



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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