
CERTIFIED PUBLIC ACCOUNTANT INTERMEDIATE LEVEL EXAMINATION

11.4: AUDITING

THURSDAY: 4 DECEMBER 2014

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
- 2. This Examination is divided into two sections (A & B)**
- 3. Section A has three (3) Compulsory Questions while Section B has four (4) questions to choose two (2)**
- 4. Five (5) questions in total are to be attempted.**
- 5. All ICPAR Examination rules and regulations apply**

Section A (Attempt all questions in this section)

QUESTION ONE

GISUBIZO Co has an operating income of Frw.70 billion and employs 1,000 people in 9 different locations. GISUBIZO Co provides various financial and investment services to individuals, maintaining books of accounts and cash forecasting in small to medium-sized companies.

The company is owned by six shareholders, who belong to the same family; it is not listed on any stock-exchange and the shareholders have no intention of applying for a listing. However, an annual audit is required by statute and additional regulation of the financial services sector is expected in the near future.

Most employees are provided with on-line, real-time computer systems, which present financial and stock market information to enable the employees to provide up-to-date advice to their clients. Accounting systems record income, which is based on fees generated from investment advice.

Expenditure is mainly fixed, being salaries, office rent, lighting and heating, etc. Internal control systems are limited; the directors tending to trust staff and being more concerned with making profits than implementing detailed controls. Four of the shareholders are board members, with one member being the chairman and chief executive officer. The financial accountant is not qualified, although she has many years experience in preparing financial statements.

Required:

a) Discuss four advantages and four disadvantages of having an internal audit department in GISUBIZO Co. (16 Marks)

b) ISA 610 *Considering the Work of Internal Auditor* states that ‘when the external auditor intends to use specific work of internal auditor, the external auditor should evaluate and perform audit procedures on that work to confirm its adequacy for the external auditor’s purpose.’

Required:

In relation to ISA 610, explain the factors that external auditor considers when evaluating the work of the internal auditor. (4 Marks)

(Total 20 Marks)

QUESTION TWO

a) International Standard on Auditing 560 *Subsequent Events* explains the audit work required in connection with subsequent events.

Required:

List the audit procedures that can be used prior to the auditor’s report being signed to identify events that may require adjustment or disclosure in the financial statements. (6 Marks)

b) International Standard on Auditing 300 (revised) *Planning an Audit of Financial Statements*, states that an auditor must plan the audit. Explain why it is important to plan an audit. (6 Marks)

c) Explain the purpose of an engagement letter and list its contents. (8 Marks)

(Total 20 Marks)

QUESTION THREE

Twister Engineering is a limited liability company and is incorporated in Rwanda with annual revenue of **Frw 32 million** 75% of its sales are on credit. At its financial year end 31 December 2013 its accounts receivable ledger contained 200 accounts with balances ranging from **Frw 100** to **Frw 15,000** and totaling to **Frw 3,000,000**. As a staff member of Twister Engineering’s external auditors you have been assigned to audit the allowance for bad and doubtful debts which has been set at **Frw 150,000**. Your initial enquiries established that **Frw 90,000** relates to allowances against specific bad and doubtful debts and **Frw 60,000** is a general allowance determined as a percentage of overdue debts with an increasing percentage being applied against

the longest overdue accounts.

Required:

- (i) Briefly explain the approaches adopted by auditors in obtaining sufficient appropriate audit evidence regarding allowance for bad debts. **(3 Marks)**
 - (ii) Describe the procedures you would apply in verifying the general allowance for bad and doubtful debts. **(9 Marks)**
 - (iii) Describe the procedures you would apply in verifying the specific allowance for bad and doubtful debts. **(8 Marks)**
- (Total 20 Marks)**

Section B (Attempt ANY TWO questions in this section)

QUESTION FOUR

- a) Explain the term 'audit risk' and the three elements of risk that contribute to total audit risk. **(4 Marks)**
- b) The EuKaRe charity was established in 1960. The charity's aim is to provide support to children from disadvantaged backgrounds who wish to take part in sports such as tennis, badminton and football. EuKaRe has a detailed constitution which explains how the charity's income can be spent. The constitution also notes that administration expenditure cannot exceed 10% of income in any year. The charity's income is derived wholly from voluntary donations. Sources of donations include:
 - (i) Cash collected by volunteers asking the public for donations in shopping areas,
 - (ii) Cheques sent to the charity's head office,
 - (iii) Donations from generous individuals. Some of these donations have specific clauses attached to them indicating that the initial amount donated (capital) cannot be spent and that the income (interest) from the donation must be spent on specific activities, for example, provision of sports equipment.The rules regarding the taxation of charities in the country EuKaRe is based are complicated, with only certain expenditure being allowable for taxation purposes and donations of capital being treated as income in some situations.

