

**TECHNICAL UNIVERSITY OF MOMBASA**

**SCHOOL OF BUSINESS**

**ACCOUNTING AND FINANCE DEPARTMENT**

**COURSE/CLASS: BACHELOR OF BUSINESS ADMINISTRATION  
BACHELOR OF COMMERCE**

**UNIT : BAC 4302**

**UNIT NAME : AUDITING I**

**SERIES : MAY 2016**

**TIME : 2 HOURS**

**INSTRUCTIONS TO CANDIDATES:**

Answer Question One (Compulsory) and any other TWO questions.

## QUESTION 1 (COMPULSORY)

- (a) Compare the responsibilities of the directors and auditors regarding the published financial statements. (6 marks)
- (b) Explain the purpose of a management representation letter. (6 marks)
- (c) Suggested format for the letter of representation has been sent by the auditors to the directors of a client company. The directors have stated that they will not sign the letter of representation this year on the grounds that they believe the additional evidence that it provides is not required by the auditor.

**Required:**

Discuss the actions the auditor may take as a result of the decision made by the directors not to sign the letter of representation. (6 marks)

- (d) In the context of ISA530 (audit sampling and other means of Testing) explain the term “sampling” risk and “Non-Sampling” risk.

**Required:**

Briefly explain how sampling and non-sampling risk can be controlled by the audit firm. (6 marks)

- (e) IAS2 ‘Inventories’ requires that inventories are measured at the lower of cost and net realizable value.

**Required:**

- (i) Explain why the audit of inventory is important to auditors. (2 marks)
- (ii) Define “Cost” and “Net realizable Value” according to IAS 2 “Inventories”. (2 marks)
- (iii) 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. (2 marks)

## QUESTION 2

Your firm is the newly appointed external auditor to a large company that sells, maintains and leases office equipment and furniture to its customers and you have been asked to co-operate with internal audit to keep total audit costs down. The company wants the external auditors to rely on some of the work already performed by internal audit.

The internal auditors provide the following services to the company:

- (i) A cyclical audit of the operation of internal controls in the company’s major functions (operations, finance, customer support and information services)
- (ii) A review of the structure of internal controls in each major function every four years.

- (iii) An annual review of the effectiveness of measures put in place by management to minimize the major risks facing the company.

During the current year, the company has gone through a major internal restructuring in its information services function and the internal auditors have been closely involved in the preparation of plans for restructuring, and in the related post-implementation review.

**Required:**

- (a) Explain the extent to which your firm will seek to rely on the work of the internal auditors in each of the areas noted above. (5 marks)
- (b) Describe the information your firm will seek from the internal auditors in order for you to determine the extent of your reliance. (5 marks)
- (c) Describe the circumstances in which it would NOT be possible to rely on the work of the internal auditors. (5 marks)
- (d) Explain why it will be necessary for your firm to perform its own work in certain audit areas in addition to relying on the work performed by internal audit. (5 marks)
- (Total = 20 marks)

**QUESTION 3**

The purpose of an external audit and its role are not well understood. You have been asked to write some material for inclusion in your firm's training materials dealing with these issues in the audit of large companies.

**Required:**

Draft an explanation dealing with the purpose of an external audit and its role in the audit of large companies, for inclusion in your firm's training materials. (20 marks)

**QUESTION 4**

- (a) Explain the situations where an auditor may disclose confidential information about a client. (5 marks)
- (b) You are an audit manager in Musa & Co., a firm of Certified Public Accountants (CPA). You are preparing the engagement letter for the audit of Azania Co. Ltd; a public limited liability company, for the year ending 30 June 2016. Azania Co. Ltd has grown rapidly over the past few years, and is now one of your firm's most important clients. The company has been an audit client for 8 years and Musa & co. has provided audit, taxation and management consultancy advice during this time.

The client has been satisfied with the services provided, although the taxation fee for the period to 31 December 2015 remains unpaid. Audit staff available for this year's audit are most of the staff from last year, including Mr. Gamba, an audit partner and Mr. Hassan, an audit senior. Mr. Gamba has been the audit partner since Azania Co. Ltd became an audit client. You are aware that Alice Gamba, the daughter of Mr. Gamba, has recently been appointed the financial director at Azania Co. Ltd. To celebrate her new appointment, Alice

Gamba has suggested taking all of the audit staff out to an expensive restaurant prior to the start of the audit work for this year.

**Required:**

Identify and discuss the risks to auditors' independence in carrying out your audit of Azania co. Ltd. for the year ending 30 June 2016, and suggest ways of mitigating each of the risks you identify. (15 marks)

**QUESTION 5**

Audit planning process allows the audit senior to acquire adequate knowledge about the entity. This process ensures an effective control and review of audit work.

**Required:**

- (a) Explain the auditor's planning process when planning for an audit of a new client. (8 marks)
- (b) How does audit planning assist in the conduct of an audit? (6 marks)
- (c) Explain the following controlling procedures in a well planned audit:
  - Direction and supervision of work
  - Review and co-ordination of work
  - Quality controls. (6 marks)