manual procedures which should be exercised before the system allows goods to be dispatched to a company where the computer's criteria rejects dispatch of the goods. (3 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Describe the circumstances that could lead to each of the following audit opinions and the implications of each opinion:
- (i) Adverse opinion. (2 marks)
  - (ii) Emphasis of matter. (2 marks)
  - (iii) Disclaimer of opinion. (2 marks)
  - (iv) 'Except for' opinion. (2 marks)
- (b) Discuss the factors that could influence an auditor's decision in the following matters:
- (i) Whether to apply statistical or judgemental sampling technique. (2 marks)
  - (ii) Determining the size of the sample to be used for testing. (4 marks)
- (c) Explain the peculiar risks that an auditor faces when auditing and expressing an opinion on the following:
- (i) Holding companies, subsidiaries and associates. (2 marks)
  - (ii) Related party transactions. (2 marks)
  - (iii) Branches and segments. (2 marks)

**(Total: 20 marks)**

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CPA ADVANCED LEVEL

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 17 December 2021.

Time Allowed: 3 hours.

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

**QUESTION ONE**

- (a) One of the practices that has gained momentum in the recent past is remote auditing, particularly following the outbreak of the COVID-19 pandemic.

**Required:**

As an auditor, describe how you would approach remote auditing from a practical perspective. (6 marks)

- (b) Management audit calls for an inter-disciplinary approach considering the scope and focus of the audit.

**Required:**

Discuss the above statement with particular reference to:

- (i) Steps involved in a management audit. (3 marks)
- (ii) Management functions appraised. (4 marks)
- (iii) Audit techniques adopted. (3 marks)
- (c) Explore the potential threats to an auditor's independence. (4 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) You are the Audit Manager at Milele Associates, a firm of Certified Public Accountants. You are assigning staff to the final audit of Melrose Ltd., a company listed on the Securities Exchange, for the year ended 30 September 2021. You are aware of the following critical matters:

- Melrose Ltd. has recently issued a profit warning. The company has announced that significant synergies expected from the acquisition of Atalanta Ltd., a former competitor company, have not materialised. Moreover, it has emerged that some of Atalanta Ltd.'s assets are significantly impaired.
- Your firm's Corporate Finance Department assisted by two audit trainees carried out due diligence on behalf of Melrose Ltd. before the purchase of Atalanta Ltd. was completed in September 2020.

**Required:**

Comment on the ethical and other professional issues raised by the above matter and their implications, if any, for staffing the final audit of Melrose Ltd. for the year ended 30 September 2021. (6 marks)

- (b) You are the Audit Manager at ABC & Co., a firm of Certified Public Accountants. Currently, you are responsible for the audit of two companies, L Ltd. and M Ltd. The year end for each of the companies is 30 June. You are currently reviewing the audit working papers, files and the audit seniors' recommendations for the auditors' reports. The details are as follows:

- (i) L Ltd. is a subsidiary of K Ltd. Serious going concern problems have been noted during this year's audit. L Ltd. will be unable to trade for the foreseeable future unless it continues to receive financial support from the parent company. L Ltd. has received a letter of support (comfort letter) from K Ltd.

The Audit Senior has suggested that due to the seriousness of the situation, the audit opinion must at least be qualified "except for".

- (ii) M Ltd. has changed its accounting policy for goodwill during the year from amortisation over its estimated useful life to annual impairment testing. No disclosure of this change has been made in the financial statements. The carrying amount of goodwill in the statement of financial position as at 30 June 2021 is the same as at 30 June 2020 as management's impairment test shows that it is not impaired.

The Audit Senior has concluded that a qualification is not required but suggests that attention could be drawn to the change by way of an emphasis of matter paragraph.

**Required:**

Discuss, with justification, whether you would agree with the Audit Senior's conclusions in each of the cases above. (10 marks)

- (c) Explain the case against the rotation of auditors by a client. (Hint: Approach from both the auditor's and client's perspective). (4 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) An audit strategy sets the direction, timing and scope of an audit.

**Required:**

In the context of the statement above:

- (i) Explore the salient features that distinguish a systems-based approach from a risk-based approach to an audit. (4 marks)

- (ii) Describe the factors that influence the choice of an audit strategy. (4 marks)

- (b) There is a strong inter-connection between a financial audit and an operational audit. However, differences also exist.

