



(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2020/2021 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER

MAIN EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCA 450E

COURSE TITLE: AUDITING AND INVESTIGATIONS

DATE: 12TH OCTOBER 2021

TIME: 9.00AM - 11.00AM

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 Hours

SECTION A

QUESTION ONE (Compulsory)

- a) Auditors are required to plan and perform an audit with professional scepticism, exercise professional judgement and comply with ethical standards.

Required

- i) Explain what is meant by 'professional scepticism' and why it is so important that the auditor maintains professional scepticism throughout the audit. (6 marks)
- ii) Define 'professional judgement' and describe two areas where professional judgement is applied when planning an audit of financial statements. (4 marks)

(b) You are an audit senior for Mills & Co. Mills & Co were recently appointed as external auditors of Bungoma Furniture Ltd for the year ending 31 March 2018 and you are in the process of planning the audit. The previous auditors issued an unmodified audit opinion last year and access to prior year working papers has been granted. The company's principal activity is the manufacture and sale of expensive high quality beds which are largely sold to luxury hotels and owners of holiday apartments. Each bed is crafted by hand in the company's workshop. Construction of each bed only begins once a customer order is received, as each customer will usually want their bed to have a unique feature or to be in a unique style.

The business is family run and all the shares in Bungoma Furniture Ltd are owned by the two joint Managing Directors. The directors are two sisters, Anna and Sophy and they both have a number of other business interests. As a result they only spend a few days a week working at the company and rely on the small accounts department to keep the finances in order and to keep them informed. There is no finance director but the financial controller is a qualified accountant. Bungoma Furniture Ltd requires customers who place an order to pay a deposit of 40% of the total order value at the time the order is placed. The beds will take 4 to 8 weeks to build, and the remaining 60% of the order value is due within a week of the final delivery. Risks and rewards of ownership of the beds do not pass to the customer until the beds are delivered and signed for. Beds also come with a two year guarantee and the financial controller has made a provision in respect of the expected costs to be incurred in relation to beds still under guarantee.

Although the company does have some employees working in the workshop, it often uses external subcontractors to help make the beds in order to fulfil all its orders. These subcontractors should invoice the company at the end of each month for the work they have carried out, but sometimes do not get round to it until the following month.

The company undertakes a full count of raw materials at the year end. The quantities are recorded on inventory sheets and the financial controller assigns the costs based on the cost assigned in the previous year or, if there was no cost last year, using the latest invoice. Most beds are made of oak or other durable woods and the cost of these raw materials is known to fluctuate considerably.

It is expected that work in progress will be insignificant this year, but there will be a material amount of finished goods awaiting dispatch. Anna will estimate the value of these finished goods and has said she will take into account the order value when doing so.

There has been steady growth in sales in recent years and, in January 2018 the company purchased a building close to its existing workshop. Anna and Sophy plan to turn this into another workshop which should more than double its existing manufacturing capacity. The new workshop is currently undergoing extensive refurbishment in order to make it suitable for bed manufacturing. The purchase of the new premises was funded by a bank loan repayable in monthly installments over 12 years and has covenants attached to it. These covenants are largely profit related measures and if they are breached the bank has the option to make the remaining loan balance repayable immediately.

Required

- i) Identify and explain **six** audit risks in respect of the financial statements of Bungoma Furniture Ltd for the year ending 31 March 2018. For each risk suggest a suitable audit response (12 marks)
- ii) Describe the procedures the auditor should carry out to gain evidence over the adequacy of the value of the workshop and the related disclosures included in the financial statements. (8 marks)

SECTION B :

QUESTION TWO

Auditors have a responsibility under ISA 265 *Communicating Deficiencies in Internal Control to those Charged with Governance and Management*, to communicate deficiencies in internal controls. In particular, SIGNIFICANT deficiencies in internal controls must be communicated in writing to those charged with governance.

Required

- a) Explain examples of matters the auditor should consider in determining whether a deficiency in internal controls is significant (8 marks)
- b) Critically evaluate the measures that an auditor would take if there is deficiency in the entity's internal control system (12 marks)

QUESTION THREE

- a) Explain the external auditors' responsibilities in relation to the prevention and detection of fraud and error. (6 marks)
- b) You are the audit manager of DK & Co and you are planning the audit of Imarika Finance Co which specializes in the provision of loans and financial advice to individuals and companies. DK & Co has audited Imarika Finance Co for many years whose directors are planning to list it on a stock exchange within the next few months and have asked if the engagement partner can attend the meetings with potential investors. In addition, as the finance director of Imarika Finance CO is likely to be quite busy with the listing, he has asked if DK & Co can produce the financial statements for the current year.

During the year, the assistant finance director of Imarika Finance Co left and joined DK & Co as a partner. It has been suggested that due to his familiarity with company, he should be appointed to provide an independent partner review for the audit. Once the company obtains its stock exchange listing it will require several assignments to be undertaken, for example, obtaining advice about corporate governance best practice. DK & Co is very keen to be appointed to these engagements, however, Imarika Finance CO has implied that in order to gain this work DK & Co has to complete the external audit quickly and with minimal questions/issues. Further, the finance director has informed you that once the stock exchange listing has been completed, he would like the engagement team to attend a weekend away at a luxury hotel with his team, as a thank you for all their hard work. In addition, he has offered a senior member of the engagement team a short-term loan at a significantly reduced interest rate.

Required

- a) Explain **SIX** ethical threats which may affect the independence of DK & Co's audit of Imarika Finance Co and for each threat explain how it might be reduced to an acceptable level. (12 marks)
- b) Imarika finance co is aware that subsequent to the stock exchange listing it will need to establish an internal audit department and has asked for some advice in relation to this.

Required

Explain the factors that should be considered by an external auditor before reliance can be placed on the work performed by a company's internal audit department. (8 marks)

QUESTION FOUR

"The auditor has a responsibility to design audit procedures to obtain sufficient and appropriate evidence." There are various audit procedures for obtaining evidence, such as external confirmation.

Required

Apart from external confirmation:

- a) Explain **FIVE** procedures for obtaining audit evidence and for each procedure, describe an example relevant to the audit of purchases and other entity's expenses. (10 marks)
- b) Examine five ways in which the reliability of audit evidence would be established. (10 marks)

QUESTION FIVE

- a) Explain the stages of an audit when analytical procedures can be used by the auditor (8 marks)
- b) Explain **SIX** potential indicators that a business firm is not a going concern. (4 marks)
- c) Describe the audit procedures which you should perform in assessing whether or not a business firm is a going concern (6 marks)