



(Knowledge for Development)  
KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

THIRD YEAR SEMISTER ONE

SPECIAL EXAMINATION

FOR THE DIPLOMA IN BUSINESS MANAGEMENT

COURSE CODE: BBM 320

COURSE TITLE: PRINCIPLES OF AUDITING

DATE: 21<sup>ST</sup> AUGUST, 2023 TIME: 8.00AM – 10.00AM

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**INSTRUCTIONS TO CANDIDATES**

Answer Question One in Section A and Any other THREE (3) Questions in Section B

TIME: 2 Hours

**KIBU observes ZERO tolerance to examination cheating**

This Paper Consists of 2 Printed Pages. Please Turn Over.

## SECTION A

### QUESTION ONE

- a) Internal control systems are designed, amongst other things, to prevent error and misappropriation.

**Required:**

Describe the errors and misappropriations that may occur if the following are not properly controlled:

- (i) Receipts paid into bank accounts; (2 marks)
- (ii) Payments made out of bank accounts; (3 marks)
- (iii) Interest and charges debited and credited to bank accounts. (2 marks)

- (b) A book-selling company has a head office and 25 shops, each of which holds cash (banknotes, coins, and credit card vouchers) at the balance sheet date. There are no receivables. Accounting records are held at shops. Shops make returns to head office and head office holds its own accounting records. Your firm has been the external auditor to the company for many years and has offices near to the location of some but not all of the shops.

**Required:**

List the audit objectives for the audit of cash and state how you would gain the audit evidence in relation to those objectives at the year-end. (8 marks)

- c) The external auditors of companies often write to companies' bankers asking for details of bank balances and other matters at the year-end.

**Required:**

Explain why auditors write to companies' bankers and list the matters you would expect banks to confirm. (5 marks)

**(Total: 20 marks)**

## SECTION B

### QUESTION TWO

Towards the end of an audit, it is common for the external auditor to seek a letter of representation (written representations) from the management of the client company.

**Required:**

- (a) Explain why auditors seek letters of representation. (5 marks)
- (b) List the matters commonly included in the letter of representation. (6 marks)

- (c) Explain why it is important to discuss the content of the letter of representation at an early stage during the audit. (3 marks)
- (d) Explain why management is sometimes unwilling to sign a letter of representation and describe the actions an external auditor can take if management refuses to sign a letter of representation. (6 marks)

(Total: 20 marks)

### QUESTION THREE

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:

- a) Explain the responsibilities of external auditors to directors and shareholders. (5 marks)
- b) Describe the limitations of the external audit in relation to the detection and reporting of fraud. (5 marks)
- c) Explain why it is essential for external auditors to be independent of their clients. (5 marks)
- d) Explain the advantages and disadvantages of external auditors providing consulting services to their audit clients. (5 marks)

(Total: 20 marks)

### QUESTION FOUR

- (a) Briefly explain the meaning of the term "control procedures". (4 marks)
- (b) What is the importance of segregation of duties as a control procedure? (4 marks)
- (c) In carrying out an audit, the auditor appraises and tests the system of internal control in order to ascertain that it is capable of processing transactions or determining quantities and values completely and accurately. The auditor further carries out substantive tests in an attempt to ensure that the transactions, assets and liabilities recorded in the accounting records upon which the figures in the financial statements are based, are completely and accurately recorded.

Required:

List and briefly explain the substantive tests the auditor would carry out to verify the values attributed to:

- (i) Trade debtors in a company's financial statements. (6 marks)
- (ii) Trade creditors in a company's financial statements. (6 marks)

(Total: 20 marks)

### QUESTION FIVE

- a) In the context of a computer based accounting system, explain the meaning of the following terms:
- i. Application controls; (4 marks)
  - ii. General controls (4 marks)
- b) Explain the importance of having proper systems documentation (6 marks)
- c) A Company wishes to change from an old computerized system to a new computer based accounting system. Explain how and why both systems should run parallel prior to the change over to the new system. (6 marks)

(Total: 20 marks)