



The Co-operative University of Kenya

END OF SEMESTER EXAMINATION DECEMBER-2016

EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE **(BCOM YR IV SEM I)**

UNIT CODE: HBA 2402

UNIT TITLE: ADVANCED AUDITING/ ADVANCED AUDIT ASSURANCE

DATE: 16TH DECEMBER, 2016

TIME: 2:00 PM – 4:00 PM

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

- (a) XYZ Ltd is a firm where the CEO and chairman of the board of directors Mr. Oscar Mkubwahas appointed a board consisting of 5 executive directors. In the firm, there are no formal targets for the board member and meetings are ad hoc and unplanned. The remuneration of the directors is set and paid by the CEO based on his assessment. Internal controls of the company are established and monitored by the chief accountant who then report the findings to the CEO. The CEO has recently appointed his eldest son a major supplier of the company to deputize him and chair the board meetings when he is absent

Required:

Assess whether the corporate governance standards have been met and it not describe the changes you would propose (10 marks)

- (b) Your colleague has been recently promoted as an audit senior at CPA Associated firm and is required to lead a team of auditors to NM Ltd a computer sales and maintenance firm

Required: Describe the working papers that your colleague should request to familiarize himself with NM Ltd audit and also explain what information he should obtain from them (10 marks)

- (c) Another colleague of your has been appointed as the audit manager of City County Office which deals with offering public services including garbage collection, cleaning of city streets, control of vehicle parking, city public health services, city planning and public works and city education. The county office has long time is associated with poor good corporate governance and poor transparency and lack ethics among its staff and member. Your colleague is required to plan an audit and ensure that audit risk is kept at less than %%

Required: identify and describe matters that give rise to audit risk and explain how possible if is for the audit risk to be kept below 5% of the City County Office case (10 marks)

QUESTION TWO

You are an audit senior of S Ltd and you are in the process of reviewing the system testing completed on the payroll cycle of B Ltd as well preparing the audit procedures for the final audit. B Ltd operates a plant that functions 24 hours a day, seven days a week and employees

work a standard shift of eight hours and are paid for hours worked at an hourly rate. Factory employees are paid weekly, with approximately 80% being paid bank transfer and 20% in cash; the different payment methods are due to employee preferences and B Ltd has no plans to change these methods. The administration and sales teams are paid monthly by bank transfer.

Factory staff are issued a sequentially numbered clock card which details their employee number and name. Employee swipe their cards at the beginning and end of the eight hour shift and this process is not need to clock out to access the dining area. Clock card data links into the payroll system, which automatically calculates gross and net pay along with any statutory deductions. The payroll supervisor for each payment run checks on a sample basis some of these calculations to ensure the system is operating effectively.

B Ltd has a human resource department which responsible for recruitment new permanent employees. Appointments temporary staff are made by factory production supervisors. Occasionally overtime is required of factory staff, usually to fill gaps caused by staff holidays. Overtime reports which detail the amount of overtime worked are sent our quarterly by the payroll department to production supervisors for their review.

To encourage staff to attend work on time for all shifts B Ltd pays a discretionary bonus every six months to factory staff; the production supervisors determine the amounts to be paid. This is communicated in writing by the production supervisors to the payroll department and the bonus is input by a clerk into the system.

For employees paid by bank transfer, the payroll manager reviews the list of the payments and agrees to the payroll records prior to authorizing the bank payment. If any changes are required, the payroll manager amends the records. For employees paid cash, the pay packets are prepared in the payroll department and a clerk distributes them to employees; as she knows most of these individuals she does not required proof identify.

Required:

- i. Identify and explain FOUR internal control weaknesses in B Ltd payroll system and provide a recommendation to address each of these deficiencies (7 marks)
- ii. Describe FOUR tests control that you should perform in B Ltd payroll expense (6 marks)
- iii. Describe FOUR substantive procedures you should perform in B payroll expense (7 marks)

QUESTION THREE

Z Ltd is a convenience store, and its year end is 30 September 2015. You are the audit supervisor of CPA Associates and are developing the audit procedures for the forthcoming interim audit. The company's internal audit department had provided you with documentation relating to the stocks assets cycle including the related controls listed below.

Z Ltd has a capital expenditure committee and all 5, purchase orders for inventory items are required to be authorized by this committee.

On receipt, each inventory items is assigned a unique serial number and this is recorded on asset and in the non-current assets register.

When an inventory item arrives, a goods received note (GRN) is completed which details the nature of the expenditure (i.e whether is it capital or revenue), and the GRN classification is reviewed and initialed by a responsible official

Periodically, internal audit undertakes a review of inventories recorded in the bin cards and compares them to physical inventories to confirm physical existence

Access to the bin cards is restricted through passwords to a small number of staff in the cash and finance office

Required

- i. Explain FIVE factors which influence the reliability of audit evidence (5marks)
- ii. Identify and explain the FIVE factors that determine the audit sample size (5 marks)
- iii. Describe the types of sampling error (4 marks)
- iv. Discuss the merits and demerits of random and non-random audit sampling methods (6 mark)

QUESTION FOUR

S Ltd's new finance director has read about review engagements and is interested in the possibility of M Ltd undertaking these in the future. However, she is unsure how these engagements differ from an external audit and how much assurance would be gained for this type of engagement

Required:

- i. Describe the level of assurance provided by external audits and review engagements (4 marks)
- ii. Describe compilation and due diligence engagements (4 marks)
- iii. Identify financial statement assertions and describe an audit procedure relevant to each assertion (12 marks)

QUESTION FIVE

- (a) Describe the period that are deemed to occur after the balance sheet date and indicate the auditor's obligation towards audit of financial statements relating to each period (10 marks)
- (b) G Ltd has a chain of supermarkets across the country. The audit for the year ended 31 December 2015 is almost complete the financial statements and audit report are due to be signed on 1st February 2016 and financial statements issued in 1st March 2016. The profit before taxation is shs 79 million. The following events have occurred subsequent to the year end and no amendments or disclosure have been made in the financial statements

Even 1 – fire

On 15th February 2016, fire occurred and caused extensive damage to 40% of the company's inventory which fortunately was insured. However, there are concerns for the fire was started deliberately and if true, would invalidate any insurance cover.

Even 2 – Inventory

18 February 2016, it was discovered that a large batch of G Ltd's inventory at the year end was defective, as it was beyond sell by date. To date no sales inventory have been made. The cost of the defective batch inventory is shs 9.15 million and the defects cannot be corrected.

Required:

For each of the two subsequent events described above;

Based on the information provided, explain whether the financial statements required amendment (10 marks)