



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)