



JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY
SCHOOL OF BUSINESS & ECONOMICS
UNIVERSITY EXAMINATION FOR THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION (MBA)
FOR
SECOND YEAR SEMESTER ONE ACADEMIC YEAR 2018/2019
MAIN CAMPUS – PART-TIME

COURSE CODE: MBA 814

COURSE TITLE: AUDITING & INVESTIGATION

EXAM VENUE:

DATE:

EXAM SESSION:

DURATION: 3 HOURS

INSTRUCTIONS

- 1. Answer ANY FOUR questions. Each question carries equal marks.**
 - 2. Candidates are advised not to write on the question paper**
 - 3. Candidates must hand in their answer booklets to the invigilator while in the examination room**
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QUESTION ONE (25 MARKS)

- (a) What is the general definition of an audit? Briefly discuss the key component parts of the definition. [7 Marks]
- (b) What are the four phases of an audit process model? Briefly describe each. [8 Marks]
- (c) Based on ISA 200 what are the general principles governing an audit of financial statements. Discuss ethics, professional skepticism, audit scope, business risk and audit risk. [10 Marks]

QUESTION TWO (25 MARKS)

- (a) The general public thinks that an auditor guarantees the accuracy of financial statements. Is this true? Why? What other things does the public believe about audited financial statements? [5 Marks]
- (b) The responsibilities of external auditors are not always well understood, especially with regard to the detection and reporting of fraud. When external auditors provide non-audit services to their audit clients, it is essential that the auditors make a clear distinction between their audit and non-audit responsibilities.

Required:

- (i) Explain the responsibilities of external auditors to directors and shareholders. [5 Marks]
- (ii) Describe the limitations of the external audit in relation to the detection and reporting of fraud. [5 Marks]
- (iii) Explain why it is essential for external auditors to be independent of their clients. [5 Marks]
- (iv) Explain the advantages and disadvantages of external auditors providing consulting services to their audit clients. [5 Marks]

QUESTION THREE (25 MARKS)

Rusha is a company that provides call center services for a variety of organizations. It operates in a medium sized city in which yours is the largest audit firm. Rusha is owned and run by two entrepreneurs with experience in this sector and has been in existence for five years. It is expanding rapidly in terms of its client base, the number of staff it employs and its profits. It is now 15 June 2014 and you have been approached to perform the audit for the year ending 30 June 2014. Your firm has not audited this company before. Rusha has had three different firms of auditors since its incorporation. Rusha's directors have indicated to you informally that the reason they wish to change auditors is because of a disagreement about certain disclosures in the financial statements in the previous year. The directors consider that the disagreement is a trivial matter and have indicated that the company accountant will be able to provide you with

the details once the audit has commenced. Your firm has explained that before accepting the appointment, there are various matters to be considered within the firm and other procedures to be undertaken, some of which will require the cooperation of the directors. Your firm has other clients that operate call centers. The directors have asked your firm to commence the audit immediately because audited accounts are needed by the bank by 30 July 2014. Your firm is very busy at this time of year.

Required:

- (i) Describe the matters to consider within your firm and the other procedures that must be undertaken before accepting the appointment as auditor to Rusha. [10 Marks]
- (ii) Explain why it would be inappropriate to commence the audit before consideration of the matters and the procedures referred to in (i) above have been completed. [8 Marks]
- (iii) Explain the purpose of an engagement letter and list its contents. [7 Marks]

QUESTION FOUR (25 MARKS)

- (a) The objectivity of the external auditor may be threatened or appear to be threatened where:
 - 1. There is undue dependence on any audit client or group of clients.
 - 2. The firm, its partners or staff have any financial interest in an audit client.
 - 3. There are family or other close personal or business relationships between the firm, its partners or staff and the audit client.
 - 4. The firm provides other services to audit clients.

Required:

- (i) For each of the four examples given above, explain why the objectivity of the external auditor may be threatened, or appear to be threatened, and why the threat is important. [16 Marks]
- (ii) Describe ISAs requirements that reduce the threats to auditor objectivity for each of the four examples given above. [9 Marks]

QUESTION FIVE (25 MARKS)

- (a) Four friends who are auditing students have a discussion. John says that the primary responsibility for the adequacy of disclosure in the financial statements and footnotes rests with the auditor in charge of the audit field work. Maingi says that the partner in charge of the engagement has the primary responsibility. Abdul says the staff person who drafts the statements and footnotes has the primary responsibility. Yolanda contends that it is the client's responsibility.

Required:

Which student is correct and why? [5 Marks]

- (b) As part of the process of planning the external audit of Five Dock, a public listed company, for the year ending 31 October 2012, you have reviewed the minutes of meetings of the Board of Directors for the year to date. You have identified the following items likely to have a bearing on the assessment of audit risk and the design of audit procedures when drawing up an audit plan.
1. On the recommendation of its nonexecutive Chairman, Five Dock has invested a substantial amount in the shares of Burwood, a private company, of which the Chairman is chief executive and major shareholder.
 2. Development project 21A is behind schedule. Unexpected problems have emerged which will substantially increase the cost of development and the production cost of the new product. Sh.120,000 of development cost was recognised as an asset in the balance sheet last year. A further Sh.50,000 has been spent this year. The original budget was Sh.130,000.
 3. In order to encourage performance, a bonus scheme has been introduced for senior management. In total, 25% of the company's reported profits before tax in excess of the previous period's profits will be set aside to provide for bonuses. No bonus will be paid if profits do not exceed the previous year.
 4. An internal audit department has been established.
 5. In order to finance investment in new projects, Five Dock has taken out a substantial bank loan. The loan agreement states that the company's gearing ratio (the proportion of loan capital to equity capital) must not exceed 30%. Last year's financial statements had a gearing ratio of 20% and the latest monthly management accounts show a gearing ratio of 25%.

Required:

For each of the items (1) to (5) above:

- (i) Explain how it might affect the assessment of inherent or control risk. [8 Marks]
- (ii) Consider how it might affect the design of audit procedures specific to that item.

[12 Marks]

NB: (Assume each item is potentially material. Consider each item separately).

QUESTION SIX (25 MARKS)

- (a) Based on the standard Audit Process Model, trace the procedures an auditor would use to audit a retail clothing business (continuing client) from the initial client contact to the audit opinion. [5 Marks]
- (b) Amongst matters required to be considered by the auditor when planning the audit in accordance with the requirements of ISA 300 *Planning an Audit of Financial Statements* are those of 'materiality' and the 'direction, supervision and review' of the audit. Materiality is

further the subject of ISA 320 *Audit Materiality*. Direction, supervision and review are considered in more detail within other Auditing Standards.

Required:

- (i) Explain the concept of materiality and how materiality is assessed when planning the audit. Your answer should include consideration of materiality at the overall financial statement level and in relation to individual account balances. [12 Marks]
- (ii) Explain the nature and significance of direction, supervision and review both in planning the audit and subsequently during the performance of the audit on a particular engagement. [8 Marks]

END
