



**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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