

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL ONE

AUDIT THEORY – PAPER 7

THURSDAY, 16 JUNE 2011

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 **all** questions in Sections **A** and **B**, and any **two** questions in Section **C**.
3. Section **A** has **twenty** compulsory multiple-choice questions, each carrying 1 mark.
4. Section **B** has **one** compulsory question carrying 30 marks.
5. Section **C** has **three** questions and only **two** are to be attempted. Each question carries 25 marks.
6. Please read further instructions on the answer booklet, before attempting any question.

SECTION A

Question 1

- (i) Which of the following is **NOT** an advantage of using audit programmes?
 - (a) Providing a record of work carried out and by whom.
 - (b) Presenting an opportunity for settling disputes between the audit staff and management.
 - (c) Giving a clear set of directions on the work to be carried out.
 - (d) Presenting an opportunity for supervisor and manager review.
- (ii) The auditor's judgement on sufficiency of audit evidence is, among other factors, dependent upon:
 - (a) the express and implied assertions made by the directors.
 - (b) the mathematical correctness of the figures in the financial statements.
 - (c) the nature of the accounting, internal control and control environment.
 - (d) systems and controls testing with compliance tests.
- (iii) Which of the following describes audit procedures that should be carried out when reviewing possible management override of controls?
 - (a) Confirming journal entries and direct transfers in the general ledger with underlying documentation or authority.
 - (b) Checking that inventory valuation, gross profit margins and cut-off are fairly stated.
 - (c) Confirming that physical counts of inventories were carried out at the date of the audit.
 - (d) Checking that the general ledger control accounts and gross profit are fairly stated.
- (iv) The safeguard of business assets and securing the reliability of financial records of an enterprise is an indication of:
 - (a) authorisation and authentication of transactions.
 - (b) management decision process.
 - (c) achievement of administrative objectives.
 - (d) objectives of internal control.

- (v) Which of the following represents an **IMPERFECT** element of internal control?
- (a) Sales personnel's responsibility over credit control.
 - (b) Separation of custody from recording.
 - (c) Segregation of authority and responsibility.
 - (d) Employee rotation and compulsory annual leave.
- (vi) The use of accounting policies that are at variance with industry norms by management could be an indicator of:
- (a) past misstatements, errors and adjustments.
 - (b) use of off-balance sheet finance.
 - (c) circumstances of error or fraud.
 - (d) unavailability of capital and credit.
- (vii) The primary objective of an audit is to enable the auditor:
- (a) detect errors and fraud in the financial statements.
 - (b) express an opinion on financial statements.
 - (c) detect errors that would render financial statements not show a true and fair view.
 - (d) assist clients with accounting ,taxation and risk management.
- (viii) Which of the following is a basic technique of collecting audit evidence?
- (a) Assessment of the strength of the internal control system.
 - (b) Physical examination and counting.
 - (c) Verifying the number of items involved.
 - (d) Assessment of the audit risk involved.
- (ix) Which of the following is a type of auditor's modified opinion?
- (a) Unqualified opinion.
 - (b) Limitation of scope.
 - (c) Disclaimer of opinion.
 - (d) Except for opinion.
- (x) Ethical rules as laid down by the Institute of Certified Public Accountants of Uganda require that professional accountants:
- (a) refrain from misconduct which is likely to discredit themselves and the Institute.
 - (b) refrain from professional etiquette as required by the Institute.
 - (c) perform corporate social responsibility.
 - (d) perform their professional duties without hindrance.

- (xi) Auditors are interested in the proper maintenance of statutory books by companies because:
- (a) the Companies Act lays down rules for keeping proper accounting records.
 - (b) directors are responsible for maintenance of accounting records and statutory books.
 - (c) they are directly concerned with the accounts.
 - (d) it would prevent the accountant from making frequent alteration in accounting records.
- (xii) Which of the following reasons explain why auditors issue management letters to clients?
- (i) Means of communicating matters that may impact on future audits.
 - (ii) Means of coordinating auditing with accounts preparation.
 - (iii) Making directors clearly know their legal responsibilities and consequences of weak internal control.
 - (iv) Clearly define the extent of auditor's responsibilities.
- (a) (i) and (ii).
 - (b) (iii) and (iv).
 - (c) (i) and (iii).
 - (d) (ii) and (iv).
- (xiii) In case some irregularities are discovered during an audit, which of the following would be the best action to be taken by the auditor?
- (a) Determine the system of internal control.
 - (b) Report the matter to the Institute of Certified Public Accountants of Uganda.
 - (c) Examine and check control accounts.
 - (d) Perform appropriate additional tests if the matter is material.
- (xiv) Which of the following factors should the auditor consider when planning an audit?
- (a) Amount of evidence required in each audit area.
 - (b) Means of informing and educating the client.
 - (c) Matters constructive to efficient use of client resources.
 - (d) Concise means of recovering client's written acceptance.

- (xv) International Standard on Auditing 230: Documentation, requires that auditors should document, in their working papers, matters to support their report. Which of the following is a challenge to audit documentation?
- (a) Retracing bookkeeping procedures.
 - (b) Alternatives to use for physical inspection and counting during audit.
 - (c) Availability of records on matters of continuing importance to future audits.
 - (d) Auditor's failure in understanding the whole or part of the audit process.
- (xvi) Which of the following represent vouching in auditing?
- (i) Evaluating risks associated with audit client.
 - (ii) Examining source documentary evidence.
 - (iii) Confirming that details recorded relate to ordinary transactions.
 - (iv) Comparing transactions at succeeding year ends.
- (a) (i) and (ii).
 - (b) (ii) and (iii).
 - (c) (iii) and (iv).
 - (d) (iv) and (i).
- (xvii) Audit risk is the risk that the auditor could express an inappropriate opinion on financial statements. Risks arising out of particular audits can be minimised by:
- (a) qualifying the audit report.
 - (b) reducing overstated profitability.
 - (c) overcoming loss of audit trail.
 - (d) appropriate staff allocation.
- (xviii) Which of the following approaches could an auditor employ in carrying out an audit of a client engaged in e-commerce?
- (a) Estimation of human resource needs.
 - (b) Professional education of staff.
 - (c) Appropriate technical expertise.
 - (d) Coaching by more experienced staff.

