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# CERTIFIED PUBLIC ACCOUNTANT

## INTERMEDIATE LEVEL EXAMINATION

### L1.4 : AUDITING

**THURSDAY: 12 JUNE 2014**

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#### INSTRUCTIONS:

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

## SECTION A

*(Attempt all questions in this section)*

### QUESTION ONE

**Construct Ltd** is a construction contractor. The construction work is carried out using a mixture of machines and casual workers. Casual workers normally work a standard seven hour day, although this is supplemented by overtime on a regular basis as the company attempts to meet the deadline.

Casual workers arrive at work at about 6.00 am and ‘clock in’ using an electronic identification card. The card is scanned by the time recording system and each worker’s identification number is read from their card by the scanner. The worker is then logged in as being at work. Workers are paid from the time of logging in. The logging in process is not monitored as it is assumed that workers would not work without first logging in on the time recording system.

Workers are divided into two groups of about 40 employees, with each group under the supervision of a group manager. Each day, each group of workers is allocated a specific task to be completed.

If necessary, overtime is worked to complete the day’s assigned task. The group manager is not required to monitor the extent of any overtime working, although the group manager does ensure workers are not taking unnecessary or prolonged breaks which would automatically increase the amount of overtime worked. Workers log off at the end of each day by re-scanning their identification cards.

Details of hours worked each week are sent electronically to the payroll department, where hours worked is allocated by the computerized wages system to each employee’s wages records. Staff in the payroll department compare hours worked from the time recording system to the computerized wages system, and enter a code word to confirm the accuracy of transfer. The code word also acts as authorization to calculate net wages. The code word is generally known around the department.

Each week the computerized wages system calculates :

- (i) Gross wages, using the standard rate and overtime rates per hour for each employee,
- (ii) Statutory deductions from wages, and
- (iii) Net pay

The list of net pay for each employee is sent over Construct Ltd’s internal network to the accounts department. In the accounts department, an accounts clerk ensures that employee bank details are on file. The clerk then authorizes and makes payment to those employees using the company’s online banking systems.

When employees leave the company, the personnel department sends an e-mail to the payroll department detailing the employee’s termination date and any unclaimed holiday pay. The receipt of the e-mail by the payroll department is not monitored by the personnel department.

All group managers are paid an annual salary; there are no overtime payments.

Salaries were increased in January by 10% and an annual bonus of 4% of salary was paid in May.

**Required :**

- (a) State **FOUR** control objectives of a wages system. **(4 Marks)**
- (b) As the external auditor of Construct Ltd;
  - (i) Identify and explain four deficiencies in that system. **(4 Marks)**
  - (ii) Explain the possible effect of each deficiency. **(4 Marks)**
  - (iii) Provide a recommendation to alleviate each deficiency. **(4 Marks)**
- (c) List **TWO** substantive analytical procedures you should perform on the group manager's salary system. For each procedure, state your expectation of the results of that procedure. **(4 Marks)**

**(Total 20 Marks)**

**QUESTION TWO**

The recent global economic crisis has provided many challenges for the auditors of financial statements as businesses faces different challenges such as reduced customer demand and lack of capital investment. This implies that some companies may no longer be a going concern entity. All audits should involve an assessment of the appropriateness of the going concern assumption and it is obvious that an auditor has to perform additional audit procedures at the audit completion stage.

**Required:**

- a) Define the term “**going concern**” and discuss the auditor's responsibilities for the appropriateness of the going concern assumptions as a basis for the preparation of financial statements. **(5 Marks)**
- b) Explain the audit procedures to be carried out to evaluate whether the going concern assumptions have been used appropriately in preparing the financial statements. **(8 Marks)**
- c) Explain the audit procedures the auditor may perform where the auditor has decided that a company is unlikely to be a going concern **(7 Marks)**

**(Total 20 Marks)**

**QUESTION THREE**

- (a) Explain the term “**audit risk**” and the three elements of risk that contribute to total audit risk. **(6 Marks)**
- (b) The Amani club was established in 2010. The club's aim is to provide entertainment to its members who wish to take part in sports such as basketball, volleyball and football.

Amani club has a detailed constitution which explains how the club income can be spent. The constitution also shows that the administration expenses cannot exceed 10% of income in a year.

The club income is generated wholly from members. Sources include :

- i) Members' contributions in cash
- ii) Members' contributions by cheque sent directly to head office of the club
- iii) Donations from generous individuals. Some of these donations have specific clauses attached to them indicating the initial amount donated cannot be spent and that the income derived from the donations must be spent on provision of sports equipment.

The taxation laws of clubs in a country where Amani club operates are complex. Only certain expenses are allowable for taxation purpose.

**Required :**

- i) Identify and explain the inherent risk to be considered when designing the audit approach.

**(10 Marks)**

- ii) Discuss why the control environment of Amani club may be weak.

**(4 Marks)**

**(Total 20 Marks)**

## **SECTION B**

**Attempt ANY TWO questions in this section**

### **QUESTION FOUR**

- a) Contrast the role of internal and external auditors. **(10 Marks)**

Both internal and external auditors are required to deal with risks due from fraud or error of the entity. However, the responsibilities of internal and external auditors in relation to the risk of fraud and error differ.

**Required:**

- b) Explain how the internal audit function helps an entity deal with the risk of fraud and error. **(5 Marks)**
- c) Explain the responsibilities of external auditors in respect of the risk of fraud and error in an audit of financial statements. **(5 Marks)**

**(Total 20 Marks)**

### **QUESTION FIVE**

Auditors are required to adhere to the fundamental principles of professional ethics while they are conducting audit assignments.

**Required :**

- (a) List and explain the FIVE fundamental principles of professional ethics that govern the accounting profession. **(10 Marks)**
- (b) Explain the possible threats to independence and objectivity that may exist. **(5 Marks)**
- (c) Auditors sometimes rely on the work of experts while conducting the audit assignment.

List and explain the factors the auditor should consider before relying on the work of experts. **(5 Marks)**

**(Total 20 Marks)**

### **QUESTION SIX**

- a) The auditor has a responsibility to design audit procedures to obtain sufficient and appropriate audit evidence. There are various audit procedures available for obtaining evidence.

**Required:**

- (i) State and explain audit procedures to obtain evidence; and
- (ii) For each procedure, describe an example relevant to the audit of purchases and other expenses.

**(10 Marks)**

b) Kigali Ltd is a company dealing in manufacturing of plastic items. The company's year end is 31 July 2011 you are the audit senior and you are going to start planning the audit.

**Required :**

1. Describe the process the auditor should perform to ensure the preconditions for an audit are present.

**(3 Marks)**

2. List four examples of matters the auditor may consider in order to obtain an understanding of the entity.

**(2 Marks)**

3. Discuss the role of audit planning.

**(5 Marks)**

**(Total 20 Marks)**

**QUESTION SEVEN**

The ISA 705 "Modifications to the opinion in the independent Auditor's report" provides circumstances under which audit opinion can be modified.

**Required :**

a) Explain different circumstances that could lead to the following modified audit opinion :

(i) Except for **(4 Marks)**

(ii) Adverse opinion **(2 Marks)**

(iii) Disclaimer of opinion **(2 Marks)**

b) Distinguish between "emphasis of matter" paragraph and "other matter" paragraph in the auditor's independent audit report. **(6 Marks)**

c) List six basic elements of an audit report. Briefly explain why each element is included in the report. **(6 marks)**

**(Total 20 Marks)**

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**End of question paper**

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