



***"Investing in Africa's Future"***

**COLLEGE OF BUSINESS PEACE LEADERSHIP AND GOVERNANCE**

**ADVANCED AUDITING MAC 405**

**END OF SECOND SEMESTER EXAMINATIONS**

**MAY/ JUNE 2020**

**LECTURER: N. E CHIRIMA**

**Time : 48 Hours**

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### ***INSTRUCTIONS***

ANSWER ONE QUESTION USING MICRO SOFT 97 – 2003 Document

EACH QUESTION IS WORTH 100 MARKS

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CLEAR AND NEATLY PRESENTED WORK WILL BE AWARDED MARKS FOR  
PRESENTATION

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## QUESTION 1

“Federal securities law requires that the accounting statements of publicly traded corporations be certified by an independent auditor. Enron’s auditor, Arthur Andersen, not only turned a blind eye to improper accounting practices, but was actively involved in devising complex financial structures and transactions that facilitated deception. An auditor’s certification indicates that the financial statements under review have been prepared in accordance with generally-accepted accounting principles (GAAP). In Enron’s case, the question is not only whether GAAP were violated, but whether current accounting standards permit corporations to play “numbers games,” and whether investors are exposed to excessive risk by financial statements that lack clarity and consistency. Accounting standards for corporations are set by the Financial Accounting Standards Board (FASB), a non-governmental entity, though there are also SEC requirements. (The SEC has statutory authority to set accounting standards for firms that sell securities to the public.) Some describe FASB’s standards setting process as cumbersome and too susceptible to business and/or political pressures.” (Jikling, 2003)<sup>1</sup>.

1. What audit risk components did Arthur Andersen face in the Enron Case? (Lay out your answer in three parts indicating detection risk, control risk and inherent risk).  
*15 Marks*
2. ISA 240 states that “in planning and performing the audit to reduce audit risk to an acceptably low level, the auditor should consider the risks of material misstatements in the financial statements due to fraud.” With reference to various articles on the Arthur Andersen – Enron Case, were adequate measures taken by Arthur Andersen to ensure that risk is reduced to an acceptably low level and sufficient appropriate evidence gathered?  
*25 marks*

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<sup>1</sup> Business Writer. (2019, October 18). IAS 29 An Unnecessary Burden: Accountants. *Financial Reporting in Hyperinflationary Economies*. Harare: Business Weekly.

3. Explain the responses to the rise in financial market scandals made in 4 countries (one of them should be your home country). Indicate how each of the responses has had an impact on the audit profession in the 21<sup>st</sup> century. *25 marks*
4. In your opinion, to what extent will the measures taken to strengthen the auditors independence; as per your response in part 2 of this question; prevent, detect and correct financial scandals? *35 marks*

## QUESTION 2

1. “Accounting and auditing practitioners are however of the opinion that IAS 29, which requires a detailed series of procedures represents a challenge for reporting entities and auditors without adding value.” (Business Writer, 2019)<sup>2</sup>.

As an auditor presented with the Financial Report for JZ Ltd, a timer manufacturing company listed on the Zimbabwe Stock Exchange, for the year ended 30 April 2020:

- a. Briefly explain the “challenges for reporting entities and auditors without adding value” referred to in the above quote. *15 marks*
- b. To what extent do you agree with the abovementioned opinion by accountants in Zimbabwe, as reported in the Business Weekly Newspaper. Support your answer with examples. *15 marks*
- c. In accordance with ISA 700 and ISA 701, how would the following affect your audit opinion of the financial statements:
  - i. Failure to comply with IAS 29 in all respects *2 marks*
  - ii. Wrong interpretation and application of IAS 29 requirements by the accountant *2 marks*

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<sup>2</sup> Jikling, M. (2003). *The Enron Collapse: An overview of Financial Issues*. New York: Congressional Research Service - Congress Library.

iii. Material professional judgment differences in the estimates used by the accountant. *2 marks*

iv. The indefinite lockdown period *4 marks*

2. You have started an audit engagement for which you had to move out of the city of your residence. Consequently, a number of people around you, including family, friends and colleagues, are aware of the fact that you are the manager in charge on the said audit. Some of them are interested in having certain information as discussed below:

- a. A manager in your firm (other than the engagement manager for the said client) has inquired about the internal controls in place, in respect of a specific process. Assuming that the same would be effective, he intends to recommend the same as best practice to a local pharmaceutical client.
- b. Your sister has asked you about the ingredients of a specialized nutritional product for children, being marketed by the company, which she is using for her child. You are aware of all the details about the said product, as you got the opportunity to perform tests on the costing of that product.
- c. One of your friends is working in the Ministry of Health, a Government department. He has asked you as to whether the company has complied with certain statutory requirements. You are aware of the fact that the company is not complying with the same and you have already included the matter in the management letter. With reference to specific provision of law, he has convinced you that it is his duty to enquire about the same, and you are responsible to disclose the relevant information to the Ministry. He has also informed you that in case of no response; you may be served with a legal notice.
- d. Your younger brother intends to commence distribution business. He has asked you about the rate of commission and volume rebates being allowed by the said client to its distributors, as he wants to work out the feasibility of business.
- e. Your father invests his surplus funds in the capital market. Being aware of the fact that companies like that always have a five to ten year's plan in place. He has asked you about the trend of earnings per share of the said company for the last five years, and the expected growth in the net profits for the next five years.

Briefly explain, for each situation whether or not you can provide the requisite information.  
*5 marks for each situation = 25 marks*

3. “Atlas, Inc.<sup>2</sup> was a spin-off from a large multi-national corporation. The seasoned executives were excited at the opportunity to enter the market without the bureaucratic burden of a larger corporation. With contracts and experienced personnel already in place, Atlas aggressively hit the market and their bottom-line grew quickly. The message from executive management was for employees to get back to the basics of doing good business and have fun while doing it. The president articulated that he did not want the web of policies and procedures from the previous corporate culture to follow them to Atlas. No one heard that message louder than John, the Vice President of Operations. Without oversight, John’s spending habits dramatically increased as a false sense of power overtook him. Unable to cover his debts through his corporate expense account, he took a different course of action to increase his earnings. After four years of Atlas’ strong growth and performance, an anonymous tip led executives to uncover that Atlas had been paying a false vendor for two years. The false vendor fabricated reports for the services it was supposed to have provided to Atlas. The perpetrator of this fraud was John, Atlas’ own Vice President of Operations. An ineffective and poorly designed process for the selection of new vendors allowed John the authority to approve a new vendor, review the vendor’s reports, and approve the vendor’s invoices for payments. Atlas prided itself on allowing employees to provide referrals to vendors who had the best experience serving Atlas’ unique market; however, in the absence of checks and balances, this created an environment ripe for fraud. As a result, John simply created a fake company and recommended this company to Atlas.” (Scott & Walsh, 2019)<sup>3</sup>.

1. ISA 315 outlines components of an effective Internal Control. Identify weaknesses in Atlas Inc’s Internal Controls, the risks posed by these weaknesses as well as the

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<sup>3</sup> Scott, B., & Walsh, C. (2019, August 15). *Fighting Fraud: An Inside Look at Fraud Origination and Prevention*. Retrieved January 22, 2020, from Baker Tilly: [www.bakertilly.com](http://www.bakertilly.com)

recommendations you would give to address these weaknesses as an auditor of the company. *25 marks*

2. Based on the International Standards on Auditing as well as the Company's Act, what are the auditors' responsibilities in relation to fraud? *5 marks*
3. ISA 315 clearly explains three elements that can be used as indicators of fraud; with a fourth one being added in recent publications on fraud. Identify each of the four elements in the above case. *5 marks*