**Required:**

Discuss the above statement, clearly bringing out any differences between the two types of audit. (4 marks)

- (c) The International Standards on Auditing (ISAs) address various professional standards of practice for auditors. In particular, ISA 240 - "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" requires the auditor to focus on areas where there is risk of material misstatements due to fraud, including management fraud.

**Required:**

Explain the actions that an auditor should take to effectively deal with issues of fraud during an audit. (8 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) Audit committees play a critical role in the governance structure of institutions and in the protection of public interest.

**Required:**

Discuss the key responsibilities of an audit committee. (8 marks)

- (b) Money laundering continues to gain currency in spite of efforts by countries and international financial institutions to combat it.

**Required:**

Summarise some of the measures undertaken by various countries and international financial institutions to control and prevent money laundering. (6 marks)

- (c) Describe some of the areas that an audit review should address. (6 marks)

**(Total: 20 marks)**

**QUESTION FIVE**

- (a) Explain the main rules of evidence in court proceedings relating to audit issues. (8 marks)

- (b) Discuss each of the following matters as applied in auditing and assurance:

- (i) Due diligence investigations. (4 marks)

- (ii) Role of auditors in receiverships and liquidations. (4 marks)

- (iii) Integrated reporting. (4 marks)

**(Total: 20 marks)**

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**CPA ADVANCED LEVEL**

**PILOT PAPER**

**ADVANCED AUDITING AND ASSURANCE**

**December 2021.**

**Time Allowed: 3 hours.**

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

**QUESTION ONE**

You are a manager in XYZ and Co., an international firm of auditors with specific responsibility for the quality of audits. The firm was appointed auditor of Masaku Savings and Credit Cooperative (MSCC) a provider of savings and credit services to its employees located in all parts of the country. You have just visited the audit team at MSCC head office. The audit team comprises of the manager and two audit assistants.

MSCC's draft accounts for the year ended 31 December 2020 are summarised as follows:

<b>Masaku Savings and Credit Co-operative Society Ltd.</b>			
<b>Annual report and financial statements for the year ended 31 December 2020</b>			
<b>Statistical information as at 31 December:</b>			
		<b>2020</b>	<b>2019</b>
		<b>'000'</b>	<b>'000'</b>
<b>Membership - Active</b>		65	62
Dormant		0	0
		65	62
		<b>Sh. "000"</b>	<b>Sh. "000"</b>
<b>Financial</b>			
Total assets		11,283,668	10,910,696
Members' deposits		10,301,544	9,528,044
Loans to members		10,692,984	9,540,914
Share capital		116,000	111,000
Total revenue		393,713	843,070
Total interest income		382,113	827,970
Total expenses		116,773	139,674
Current assets		11,279,009	10,904,040
Current liabilities		354,256	758,884
Working capital		10,924,753	10,145,156
Capital employed		10,929,412	10,151,812
Interest rate on members' deposits		267,840	666,964
Employees of the Sacco		521	400

Key ratios		
Liquidity ratio		14.37
Return on capital employed	31.84	12%
Interest rate on members' deposits	(2)%	7.0%
Dividend rate on members share capital	2.6%	7%

During your visit, a review of the audit working papers revealed the following:

1. One audit trainee is concerned with the ratios presented and has sought the manager's guidance with regards to the implication.
2. On the audit planning checklist, the audit manager has crossed through the analytical procedures section and written 'not applicable – new client'. The audit planning checklist has not been signed off as having been reviewed.
3. The audit manager last visited MSCC's office when the final audit commenced three weeks ago. The audit manager has since completed the audit of total assets. The Audit manager spends most of his time working from the firm's office and is currently allocated to seven other assignments as well as MSCC's audit.
4. As at 30 June 2020, trade receivables amounted to Sh.11.3 billion (2019 – Sh.10.2 billion). One of the trainees has just finished sending out first requests for direct confirmation of customers' balances as at the end of the reporting period.
5. The audit trainee is concerned with the growth in loan to members and the response provided for by management is not satisfactory.

**Required:**

Identify and comment on the implications of these findings for XYZ and Co. quality control policies and procedures.