Required:

- (i) Identify areas of inherent risk in the EuKaRe charity and explain the effect of each of these risks on the audit approach. **(12 Marks)**
 - (ii) Explain why the control environment may be weak at the charity EuKaRe. **(4 Marks)**
- (Total 20 Marks)**

QUESTION FIVE

- (a) Describe external auditor's responsibilities and the work that the auditor should perform in relation to the going concern status of companies. **(5 Marks)**
- (b) Describe the possible audit reports that can be issued where the going concern status of a company is called into question; your answer should describe the circumstances in which they can be issued. **(5 Marks)**

Celtel is a large telecommunications company that is listed on the Rwanda Stock Exchange. It is highly geared because, like many such companies, it borrowed a large sum to pay for a license to operate a mobile phone network with technology that has not proved popular. The company's share price has dropped by 50% during the last three years and there have been several changes of senior management during that period. There has been considerable speculation in the press over the last six months about whether the company can survive without being taken over by a rival. There have been three approaches made to the company by other companies regarding a possible takeover but all have failed, mainly because the bidders pulled out of the deal as a result of the drop in share prices generally.

The company has net assets, but has found it necessary to severely curtail its capital investment program. Some commentators consider this to be fundamental to the future growth of the business, others consider that the existing business is fundamentally sound. It has also been necessary for the company to restructure its finances. Detailed disclosures of all of these matters have always been made in the financial statements. No reference has been made to the going concern status of the company in previous auditor's reports on financial statements and the deterioration in circumstances in the current year is no worse than it has been in previous years.

Required:

- On the basis of the information provided above, describe the audit report that you consider is likely to be issued in the case of Celtel, giving reasons. **(4 Marks)**
 - Explain the difficulties that would be faced by Celtel and its auditors if Celtel's audit report made reference to going concern issues. **(6 Marks)**
- (Total: 20 Marks)**

QUESTION SIX

Walsh Co sells motor vehicle fuel, accessories and spares to retail customers. The company owns 25 shops. The company has recently implemented a new computerised wages system. Employees work a standard eight hour day. Hours are recorded using a magnetic card system; when each employee arrives for work, they hold their card close to the card reader; the reader recognises the magnetic information on the card identifying the employee as being 'at work'. When the employee leaves work at the end of the day the process is reversed showing that the employee has left work.

Hours worked are calculated each week by the computer system using the magnetic card information. Overtime is calculated as any excess over the standard hours worked. Any overtime over 10% of standard hours is sent on a computer generated report by e-mail to the financial accountant. If necessary, the accountant overrides overtime payments if the hours worked are incorrect.

Statutory deductions and net pay are also computer calculated with payments being made directly into the employee's bank account. The only other manual check is the financial accountant authorising the net pay from Walsh's bank account, having reviewed the list of wages to be paid.

Required:

- Using examples from Walsh Co, explain the benefits of using Computer-Assisted Audit Techniques to help the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. **(14 Marks)**
 - List **six** examples of audit tests on Walsh Co's wages system using audit software. **(6 Marks)**
- (Total: 20 Marks)**

QUESTION SEVEN

IAS 2 'Inventories' requires that inventories are measured at the lower of cost and net realisable value.

Required:

- Explain why the audit of inventory is important to auditors. **(5 Marks)**
 - Define 'cost' and 'net realizable value' according to IAS 2 'Inventories' **(6 Marks)**
 - Describe the audit evidence that you would obtain for the cost and net realizable value of finished inventory in a company that manufactures household furniture. **(9 Marks)**
- (Total: 20 Marks)**

End of question paper