

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL THREE

AUDITING & OTHER ASSURANCE SERVICES – PAPER 15

TUESDAY, 16 JUNE 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

Lakeside Hotels Limited (LHL) is the holding company of a chain of hotels spread throughout the country with its headquarters in Kampala. LHL is owner-managed with a financial year end of 31 December. The company has appointed your firm as their auditors for the financial year ended 31 December 2008 without having gone through a competitive tendering process.

The company has been very profitable for a number of years but the dependence on foreign guests and workshops which have since dwindled has meant that there is a slowdown in business, the duration of which cannot be predicted. The company is thus diversifying into the pharmaceuticals business with hopes of developing a 'wonder drug' for a debilitating disease. This 'wonder drug' is being developed by one of the professors at a local university and he thus works for the company on a part-time basis. There is hope that the drug will be licensed by the Drugs Regulatory Authority in due course. All costs for this exercise are being included under research and development costs by LHL. The factory for the drugs is being constructed in a place that the Environmental Regulatory Authority has designated to be a wetland. The former finance director was dismissed and he claims that this was done unfairly. He is thus planning to sue the company.

Your initial review of the company has revealed that the company's systems of internal controls are weak and no action has been taken on matters raised by the outgoing auditors to rectify problems identified. When you requested to review the financial statements, the owner/manager issued you with two different sets of financial statements and informed you that one set was for his private use while the other set was for purposes of filing tax returns. You are aware that there have been numerous queries and investigations about LHL by both the National Revenue Authority and the Workers Social Security Fund. Furthermore, an earthquake in the western part of the country caused damage to the hotel located there and it will thus need major repairs to be carried out on it.

One of the sets of financial statements that Lakeside Hotels Limited have presented to your firm, Donado & Co, Certified Public Accountants where you are the manager in charge of audits, has been prejudged by you to be having

the correct information. The following is an extract of the financial statements:

	2008	2007
	Shs million	Shs million
Revenue	935	1,435
Operating expenses	(890)	(1,290)
Other operating income	<u>200</u>	<u>320</u>
Operating surplus	245	465
Finance costs	<u>(150)</u>	<u>(125)</u>
Profit before tax	<u>95</u>	<u>340</u>

According to the company's accounting manual, revenue is recognised when rooms are occupied by the guests or when confirmation is obtained for bookings of conference rooms. This normally happens when a 25% deposit has been obtained. Clients are expected to clear their bills before completion of the activity. You have, however, discovered that the statement of financial position includes major receivables which have remained unpaid for a long period of time.

Required:

- (a) From the foregoing information, identify and explain the business risks facing Lakeside Hotels Limited.

(14 marks)

- (b) Using the information provided, identify the financial statements risks you would take into consideration when planning the audit for the year ended 31 December 2008.

(5 marks)

- (c) Describe the measures you would take into consideration to reduce the risks identified.

(12 marks)

- (d) Describe the relationship between the business risk and financial statements risk.

(5 marks)

- (e) Prepare a memorandum to the partners of your firm, Donado & Co, assessing the issues to be taken into consideration before accepting appointment as auditors of Lakeside Hotels Limited.

(14 marks)

(Total 50 marks)

SECTION B

Question 2

Global Investment Company Limited (GICO) is involved in a number of business ventures including banking, construction, real estate development, farming, processing and export of agricultural products. Due to the current economic downturn, the company has had to lay off a number of staff as a means of remaining competitive and profitable. Up to about 40 percent of the staff at all levels of the company were affected by this redundancy. Some of the staff had to take pay cuts due to reduced working hours. The Finance Director recently requested one of the staff to carry out a review of the operations of the company. While carrying out her analytical reviews, she discovered that payroll costs had reduced by 15 percent. Further reviews of the payroll during the period indicated that most of the staff laid off still appeared thereon. The staff member carrying out the analytical reviews could not obtain any assistance on this matter from the payroll accountant who has been missing from the office since the review commenced.

You are the manager in charge of the forensic investigations department of your audit firm and the Finance Director of GICO has contracted your firm to review this suspected case of fraud.

Required:

- (a) Describe and distinguish between the terms: 'forensic auditing', 'forensic accounting', and 'forensic investigation'.

(6 marks)

- (b) Prepare a report describing the objectives of a forensic investigation and, giving examples, the procedures you would employ when carrying out a forensic investigation into the payroll fraud.

(19 marks)

(Total 25 marks)

Question 3

Multipot District Local Government officials collect some revenue in the form of taxes. In addition, they receive some grants and donations from the central government and development partners to enable them carry out the activities of the local government.

During the period ending 30 June 2008, funds were spent on several activities which included construction of an office building, roads, valley dams, wells, springs and many other activities. The councillors have been requested by one of their development partners to engage a local firm of auditors to carry out a value for money audit as part of their reporting requirements.

You are the manager in charge of audits with Kabaseke & Associates, a firm of Certified Public Accountants and your firm emerged successful in bidding for this exercise. The partners have requested you to carry out this exercise. Your initial discussions with the staff of Multipot District Local Government reveal that they do not understand what is meant by 'value for money' audit.

Required:

- (a) Describe the objectives of carrying out a value for money audit.
(10 marks)
- (b) As part of the assignment, you are required to prepare an audit plan. Describe what you would include in the audit plan of a value for money assignment.
(7 marks)
- (c) Describe, in terms of structure and content, what you would include in a value for money audit report.
(8 marks)

(Total 25 marks)

Question 4

You are an audit manager in Regionex, a regional firm of Certified Public Accountants which has a network of firms spread out in countries of the Great Lakes Region. The partners have requested you to carry out an office visit at one of the country offices. During your review of the office, you discover that one of the clients, Quick Dealers Limited, has not yet paid fees for the audit of the previous year, yet the current year audit is now taking place and is nearing the finalisation stage. This particular audit has not yet been billed.

You also discover a note from one of the clients, Holiday Resorts Limited, saying that they intend to offset an amount owed to them by the manager who was in charge of the audit engagement. This is for amounts that the manager incurred on a trip to The Seychelles for a holiday. Further investigations reveal that the trip was heavily subsidised by the client company. The audit manager informs you that he expected the invoice to be sent to his private address and no communication should have come to the office.

The fee notes also contain amounts that do not relate to professional services. One of the fee notes was raised to Kamya & Co. Advocates, one of the legal firms in town on account of clients with legal problems that the country office referred to them.

Required:

- (a) As an accountant, adhering to the professional code of ethics issued by Institute of Certified of Public Uganda (IPCAU) and International Federation of Accountants (IFAC), identify the ethical and professional issues arising from the case study above.

(7 marks)

- (b) Recommend what action should be taken against the companies and staff mentioned in the case study.

(18 marks)

(Total 25 marks)

Question 5

The global economy is experiencing a crisis which was triggered off by sub-prime lending. Because of the broad scope of the crisis and its potential to continue spreading, all audit engagement teams, regardless of industry or sector, should focus immediately on whether and how their clients may be affected and the need to appropriately identify and respond to important accounting, auditing and financial reporting matters. You are also aware, at a local level in Uganda, that leaders have pronounced the economy as strong and buoyant.

You are the audit manager in Felix & Kats, a firm of Certified Public Accountants of Uganda.

Required:

Discuss the procedures that you, as an audit manager, would take into consideration when planning and executing an audit in light of the global economic crisis and local assurances about the Ugandan economy.

(25 marks)