

**UGANDA MARTYRS UNIVERSITY
NKOZI/LUBAGA CAMPUS**

FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT

**DEPARTMENT OF ACCOUNTING & FINANCE
SEMESTER TWO 2018/19**

BAM III EVENING

COURSE UNIT: AUDITING

DATE: 3RD/05/2019

Time allowed: 3hours

Instructions to Candidates:

Read the following before answering the examination questions.

- 1) Do not write anything on this question paper.
- 2) Write neatly and show all workings clearly.
- 3) Start every question on a new page
- 4) Clearly state the question number & sections attempted
- 5) Answer **any four** questions, all questions carry equal marks

SECTION A

Question One: [Compulsory]

a) Introduction and client background

You are the audit senior of Mulungi Certified Public Accountants and your team has just completed the interim audit of Mofit company, whose year end is 31 January 2014. You are in the process of reviewing the payroll procedures, as well as preparing the audit programmes for the final audit.

Mofit Co manufactures cosmetics and due to the nature of the work involved, it employs many casual laborers who monitor the machines, put labels on the final products and pack them. The company manufactures 24 hours, seven days a week.

Below is a description of the payroll system along with deficiencies identified by the audit team:

Factory workforce

The company operates three shifts every day with employees working eight hours each. They are required to clock in and out using the clock card at the entrance. The employees put their thumbs on the clock card which then automatically shows the time and name of the employee who has reported. They do the same at the time of departure. Someone is employed to print the details of the clock card daily showing the reporting time and departure time of each employee, since employees are paid on an hourly basis. However, there are cases where the clock in card doesn't work due to technical problems. As a result, many times employees have been paid less as they were unable to record the time of arrival and departure. Sometimes, the entrance where the clock in card is located is locked during the weekend hence employees cannot record the time worked. Still employees who report at such a time when the entrance is locked stand to lose.

The payroll department calculates on a weekly basis the cash wages to be paid to the workforce, based on the hours worked report multiplied by the hourly wage rate, with appropriate tax deductions. These calculations are not cross checked by someone else. During the year the hourly wage was increased by the Human Resources (HR) department and this was notified to the payroll department verbally hence it was not implemented.

Each Friday, the payroll department prepares the payments and physically hands these out to the workforce, who operate the morning and late afternoon shifts, upon production of identification. However, for the night shift workers, the payments are given to the factory supervisor to distribute. If any night shift employees are absent on pay day then the factory supervisor keeps these wages and returns them to the payroll department on Monday.

Sales and administration staff

The sales and administration staff are paid monthly by bank transfer. Employee numbers do fluctuate and during July two administration staff joined; however, due to staff holidays in the HR department, they delayed informing the payroll department, resulting in incorrect salaries being paid out.

Required:

- i. Identify five weaknesses in the payroll system of Mofit co: [5 marks]
 - ii. Explain the possible implications of these weaknesses. [5 marks]
 - iii. Suggest a recommendation to address each weakness. [5 marks]
- b) You are an audit manager in large audit firm PWS associates which specializes in the audit of manufacturing firms. The firm currently audits Coca cola, a soft drink company, but Coca cola's main competitor, PEPSI, has approached PWS associates to act as their auditors. Both companies are highly competitive.

Required: Explain the procedures that your firm should implement to ensure that this conflict of interest is properly managed. [5 marks]

- c) ISA 500 *Audit evidence* requires the auditor to design and perform audit procedures so as to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
- (i) List five ways of obtaining audit evidence. [5 marks]

SECTION B

Question Two :

The following matters are identified in four separate company audits each with accounting periods ending 31 December 2017.

Green Ltd

In November 2017, the company was sued by sub-contractors for breach of several big contracts. This lawsuit is currently underway and is not yet complete. Until the lawsuit is completed, it is not possible to estimate, with any degree of certainty, what the company's ultimate liability will be. No provision or disclosure has been made in the financial statements for any liability at the year end.

Black Ltd

Included in the statement of financial position at the year-end are inventories of Shs 250 million, of which Shs 27,500,000 relates to a particular work-in-progress contract. This contract was managed by an employee who left the company and took the work-in-progress records with him. It is of a highly specialized nature and the auditor cannot find a suitable expert to value it. It has therefore been impossible to verify the value of this contract at the year-end. The pre-tax profit of Black Ltd is Shs 125 million.

Red Ltd

In December 2017, the company received Shs 100 million of government grants to assist it with the purchase of capital equipment. Red Ltd credited 100% of the grants to the statement of profit or loss as “other income”, even though IAS 20 Accounting for Government Grants and Disclosure of Government Assistance clearly indicates that capital grants should be released to the statement of profit or loss as the assets are depreciated. Red Ltd is a manufacturing company and its turnover for the year ended 31 December 2017 is Shs 5 billion, with pre-tax profits of Shs 1 billion.