**(Total: 20 marks)**

**QUESTION TWO**

Your firm has recently been appointed the statutory auditor of Mali Mengi Limited, a large soft drinks company in your country, for the year ended 31 December 2021. The previous auditors, from whom your firm has received professional clearance, did not wish to be re-appointed as auditors. The principal activities of the company are the distribution and retail of soft drinks. All products are imported from suppliers based in USA and delivered to Mombasa central warehouse. The company has its own retail outlets but also supplies national supermarket chains and small independent retailers.

**Additional information on the company's operations:**

1. **Sales**  
Sales through its own retail outlets are on a cash basis and sales to supermarkets and independent retailers are on a credit basis.
2. **Inventory records management**  
The company maintains computerised inventory records for inventories held at the distribution centre and retail outlets. Each sale is recorded and the computer updates the quantity sold and the inventory balance. The manager at each outlet is responsible for banking the takings on a daily basis.
3. **Website Development**  
During the year, the company engaged consultants to design and implement the company's new website with online ordering facilities.
4. **Targeted launch date**  
Under the terms of the contract, the website was scheduled to be operational by the end of October 2021 in order to take advantage of the high seasonal demand at this time of the year.
5. **Failure to launch and legal suit**  
Due to technical problems, the website was not launched until the end of December 2021. The consultants have been paid in full for their work. However, the company has commenced legal proceedings for breach of contract.
6. **Increased revenue in presented management accounts**  
Despite failing to meet its revenue targets in respect of online revenue, the management accounts for the 12 months to 31 December 2021 indicate an increase in revenue of 30 % compared with the same period in 2020.
7. **Stocks and receivables**  
Stocks and receivables balances are significantly higher than the previous year as a result of the increased level of activity.
8. **Proposed expansion**  
Management is planning to expand the retail activities of the business by opening additional retail outlets in Uganda, Tanzania and Ethiopia.

9. **Funding of expansion**

It is hoping to fund the expansion with a bank loan and has approached the company's bankers to provide the funding. The bankers require the audited financial statements before making a decision.

Management is keen to have the funding in place to progress with the expansion and would like to have the audit completed by 31 December 2021.

**Required**

Identify, from the circumstances described above, the key business risks and for each risk:

- (a) List the factors which have led you to identify that risk. (10 marks)
  - (b) Outline the audit work you would perform to address the risk. (10 marks)
- (Total: 20 marks)**

**QUESTION THREE**

You are responsible for the audit of Mariba and Co. Club and have found some potential causes of concern that could indicate fraudulent activity or financial misconduct within the company.

In particular:

- 1. 52% of the products on sale by Mariba and Co. Club are supplied through one of the major international companies with a special finance arrangement deal.
- 2. Bank reconciliations were last done 11 months ago.
- 3. There has been a big turnover of staff heading the finance docket with 5 persons having been replaced over the last 6 months.
- 4. There are huge unreconciled balances in the accounts receivable and payables running into millions of shillings.
- 5. The current head of finance has taken sick leave for the last four weeks due to stress.

**Required**

- (a) Comment on the need for ethical guidance for accountants on money laundering. (5 marks)
  - (b) Explain the difference between fraud and error and how the issues shown here could be categorised as fraud or error. (6 marks)
  - (c) Discuss the role of management and the role of the auditor in the prevention and detection of fraud and error. (3 marks)
  - (d) Describe what steps you would take to further investigate and then report on the matters referred to above. (6 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

You are the manager in charge of the audit of MNOP Ltd.

The following issues have arisen:

- 1. A customer is suing the company for Sh.600 million for damage caused to their products in transit. The company is defending the claim and believes that the products were not the responsibility of the company as the goods had been delivered to an independent transporter.
- 2. A balance due from Mronjiwa Ltd. in respect of sub-contract work, of Sh.300 million, has been outstanding for over six months. Your firm has been asked by the accountant not to write to Mronjiwa Ltd. for direct confirmation of this amount as the latter company objects to such letters. You have been assured by the accountant that the relationship between the two companies is good and that the outstanding balance will be paid.

