

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

AUDITING - PAPER 15

WEDNESDAY, 19 DECEMBER 2001

INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 60 marks.
3. Section **B** has **two** questions and only **one** is to be attempted.
4. Section **C** has **two** questions and only **one** is to be attempted.
Each question in section **B** and **C** carries 20 marks.
5. Please, read further instructions on the answer book.

SECTION A

Question 1

YOURLIFE UGANDA LTD

Yourlife Uganda Ltd (YUL) is a locally incorporated company, dealing in the importation and distribution of human and veterinary drugs. YUL controls more than 60% of the human drug market in Uganda and most of the customers are government departments, large corporations and hospitals. YUL has operated with the following problems:

- i) Many incidents of drug thefts.
- ii) High labour turnover particularly in the finance department.
- iii) Strict financial reporting deadlines are never met. Some times the audit is not completed by the end of the following financial year.

The inventory balance in the management accounts of the year ended 31 December 2000 did not agree with the year end inventory taking records. YUL has been audited by Look, See and Associates, Certified Public Accountants for the last three years including the year 2000.

The last audit report was qualified on the following grounds:

- (i) Limitation of scope because of poor record keeping. Some records were not available.
- (ii) The accounts receivable control accounts were not regularly reconciled with the debtors listing. There was poor response to debtor's circularisation and there were no alternative audit tests which could be conducted. The client refused to make a general provision of Shs. 3.5 billion which was proposed by the auditors because of lack of reconciliation and poor response they got from their normal circularisation of debtors.
- (iii) Some non-current assets worth Shs. 1.2 billion bought at an auction had not be properly registered in the names of the company to effectively pass title.
- (iv) A pre-paid order of Shs 1.9 billion placed with an overseas supplier had not been honoured for over thirteen months and the supporting documentation was quite inadequate.
- (v) It was noted that a long outstanding debt of Shs 800 million was due from a company where one of YUL directors has a controlling interest.

You are the partner in charge of YUL audit. On 3 August 2001 you signed the audit report for the year ended 31 December 2000. One week later the

General Manager closed the finance department suspecting that there is a major fraud that is being perpetuated by all the staff in the department.

The General Manager has requested you to:

- (i) advise on the way forward so as not to paralyse the operations.
- (ii) send some staff from your firm to the company in order to carry out the accounting function while the suspected fraud is being investigated.
- (iii) carry out an investigation to establish the extent of the fraud and to quantify the loss to the company if any.

Required:

- (a) What issues will you discuss with the General Manager on your first visit and what advice will you give on the way forward?
(7 marks)
 - (b) What will be the implication of your firm providing accounting services to Yourlife (U) Ltd and how will it affect your next audit?
(7 marks)
 - (c) Draft the terms of reference which will form the basis of carrying out an investigation. The terms of reference will be approved by the General Manager.
(12 marks)
 - (d) Your investigation has confirmed the existence of a major fraud. What will be the consequences of your findings to the last audit report for the year ended 31 December 2000?
(3 marks)
 - (e) Distinguish between adjusting and non-adjusting post balance sheet events.
(8 marks)
 - (f) To what extent is the auditor responsible for events after the balance sheet date?
(5 marks)
 - (g) Prepare a program of work for your staff to follow in conducting an investigation on debtors and justify your approach.
(7 marks)
 - (h) To what extent will Yourlife (U) Ltd rely on your investigation for making insurance claims as well as prosecuting the perpetrators of the fraud?
(5 marks)
 - (i) Is there a possibility that your firm could be sued for negligence?
(6 marks)
- (Total 60 marks)**

SECTION B

Question 2.

JUNK AND JOIN

Junk and Join is a partnership with two lines of business;

- i) The firm imports second hand equipment from Europe which include carpentry equipment, motor vehicles and earth moving equipment. Once the equipment is received, they are reconditioned and sold off. Those that cannot be reconditioned are dismantled and sold as spare parts. Other equipment are retained as non-current assets.
- ii) The firm also makes furniture for domestic use as well as for construction sites since they started operations seven years ago. They have not had an effective inventory control system. They estimate the inventory values to be over Shs. 4 billion.

You are a certified public accountant and you have been approached by Junk and Join Partners to advise them on their inventory control system.

Required:

- (a) List the categories of inventories and the expected status in which you expect to find the inventory belonging to Junk and Join at any one time.
(5 marks)
- (b) Describe the audit procedures you will carry out to establish the inventory value at a point in time
(5 marks)
- (c) The firm is proposing to fully computerise the inventory control system. Describe the audit trail you will propose to institute.
(10 marks)

(Total 20 marks)

Question 3

The purchases cycle of XYZ and Co. Ltd is triggered by a request for quotations in purchasing a trade or other item of goods or services. Three quotations are obtained in all or most cores and a selection is made to purchase based on cost and quality by the purchasing department.

Once a selection is made approval is obtained from the requisitioning department and a pre-numbered purchase order is prepared in quadruplicate. The original and first copy is sent to the supplier, the second

copy is sent to stores and the third copy is retained in the purchasing department.

Instructions to the supplier is to make delivery with original Purchase Order with invoice attached.

On delivery of goods/services, a goods received note (numbered) is prepared by the storekeeper after prior inspection by purchasing department to ensure accuracy of order.

The suppliers invoice together with original purchase order is stamped and passed on to the accounts section where it is entered in a suppliers invoice register to start the payment process. However, on entry of a supplier's invoice in the register accounting recognition is made of the liability before payment.

A detailed suppliers ledger is kept to track all invoices received and is agreed monthly with the general ledger.

Required:

- (a) Draft a suitable audit programme of substantive tests you would perform to audit year – end creditors.

(15 marks)

- (b) Identify the controls which ensure propriety of purchases.

(5 marks)

(Total 20 marks)

SECTION C

Question 4

You are in charge of the audit of Bremens Industrial Ltd. Having just concluded core audit fieldwork where you performed an extensive ratio and trend analysis.

No material exceptions were discovered other than those listed below:

- (a) Goods inventory turnover rate has steadily decreased over the past couple of years.

- (b) The debtor's turnover in terms of number of day's sales is on the increase.
- (c) The depreciation charge as a percentage of gross assets has reduced compared to previous years.
- (d) Provision for doubtful debtors as a percentage of debtors has decreased compared to previous years.
- (e) Sales commission paid as a percentage of sales having been constant over a number of years has increased significantly in the current year and rates have not changed.

Required:

- (a) Evaluate the potential significance of each of the above analysis for proper presentation of the financial statements.
(5 marks)
 - (b) State the audit work including follow up procedures you would perform to determine and reduce the level of possible misstatements.
(15 marks)
- (Total 20 marks)**

Question 5

With the proliferation of computers in the market, almost all small businesses use computers to process their accounting statements, even if not all accounting records and data are computerised. Nevertheless, auditors have a responsibility to audit such microcomputers systems.

Required:

- (a) What are the special characteristics of such microcomputer systems used by small businesses?
(6 marks)
 - (b) Suggest desirable control procedures for microcomputers processing systems.
(10 marks)
 - (b) List the audit approaches used by the auditor to audit such systems.
(4 marks)
- (Total 20 marks)**