



ZIMBABWE EZEKIEL GUTI UNIVERSITY

FACULTY OF LAW, BUSINESS INTELLIGENCE AND ECONOMICS

DEPARTMENT OF ACCOUNTING, FINANCE AND HUMAN CAPITAL MANAGEMENT

EXAMINATION PAPER

COURSE CODE : CAC408

COURSE TITLE : ADVANCED THEORY AND PRACTICE OF AUDITING II

SPECIAL REQUIREMENTS : NONE

DURATION : 3 Hours

LEVEL : 4.2

DATE : 12 OCT 2023

INSTRUCTIONS TO CANDIDATES:

1. No cell phones are allowed in the examination venue
2. Use of silent, non-programmable calculators is allowed
3. Answer ALL questions.
4. Begin each question on a new page.
5. The number of marks for each question or part question is shown in brackets []

Question One

Chimuti Ltd provides scientific services to a wide range of clients. Typical assignments range from testing food for illegal additives to providing forensic analysis on items used to commit crimes to assist law enforcement officers. The annual audit is nearly complete. As audit senior you have reported to the engagement partner that Chimuti Ltd is having some financial difficulties. Income has fallen due to the adverse effect of two high-profile court cases, where Chimuti Ltd services to assist the prosecution were found to be in error. Not only did this provide adverse publicity for Chimuti Ltd, but a number of clients withdrew their contracts. A senior employee then left Chimuti Ltd, stating lack of investment in new analysis machines was increasing the risk of incorrect information being provided by the company. A cash flow forecast prepared internally shows Chimuti Ltd requiring significant additional cash within the next 12 months to maintain even the current level of services. Chimuti Ltd's auditors have been asked to provide a negative assurance report on this forecast.

- a) Explain the audit procedures that may be carried out to try to determine whether or not Chimuti Ltd is a going concern. **(10 Marks)**

- b) Explain the audit procedures the auditor may take where the auditor has decided that Chimuti Ltd is unlikely to be a going concern. **(8 Marks)**

- c) In the context of the cash flow forecast, define the term 'negative assurance' and explain how this differs from the assurance provided by an audit report on statutory financial statements. **(7 marks)**

[Total: 25 Marks]

Question Two

You are the external auditor of Chinzara Chinzara (CC), a public limited company. The company's year-end is 31 March. The company was formed 18 years ago to take advantage of the increase in goods being transported by road. You have been the auditor since the inception of the company.

Many companies need to transport their products by road but do not always have sufficient vehicles to do so. CC therefore, hires vehicles to different companies and has about 1,500

vehicles in total, consisting of vans and lorries. The company operates throughout Zimbabwe and the Mozambique.

Occasionally, the vehicles break down or are involved in road traffic accidents. The company has an arrangement with a motoring organisation to attend to such breakdowns or accidents and to either transport the vehicle to the nearest depot or, at the very least, to ensure that it is not causing an obstruction or danger on the road.

If the vehicle is badly damaged or suffers a serious mechanical fault, it is Jamilo's job to inspect the vehicle and to make a decision either to have it repaired or written off and sold for the residual value. Jamilo is a qualified mechanic, with many years' experience of working with heavy goods vehicles and has excellent contacts in the trade. In cases where he decides to scrap the vehicle, he will usually dispose of it to a contact in fairly close proximity to where it has broken down or been crashed, since the cost of transporting such a vehicle over a long distance is usually prohibitive. Such scrappages have to be approved in advance by the insurance company if they result from an accident but not if they result from a mechanical fault.

The newly-appointed CEO of CC has been reviewing some statistics produced by the company. She has noticed an apparent anomaly in relation to Jamilo's work. Up to about one year ago, Jamilo recommended scrapping about 15% of the vehicles he inspected, irrespective of whether they had broken down or been involved in an accident. However, in the last 12 months he has recommended scrapping nearly 90% of broken-down vehicles, but only about 10% of the vehicles that were involved in accidents. The CEO is concerned that Jamilo may be involved in some kind of fraudulent or "irregular" activity.

The CEO has asked you, as external auditor, to conduct a discreet investigation to discover if this is indeed the case and, if not, to produce a report that explains Jamilo's seemingly anomalous behaviour.

REQUIRED:

- a) Appraise the extent to which the external auditor is the most appropriate person to carry out such an investigation. **(6 Marks)**
- b) Analyse the matters to be taken into consideration before deciding whether or not to accept this appointment in addition to continuing as auditor. **(7 Marks)**

- c) Evaluate the argument that it is impossible in this case to determine whether or not Jamilo has been dishonest in the past year. (6 Marks)
- d) Recommend, stating reasons, a system that could be introduced that would allow CC to exercise greater control over Jamilo's activities. (6 Marks)

[Total: 25 Marks]

Question Three

You are the audit manager in Kurai Chartered Accountants and Registered Auditors. The below situations below have arisen in three unrelated external audit clients of your firm. It is now 10 March 2023 and the year end in each case is 31 December 2022.

MIT Supplies Ltd. (MITS):

During the year, MITS was engaged by a customer to test its resilience to a cyber-attack. The customer alleges that MITS "brought its system down", resulting in three days of lost trade. The customer has initiated legal proceedings against MITS for negligence. You have reviewed correspondence in relation to the claim and have discussed the incident with the lawyer engaged by MITS. The lawyer has stated it is very likely the customer will win the case, and has estimated the loss to be within the range of \$1,500,000 to \$1,600,000. The directors of MITS have not recorded a provision in the year-end financial statements, as they believe MITS will win the case. MITS has presented a profit before tax of \$12,000,000 in the financial statements, and materiality has been calculated at 10% of profit before tax.

Natural Stone Company Ltd. (NSC):

NSC is reliant on the continuing support of its bank to fund operations. The current loan facility expires on 30 September 2023. However, the directors expect to be able to renew the facility on similar terms, although they have no binding agreement with the bank. The directors have prepared cash-flow forecasts for the year ended 31 December 2023, based on the assumption that the facility will be renewed. These forecasts indicate that the company will be able to meet its liabilities as these fall due. The directors have agreed to include a note to the financial statements which fully discloses the situation. The audit report is due to be signed on 30 June 2023.

Kurai Building Supplies Ltd. (KBS):

KBS maintains continuous inventory records and, consequently, the company does not perform a physical count at the year end. On 5 February 2023, a fire in the office at the KBS warehouse destroyed the company's inventory and dispatch records. The physical inventory was not damaged. There were no satisfactory alternative audit procedures which could be performed. The company has included an estimated closing inventory figure of \$805,000 in the financial statements. This estimate represents 5% of total assets and 20% of profit before tax.

REQUIRED:

Assess the **THREE** situations outlined above and state whether the audit report should be modified. Justify your conclusions and outline the modifications, if any, to each audit report.

(25 Marks)

[Total: 25 Marks]

Question Four

As the audit manager you noticed that the audit clerk has tested all assertions relating to PPE but the working papers are showing that no evidence was gathered for depreciation. You are aware that this work must be done in reference to **ISA540**.

a) Explain the importance regulation in the work of an auditor. **(10 Marks)**

b) Explain why a risk based approach must be adopted when auditing depreciation.

(7 Marks)

c) Describe and explain procedures that an auditor may use to gather sufficient and appropriate evidence in this case.

(8 Marks)

[Total: 25 Marks]

END OF EXAMINATION QUESTION PAPER

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