**Required:**

For each of the above issues:

- (a) State, with reasons, the audit work that you would expect to find in undertaking your review of the audit working papers for the year ended 31 December 2021. (8 marks)
  - (b) Draft the relevant sections dealing with these issues of the written representation letter you would wish the directors to sign. (12 marks)
- (Total: 20 marks)**

**QUESTION FIVE**



As the lead auditor in the audit of XYZ Limited, a company with sole distributorship rights of a new brand of vehicles, the following issues are raised at the closing meeting with management:

1. The company's working capital has been negative for the last 3 years and financing of company operations has been through an overdraft facility.
2. The financing bank is reluctant to extend further credit to the company due to its' inability and long delays in servicing the overdraft which has fallen into huge arrears running into Sh.900 million.
3. The supplier of the vehicles is only providing vehicles upon receipt of full payment.
4. Three suppliers have moved to court to have the company put under administration for its' inability to pay their debt totalling to Sh.800 million.
5. Senior management staff in finance and human resource have recently quit for reasons they were not willing to provide.
6. Salaries to staff are in arrears for over five months and staff are demotivated.

**Required:**

- (a) Draft the audit opinion you would give under the circumstances. (5 marks)
  - (b) What audit risks are evident from the narration above and what further audit procedures would you perform for each of the issues discussed above. (12 marks)
  - (c) From the issues identified above, draft a management letter clearly highlighting the issue, implication and recommendation to management. (3 marks)
- (Total: 20 marks)**
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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 3 September 2021.

Time Allowed: 3 hours.

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

**QUESTION ONE**

- (a) Maisha Bora Welfare Group was established in the year 2015. The organisation's aim is to provide support to children from disadvantaged backgrounds who wish to take part in athletics.

The organisation has a detailed constitution which explains how the income of the welfare group can be spent. The constitution also notes that administration expenses should not exceed 10% of income in any one year.

The income of the organisation is derived wholly from voluntary donations. The sources of income include:

- Cash collected by volunteers seeking donations from the public.
- Cheques sent to the welfare group's head office.
- Donations from generous individuals. Some of these donations have specific clauses attached to them indicating that the initial amount donated (capital) cannot be spent and that the interest income from the donation must be spent on specific activities, for example, provision of sports shoes.

**Required:**

In the context of the above information:

- (i) Explain the term "audit risk", clearly indicating three elements of risk that contribute to total audit risk. (4 marks)
- (ii) Explore the areas of inherent risk in Maisha Bora Welfare Group, explaining the effect of each of these risks on the audit approach to be adopted. (6 marks)
- (b) Suggest the procedures that an auditor should perform in order to gain understanding of a client's business. (4 marks)
- (c) You are a senior audit manager in M and M Associates Certified Public Accountants. Recently, you were assigned specific responsibility for undertaking annual reviews of existing clients. The following situation has arisen in connection with one of the clients, Reward Ltd., an exporter of specialist equipment.

The Chief Executive Officer of Reward Ltd. has requested for advice on the accounting treatment and disclosure of payments being made for security consultancy services. The payments, which aim to ensure that consignments are not impounded in the destination country of a major customer, may be material to the financial statements for the year ending 31 December 2021. Reward Ltd. does not treat these payments as tax deductible.

**Required:**

Explore the ethical and other professional issues raised by the above matter and indicate the action, if any, that your firm should now take. (6 marks)

**(Total: 20 marks)**

**QUESTION TWO**

- (a) You are a manager at Dundee Associates, a firm of Certified Public Accountants. Your specific responsibility is for the quality of audits.

Your firm was appointed the auditor of Taka Ltd., a provider of waste management services, in January 2020. You have visited the audit team at Taka Ltd.'s head office. The team comprises an audit senior, an audit assistant and two trainees.

Taka Ltd.'s draft accounts for the year ended 31 December 2019 show revenues of Sh.118 million (2018 Sh.8.3 million) and total assets of Sh.40 million (2018 Sh.30 million). During your visit, a review of the audit working papers revealed the following:

- (i) On the planning checklist, the audit senior has crossed through the analytical procedures section and written "Not applicable-New client". The audit planning checklist has not been signed off as having been reviewed.
- (ii) The audit senior last visited Taka Ltd.'s office when the final audit commenced two weeks earlier on 1 February 2020. The audit senior has since completed the audit of tangible non-current assets including property and service equipment which amount to Sh.8 million as at 31 December 2019 (2018 Sh.8 million). The audit senior spends most of his time at your firm's office and is currently allocated three other assignments in addition to the audit of Taka Ltd.

