

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA(U) EXAMINATIONS

### LEVEL THREE

#### AUDITING & OTHER ASSURANCE SERVICES – PAPER 15

**TUESDAY, 8 DECEMBER 2009**

#### **INSTRUCTIONS TO CANDIDATES:**

1. Time allowed: **3 hours 15 minutes**.  
The first 15 minutes of this examination have been designated for reading time. You may not start to write your answer during this time.
2. Attempt question **one** in Section **A** and any **two** questions from Section **B**.
3. Section **A** has one compulsory case study question carrying 50 marks.
4. Section **B** has **four** questions and only **two** are to be attempted. Each question carries 25 marks.
5. Please, read further instructions on the answer

## SECTION A

### Question 1

Common Interests Limited (CIL) is a management company that was set up five years ago. Two years ago, the company won a tender to organise a large international symposium that was being hosted by the government. Since the delegates to the symposium were expected to visit many parts of the country, the company also established regional offices which have not been closed because they are expected to be put to use for future events of this nature.

Due to its nature of undertakings, CIL is only busy for about eight months in a year. The company is just beginning the process of preparing an accounting and internal control manual which has not been in place until now. Arising from the international symposium that was held two years ago, it has emerged that funds were probably misused and the company is under investigation by the People's Accounts Committee. This committee has found that no tax returns were submitted by the company to the relevant tax authority and that no taxes have been paid yet to the authority. The company took up some loans denominated in US dollars to enable them prepare the symposium. Though some of this money has been repaid to the lenders, some of it is yet to be paid. The local currency has in the meantime depreciated significantly against the US dollar. The country has been experiencing higher than normal inflationary pressures over the last two years. The directors of the company routinely borrow funds from the organisation for their personal use at a preferential rate. The related taxes are not remitted to the tax body.

The directors are paid a performance bonus in case they manage to meet or exceed pre-determined targets. They also have some stock-based compensation payments. The company has not paid the workers' social security benefits for at least two years but the directors have informed you that this is going to be worked upon in the very near future. The workers are completely demoralised over this and it is likely to lead to reduced productivity.

The following is an extract of the company's statement of financial position as at 30 September 2009:

<b>Current liabilities</b>	<b>Shs '000'</b>
Borrowings (Bank overdraft)	300,580
Payables	110,567

You are the audit manager of a firm of certified public accountants. Your firm has been appointed by the directors of the company to audit their financial statements for the year ended 30 September 2009 and the partners have requested you to prepare the audit strategy memorandum for the engagement.

**Required:**

- (a) Identify and explain the various categories of evidence that an auditor collects in a bid to form an appropriate opinion. (12 marks)
  - (b) Discuss the limitations an auditor is likely to encounter while collecting audit evidence. (5 marks)
  - (c) From your review of the draft statement of financial position, you note an item "Bank overdraft" as shown above. Identify and discuss the express and implied assertions that management is making by showing the above item in their statement of financial position. (8 marks)
  - (d) From the case study above, identify and explain the business risks facing Common Interests Limited. (15 marks)
  - (e) Discuss the measures that you as the auditor of the company would institute to overcome these perceived risks. (10 marks)
- (Total 50 marks)**

**SECTION B**

**Question 2**

Mugi Limited is a company which has undergone a substantial period of growth since it was set up seven years ago. The company's directors who are also the owners are engineers by profession. They have been relying on a small firm of certified public accountants for the preparation of their financial statements and also for the statutory audit. The company deals in the purchase and sale of construction machinery and due to the boom in the construction industry, their business has also grown. This growth in the business has meant that the company has got a lot of dealings on credit for both its purchases and sales.

The auditors have over the years had particular concern over the failure of the company to develop internal control systems appropriate to its size. The directors have finally consented to have internal controls instituted.

You are the audit manager in the firm of certified public accountants and the partners have assigned you the duty of spear heading this initiative.

**Required:**

Prepare a list of internal control objectives, and describe the common features of internal controls for each of the following areas:

- (a) Purchases and trade creditors. (12 marks)
  - (b) Sales and trade debtors. (13 marks)
- (Total 25 marks)**

### Question 3

You are an audit senior with a firm of certified public accountants. You have been assigned to head the team of auditors for Green Lights Limited (GLL) which owns a string of schools and other businesses spread all over the central region of the country. The company is owned by a group of families who raised the initial capital to start it up and many of whom have continued to be involved in the day-to-day management of the company. One of the people you completed your professional course with has indicated to you that the company has some financial problems without really giving you any specific details.

The audit manager is aware of some of these problems and has expressed his concern about the company's ability to continue trading as he has noted that the company borrowed money from a number of banks to finance its expansion programme and is having a poor repayment regime. The manager has asked you to visit the company in order to ascertain the state of affairs.

#### Required:

- (a) Draw up a schedule of issues that you are likely to discuss with the Finance Director of GLL to enable you properly assess the future viability of the company.  
(10 marks)
- (b) Explain the audit procedures you would carry out to give further assurance that the company can indeed continue trading as a going concern.  
(11 marks)
- (c) In case you concluded that the company was indeed unable to continue trading for the foreseeable future, explain briefly the audit opinion that you would give.

(N.B. You are not required to draft the full audit report.)

(4 marks)

**(Total 25 marks)**

#### Question 4

You are currently engaged on the audit of the financial statements of Phones Limited which deals in the wholesale and retail of a variety of phones which it obtains directly from local and overseas suppliers. They sell to both large and small retailers. Starting with the financial year now being audited, all transactions have been processed and recorded using computers.

The audit firm that you work for has got a lot of experience in auditing computerised systems and you have decided that all controls over the computerised system will be tested during the audit of this financial year and that computer audit programs are to be used to test all the accounting records.

#### Required:

- (a) Discuss the advantages and disadvantages of using computer aided audit programs. **(10 marks)**
- (b) Briefly explain the controls you expect to find and would be testing over:
  - (i) computer operators. **(7 marks)**
  - (ii) accounting records. **(8 marks)**

**(Total 25 marks)**

#### Question 5

You are the audit senior in a firm of certified public accountants. You are assigned to carry out an audit of the financial statements of Go Limited which is a new client of the firm. You are now in the process of planning for the audit of the company. You have also read in the press that there could have been some irregularities in the company and you need to adequately plan for this situation because Go Limited could be screened as a risky client.

#### Required:

- (a) Describe the possible indications of the existence of irregularities that you would be on the lookout for during the audit. **(15 marks)**
- (b) Explain the items that you would expect to include in your overall audit strategy document. **(10 marks)**

**(Total 25 marks)**