



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"
Income		
Fixed interest investments	44,200	41,900
Shares in listed companies	<u>123,900</u>	<u>123,500</u>
	<u>168,100</u>	<u>165,400</u>
Expenditure		
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>
	<u>170,400</u>	<u>171,900</u>
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"
Cost of investments		
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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