**Required:**

Discuss the implications of the two findings above for Dundee Associate's quality control policies and procedures. (8 marks)

- (b) Explain the role of support/comfort letters as evidence in the audit of group financial statements. (6 marks)
- (c) Discuss how horizontal groups (non-consolidated entities under common control) affect the scope of an audit and the audit work undertaken. (6 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) Following the outbreak of the Covid-19 pandemic with its associated uncertainty and crisis management requirements, internal audit is now in an interesting position to guide organisations through a completely new landscape of risk. It is evident that new trends have emerged in internal audit that will change the way audit is perceived for years to come.

**Required:**

In the context of the above statement, explain how the following recent trends are transforming the audit landscape:

- (i) Artificial intelligence. (3 marks)
  - (ii) Soft controls and company culture. (3 marks)
- (b) Describe how the following factors are posing risks to internal audit in the new dispensation:
    - (i) Cyber security in the remote world of work. (3 marks)
    - (ii) Changing regulatory risks. (3 marks)
  - (c) Most auditing practitioners agree that legal liability is part of the risk associated with their work. However, they argue that practising auditors may also take specific action to minimise their liability.

**Required:**

Evaluate the measures that auditors may take to minimise the possibilities of legal liability. (8 marks)

**(Total: 20 marks)**

**QUESTION FOUR**

- (a) You are the auditor of Benrose Ltd. which undertakes construction contracts on behalf of its clients.

Last year, you qualified the auditor's report due to lack of evidence to support the client's schedules of estimated costs to completion. During the year, a quantity surveyor joined the management team of Benrose Ltd. His main role is to prepare year end schedules, by contract, of total costs to completion. This includes:

- Direct costs incurred to the balance sheet date.
- Attributable overheads.
- Estimated costs to completion.

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

**Required:**

- (i) Explain the nature and extent of the reliance which you would seek to place on the work of the quantity surveyor. (4 marks)
  - (ii) Describe the audit work you would perform in respect of total costs to completion. (8 marks)
- (b) Describe the audit work that you would carry out in respect of the following:
- (i) Segment information. (3 marks)
  - (ii) Transfer of shares. (3 marks)
  - (iii) Dividends. (2 marks)
- (Total: 20 marks)**

**QUESTION FIVE**

- (a) Discuss the nature and purpose of the following:
- (i) E-Commerce audits. (3 marks)
  - (ii) Value for money audits. (3 marks)
  - (iii) Social audits. (3 marks)
- (b) Discuss the practical challenges that professional bodies might face in trying to conduct audit quality assurance (AQA) activities in member audit firms. (6 marks)
- (c) Identify the practical steps that auditors might take to ensure independence and objectivity in their work. (5 marks)
- (Total: 20 marks)**
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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

FRIDAY: 21 May 2021.

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) 220 (Quality Control for an Audit of Financial Statements) requires that for audits of financial statements of listed entities, and for those other audit engagements if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed.
- Discuss significant matters arising during the audit engagement, including those identified during the audit control review, with the engagement quality control reviewer.

In addition, the standard requires that the engagement quality control reviewer shall perform an objective evaluation of the significant judgements made by the engagement team, and the conclusions reached in formulating the auditor's report.

**Required:**

In the context of the above provisions, and making reference to any other relevant provisions of ISA 220, discuss the key issues that the engagement quality control reviewer should consider during the evaluation of the significant judgements made by the engagement team, with particular reference to listed entities. (8 marks)

(b) The auditor needs to have a sufficient understanding of the entity and its environment to enable identification of the events, transactions and practices that may result in a risk of material misstatement regarding related parties and transactions with such parties. While the existence of related parties and transactions between such parties are considered ordinary features of business, the auditor needs to be aware of them:

**Required:**

- (i) Evaluate the reasons why, during the course of an audit, the auditor needs to be aware of the existence of related parties. (6 marks)
- (ii) Describe the audit procedures that should be carried out to identify the existence of transactions with related parties. (6 marks)

**(Total: 20 marks)**

**QUESTION TWO**

(a) In an engagement to examine prospective financial information, the auditor should obtain sufficient and appropriate evidence as to whether management's best-estimate assumptions on which the prospective financial information is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information.

**Required:**

In the context of the above statement:

- (i) Explore the difference between a "forecast" and a "projection" with reference to prospective financial information. (4 marks)
- (ii) Explain the matters you would consider before accepting an engagement to examine prospective financial information. (4 marks)
- (iii) Describe in detail the key areas of focus during the actual audit of prospective financial information. (6 marks)

- (b) Nyota Ltd. intends to invite tenders for provision of external audit services, following the expiry of the contract of the current auditor.