- (xix) Which of the following matters should the auditor consider when assessing a client's integrity before accepting an audit engagement?
- (a) Reasons for appointing your firm other than the outgoing firm.
 - (b) Purpose of engagement letter.
 - (c) Responsibilities of the directors and management.
 - (d) Overlooking unusual circumstances.
- (xx) A new auditor must confirm that he was properly appointed. This confirmation could be achieved by:
- (a) attending the company's annual general meeting and speaking if asked to do so.
 - (b) examining the minute book and obtaining a copy of the minute from the permanent audit file.
 - (c) setting out agreement between the auditor and the client.
 - (d) sending a letter of professional etiquette to the retiring auditor.

SECTION B

Question 2

ESTABLISHERS CERTIFIED PUBLIC ACCOUNTANTS (ECPA)

The Companies Act CAP 110 requires auditors to report in certain circumstances on the state of the companies they audit. To achieve the expected assurance in practice, auditors rely on information which they have gathered using various techniques and confirmed to be fairly stated. You are an audit senior with ECPA and have been assigned to head the field audit team to Continuing Trading Company (CTC) based in Mbale. You have also been assigned two audit assistants for this assignment.

While carrying out a review of the correspondence file and previous year audit file, you noted that CTC had changed some of their accounting policies from those that have been in use. These changes may have resulted in a reclassification of some of the prior year comparative figures.

The draft financial statements together with the trial balance have been delivered to your office and, in your preliminary review you noted that some balances in the draft financial statements could not be traced back to the figures in the trial balance. The chief accountant at CTC had earlier on informed the audit manager that the draft financial statements were prepared by his accountant after the balances were extracted by the accounts assistant. Your

assessment is that since the balances are falling apart, the audit will not be an easy one.

Your confidence is somehow restored on realising that CTC is fully computerised and that your team could apply the auditing software currently used by the firm. One of your assistants is still wondering how the computerisation would help sort out the problem especially if during the making of the changes in the accounting policies, attention was not paid to policy related entries made during the course of the year.

Required:

- (a) Briefly describe the audit work you would carry out on the comparative information and the closing trial balance of CTC.
(12 marks)
 - (b) Explain circumstances under which the Companies Act requires auditors to report on their clients' affairs.
(6 marks)
 - (c) Explain the advantages of computer audit programs in the audit of CTC.
(8 marks)
 - (d) Clearly state circumstances that may lead to restatement of comparative amounts for the prior periods in audited financial statements.
(4 marks)
- (Total 30 marks)**

SECTION C

Question 3

ICEME CONSTRUCTION LIMITED (ICL)

Section 159 of the Companies Act Cap 110 of the Laws of Uganda stipulates that every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting, until the conclusion of the next annual general meeting.

On the other hand, the Combined Code on Corporate Governance requires that listed companies which do not have an internal audit function should from time to time review the need for one.

Geoffrey Eyolle, the accountant of ICL, had a feeling that his company's internal auditor had done quite a lot to help his accounts assistant improve on her work in performing bank reconciliation statements and had hope that the external auditor would most likely not have difficulties in reviewing the reconciliation statements during the year-end audit.

You are an audit senior and your firm has just been appointed to carry out the audit of ICL for the year ended 31 March 2011.

Required:

- (a) Briefly describe the preliminary work you would perform before commencing the detailed field audit.
(10 marks)
 - (b) Describe the common interests held by both internal and external auditors in the execution of their duties.
(7 marks)
 - (c) Describe the audit tests that you would carry out on ICL's bank reconciliation statements.
(8 marks)
- (Total 25 marks)**

Question 4

WORKING PAPERS AND AUDITORS' INDEPENDENCE

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (sometimes referred to as 'working papers' or 'work papers'). Working papers help in achieving audit objectives such as providing a record of the basis for the auditor's opinion in accordance with International Standard on Auditing 230: Documentation.

You work with an audit firm and your audit manager was addressing newly recruited audit staff on working papers and auditors' independence during their induction recently. As an audit senior, one of the new staff approached you to guide them in more detail on audit documentation and self-interest threats to auditors.

Required:

- (a) Briefly describe what should be contained in audit working papers.
(10 marks)
 - (b) Clearly describe the advantages and disadvantages of using standardised audit working papers.
(8 marks)
 - (c) Explain what you understand by self-interest threats in auditing.
(7 marks)
- (Total 25 marks)**

Question 5

AUDITORS' REPORT

The Companies Act, Cap. 110, Section 162 requires that the auditor must 'state whether, in the auditor's opinion, the financial statements have been properly prepared in accordance with the Act, and give a true and fair view'.

The International Standard on Auditing 700: Forming an Opinion and Reporting on Financial Statements, also governs the content and the wording of the auditor's report issued as a result of an audit of general purpose financial statements.

Required:

- (a) Explain the:
 - (i) concept of 'true and fair view'.

(4 marks)
 - (ii) factors that the auditor should consider when forming an opinion that financial statements show a true and fair view.

(5 marks)
 - (b) Outline the elements of the auditor's report in an audit conducted in accordance with International Standards on Auditing.

(10 marks)
 - (c) Briefly explain the **three** types of modified opinions.

(6 marks)
- (Total 25 marks)**