Pink Ltd

The sales ledger of Pink Ltd has been corrupted by a computer virus and therefore no detailed testing has been performed on revenue and receivables. The audit team is considering confirmation procedures for revenue and receivables in an alternative. If they are unable to do this, then two significant balances in the financial statements will not have been verified. Revenue and receivables are both higher than the total profit before tax (PBT) of Shs 200m. Receivables are 170% of PBT and revenue is nearly eight times the PBT and hence this is a very material issue.

Required:

In respect of each of the matters above, Discuss whether or not the audit report should be modified, giving reasons for your conclusion. Clearly show the nature of modification. *[25 marks]*

Question Three:

ISA.610: Defines Internal Audit as; “An appraisal or monitoring activity established by management and the directors, for the review of the accounting and internal control systems as a service to the entity”.

- a) Discuss the scope of the internal Audit as may be set by Management of a manufacturing entity
[5marks]
- b) Explain the key aspects which the external auditor will have to assess before relying on the work of internal auditors *[5 marks]*
- c) Your firm is the auditor of Leisure limited, a company operating three large centers which sell wooden furniture (such as garden benches, seats and playhouses) to the general public. You are involved in the audit of the company’s Non-current assets. The main categories of Non-current assets are as follows:
 - Land and buildings (all of which are owned outright by the company)
 - Computers (on which an inventory control and sales system is operated)
 - A number of large and small vans, mostly used for the delivery of inventory to customers
 - Equipment for packaging and pricing products.

Required:

- i) Explain the main risks associated with financial statement assertions relating to Non Current assets. *[5 marks]*
- ii) List the sources of evidence available to verify the ownership and cost of land& buildings, computers and motor vehicles. *[5 marks]*
- iii) As an auditor, describe the substantive procedures you would carry out to confirm completeness in relation to the Non-current assets above. *[5marks]*

Question four:

- a) ISA 315 *Identifying and assessing the risks of material misstatement through understanding the entity and its environment* requires the auditor to obtain an understanding of the entity and its environment, including the entity's internal control, as a basis for designing and performing audit procedures in response to the assessed risks of material misstatement.
 - i. Explain four advantages of audit planning to an auditor. *[6 marks]*
 - ii. Highlight matters the auditor may consider when obtaining an understanding of the entity. *[10 marks]*
 - iii. Explain term analytical procedures and explain how analytical procedures are used during the planning stage. *[5 marks]*

- b) During training organized by ICPAU, the trainer emphasized the need for the auditor designing an audit program before the audit.

Required. Explain what an audit program is and why it is important for the auditor to design one before the actual audit. *[4 marks]*

Question Five:

You are the audit manager of Quick Solutions & Co and you have been given the financial statements extracts and the following information about your client, Safi Kitchen Designs Ltd (SKDL), which is a kitchen manufacturer. The company's year-end is 30 June 2012.

SDL has recently been experiencing trading difficulties as its major customer who owes Shs 60m has ceased trading and it is unlikely any amount of this will be received. However this balance is included in the financial statements extracts below. The sales director has recently left Strawberry and has yet to be replaced.

The monthly cash flow has shown a net cash outflow for the last two months of the financial year and is forecast as negative for the forthcoming financial year. As a result of this, the company has been slow in paying its suppliers and some are threatening legal action to recover the sums owing.

Due to its financial difficulties, SKDL missed a loan repayment and as a result of this breach in the loan covenants, the bank has asked that the loan of Shs 480m be repaid in full within six months. The directors have decided that in order to conserve cash, no final dividend will be paid in 2012.

Financial statements extracts for year ended 30 June:

	DRAFT 2012 Shs 000	ACTUAL 2011 Shs 000
Current Assets		
Inventory	340,000	160,000
Receivables	140,000	220,000
Cash	—	120,000
Current Liabilities		
Trade payables	190,000	90,000
Overdraft	80,000	—
Loans	480,000	20,000

Required:

- Explain the potential indicators that SKDL is not a going concern. *[5 marks]*
- Describe the audit procedures that you should perform in assessing whether or not the company is a going concern. *[10 marks]*
- Having performed the going concern audit procedures, you feel that the financial statements should be adjusted, but the Finance Director has objected to the Adjustment. State Quick Solution & Co.'s responsibility for reporting on going concern to the directors of SKDL. *[5 marks]*
- If the directors refuse to amend the financial statements, describe its impact on the audit report. *[5 marks]*

Question Six:

- Discuss who is eligible to be an auditor in Uganda according to the Companies Act and why such requirements exist. *[5 marks]*
- ICPAU has issued a code of ethics to members to guide them in areas where an ethical dilemma may exist. Discuss the fundamental principles of the code of ethics. *[10 marks]*
- 'Professional independence is currently seen as the core as far as ethical issues in auditing are concerned. Independence is both something that is a matter of fact but is also something which is a matter of appearance. It is important to be independent, but it is also important to appear to be independent.'

Required:

- i) Explain, with illustrations, the importance of the concept of professional independence to the auditor. **[4 marks]**
- ii) Outline and briefly explain at least **six** ways in which the auditors' independence can be impaired. **[6 marks]**

END