The company has approached you, as an independent audit consultant, to advise on the general guidelines to be followed to ensure the best auditor is engaged.

**Required:**

From your professional background, advise the company on some of the key guidelines to observe in the tender for audit services. (6 marks)

**(Total: 20 marks)**

**QUESTION THREE**

- (a) You are the auditor of Majiwa Electronics, a small family-owned entity involved in selling electronic items.

During your upcoming audit planning meetings, one of the matters to be discussed is whether the auditor will perform analytical procedures.

**Required:**

- (i) Describe the steps involved in conducting analytical procedures. (4 marks)

- (ii) Analyse the criteria used to assess whether substantive analytical procedures might be used. (5 marks)

- (b) You are the auditor of Wazee Pensioners, which is registered as a charity to provide support for retired employees of a church with branches all over the country. The charity receives funds from overseas donors which are invested in fixed interest securities and shares in listed companies.

The trustees manage the charity and a full time administrator keeps the accounting and other records. A draft summarised income and expenditure account for the year ended 30 September 2020 and an extract from the statement of financial position as at 30 September 2020 are given below together with the audited figures for the year ended 30 September 2019.

**Income and expenditure account for the year ended 30 September:**

	2020	2019
	Sh. "000"	Sh. "000"
<b>Income</b>		
Fixed interest investments	44,200	41,900
Shares in listed companies	<u>123,900</u>	<u>123,500</u>
	168,100	165,400
<b>Expenditure</b>		
Payments to pensioners	141,300	144,300
Administration costs	21,600	20,500
Audit and accountancy	4,700	4,500
Sundry expenses	<u>2,800</u>	<u>2,600</u>
	170,400	171,900
Net (deficit) for the year	<u>(2,300)</u>	<u>(6,500)</u>

**Extracts from the statement of financial position as at 30 September:**

	2020	2019
	Sh. "000"	Sh. "000"
<b>Cost of investments</b>		
Fixed interest investments	511,200	511,200
Shares in listed companies	<u>1,445,600</u>	<u>1,262,700</u>
	<u>1,956,800</u>	<u>1,773,900</u>

The following additional information has been provided:

- During the year ended 30 September 2020, some shares were sold at a profit of Sh.182,900,000 and the proceeds were re-invested in shares of other companies.
- There were no purchases or sales of fixed interest investments in the year ended 30 September 2020. In the year ended 30 September 2019, some of the fixed interest investments were sold and others purchased using the proceeds of sale.
- The charity is managed by voluntary trustees from the church who meet four times a year, and the administrator who is a priest in the church keeps the minutes of the meetings.
- The trustees receive applications for payments to pensioners and approve them if they are suitable and there is sufficient income from investments.
- As the auditor of the charity, you prepare the financial statements from the accounting records kept by the administrator and audit those financial statements. Your audit report is addressed to the trustees of the charity.

**Required:**

- (i) Describe the audit work you would carry out to verify that payments to pensioners are made to authorised pensioners and that the pensioners exist. (4 marks)
- (ii) Explain the important matters which you would consider in confirming the ownership of fixed interest investments and shares in listed companies. (4 marks)
- (c) Outline the importance of the concept of “materiality” as applied in the audit of financial statements. (3 marks)
- (Total: 20 marks)**

**QUESTION FOUR**

- (a) You are the auditor of Tamba Mattresses Ltd., a company involved in bulk production of mattresses for sale to individual consumers. The company’s year end is 31 December 2020.

Assume further that the following information has just been availed to you before the audit report is signed:

“The springs in a new type of mattress have been found to be defective, making the mattresses unsafe for use. There have been no sales of this type of mattress. It was due to be marketed in the next four weeks. The company’s insurers estimate that inventory to the value of Sh.75 million has been affected. The insurers also estimate that the mattresses were now only worth Sh.22.5 million. No claim can be made against the supplier of the springs as the supplier is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay Tamba Mattresses Ltd. the reduction in value of the inventory as the company was under insured. All of this inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end”.

**Required:**

With reference to applicable International Standards on Auditing:

- (i) Determine whether the above event is an adjusting or non-adjusting event. (3 marks)
- (ii) Discuss the auditors’ responsibility and the audit procedures and actions that should be carried out in the above scenario. (10 marks)
- (b) The Board of Directors of Jaribu Ltd. are considering a proposal from the Chief Internal Auditor to establish an audit committee. The committee would consist of one executive director, the Chief Internal Auditor as well as three new appointees. One appointee would have a non-executive seat on the Board of Directors.

**Required:**

Argue the case for the establishment of the Audit Committee by Jaribu Ltd.

(7 marks)  
**(Total: 20 marks)**

**QUESTION FIVE**

- (a) You are the audit partner at Utopia Certified Public Accountants operating in country Z. You have been invited to a stakeholders’ forum attended by officers from the registrar of companies, the revenue authority, donors, profit making entities, government entities, non-governmental organisations (NGOs), professional institutes and other interested parties. All profit making entities have their financial year end on 31 December and have to file returns (including audited accounts) on or before 31 March of the following year.

Key issues of concern to some of the stakeholders are:

1. The three month period between the year end and filing deadline is too short, limiting entities’ ability to provide accurate financial statements.
2. Auditors sometimes issue disclaimers of opinion, which in their opinion is of no value. It would be better if they declined appointment.
3. Audit fees are too high and are charged even when businesses are making losses causing unnecessary financial burden on entities.
4. In an attempt to attract clients, some auditors charge very low fees hence there is need for the institute of accountants to set minimum fees.
5. Whenever clients are penalised for non-compliance with regulations, the auditor goes scot-free even when the penalties are based on audited accounts. There is need for the auditor to bear part of the penalties.
6. Some auditors have audited the same clients for too long. There is need for mandatory auditor rotation periods specified by regulators for all clients.

**Required:**

Evaluate each of the issues raised above and provide an informed opinion, justifying your position with relevant facts and examples. (12 marks)

(b) Madini Ltd. is a company involved in buying and exportation of minelite, a newly discovered type of mineral. The mineral is mined and purchased when still wet. As the newly appointed auditor for the year ended 30 September 2020, you gather the following from the Managing Director of Madini Ltd.:

1. It takes about two months by sea to transport the mineral to company X, the major buyer based in country Z. During transportation, the mineral loses some weight due to evaporation.
2. Company X tests the quality of the mineral and pays based on the quality determined, not the invoice generated by Madini Ltd.
3. Madini Ltd. pays 4% to its home country's revenue authority as export levy based on the invoice to Company X and other buyers.
4. Of late, Madini Ltd. has experienced heavy losses due to currency fluctuations, inadequate supplies of the mineral and falling prices in the international market. The major shareholder is contemplating closing down the business.

**Required:**

(i) Explore the key audit risks that the auditor is exposed to in auditing the financial statements of Madini Ltd. (3 marks)

(ii) Formulate a realistic audit plan to determine the gross profit of Madini Ltd. (5 marks)

**(Total: 20 marks)**

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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. (6 marks)

- (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)

**(Total: 20 marks)**

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CPA PART III SECTION 6

ADVANCED AUDITING AND ASSURANCE

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:

1. 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.
2. 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

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.

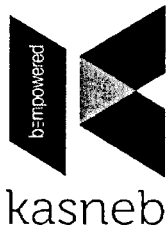
(8 marks)

- (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

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.

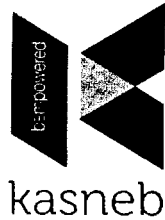
**Required:**

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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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

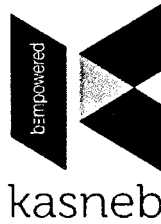
You are the lead auditor of Douala Holdings Limited, a large conglomerate with a number of subsidiaries. Some of the subsidiaries are audited by other firms.

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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# KASNEB

## 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.

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:**

	<b>Bakari Ltd.</b>	<b>Makali Ltd.</b>
	<b>Sh. "000"</b>	<b>Sh. "000"</b>
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>
<b>Financed by:</b>		
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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## 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:**

- 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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## 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:**

<b>Fixed Assets:</b>		
Cost	183,060	176,400
Accumulated depreciation	<u>(114,993)</u>	<u>(105,840)</u>
	<u>68,067</u>	<u>70,560</u>
<b>Current Assets:</b>		
Stock	185,336	86,111
Debtors	<u>67,627</u>	<u>63,141</u>
	<u>252,963</u>	<u>149,252</u>
<b>Current Liabilities:</b>		
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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