



UNIVERSITY EXAMINATIONS: 2013/2014

**EXAMINATION FOR THE MASTERS OF SCIENCE (MSC) IN COMMERCE
(FINANCE AND ACCOUNTING)**

MFA 604 ADVANCED AUDITING AND INVESTIGATION (EVE)

DATE: APRIL, 2014

TIME: 3 HOURS

INSTRUCTIONS: Answer Question One and Any Other Three Questions

QUESTION ONE (31 MARKS)

Companies, depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, face a variety of business and financial risks. The risk that causes the greatest concern by the auditor is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated (known as audit risk). The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit (ISA 200). The auditors achieve this by designing procedures to test the management assertions.

Management assertions are implied or expressed representations by management about classes of transactions and related accounts in the financial statements. An example of a management assertion is that the company's financial statements are prepared based on International Financial Reporting Standards.

Required

- a) Briefly explain the various types of business and financial risks that have a bearing on audit risks (8 Marks)
- b) Briefly outline and explain the management assertions in the financial statements clearly

- indicating how they influence the audit procedures (9 Marks)
- c) Discuss the auditor responsibility over financial statements compliance with International Financial Reporting Standards (4 Marks)
- d) Explain the meaning of the term inherent risk, control risk and detection risk in the context of consolidated financial statements (10 Marks)

QUESTION TWO (23 MARKS)

International Standard on Auditing 260 covers communication with those charged with governance. The standard identifies the auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements.

Required:

- a) State and explain two specific responsibilities of those charged with governance (4 Marks)
- b) Explain four examples of matters that might be communicated to them by the auditor. (8 Marks)
- c) State and explain the auditor responsibility in respect to fair value accounting estimates (5 Marks)
- d) Explain the importance of emphasis of matter paragraph in unqualified audit report by giving examples of issues to be covered by the auditor (6 Marks)

QUESTION THREE (23 MARKS)

Your external audit client is considering whether to recruit in-house internal audit or to outsource the internal audit function. If outsourced, your client would require a team to undertake monthly visits to test controls at the various outlets across the country, and to perform operational reviews at the head office.

Required:

- a) Explain the benefits of outsourcing internal audit function (6 Marks)
- b) Explain the ethical threats which may affect the independence of your firm in respect of the audit of your client if your firm is also outsourced as internal auditors and also serve in the board, and for each threat explain how it may be reduced. (8 Marks)
- c) Explain how a strong internal audit department can influence the work of the external auditor and the procedure to evaluate the work of internal auditors (9 Marks)

QUESTION FOUR (23 MARKS)

You are the audit manager of A and A International a consulting firm, you are briefing your team on the approach to adopt in undertaking the review and finalization stage of the audit. In particular, your audit senior is unsure about the steps to take in relation to the following uncorrected misstatements.

The investment property balance was revalued as required by International Accounting Standard 40. An independent expert valuer was involved but an error was made in relation to the assumptions given to the management by the valuer.

Receipts from customers being diverted into employees' personal accounts and fake invoices issued to such customer to cover up. The allowance for credit losses are also below the industry average.

Required:

- a) Explain the term 'fraud' and describe the auditor's responsibility in relation to fraud. (5 Marks)
- b) Describe the factors you should consider when placing reliance on the work of the independent expert. (9 Marks)
- c) Describe substantive procedures the auditor should perform to confirm year-end accounts receivable (debtors) balance considering the above issues. (9 Marks)

QUESTION FIVE (23 MARKS)

It is the primary responsibility of the management of the entity to prepare financial statements in which all the assets, liabilities, incomes and expenses are recognized, measured, presented and disclosed in accordance with the applicable financial reporting framework and to ensure that such financial statements give true and fair view of the business. When such financial statements are prepared, published and made available to the users of the financial statements then it means management has taken care of recognition and measurement principle and information has been presented and disclosed appropriately in what is called assertions of the financial statements.

Required

- a) List four assertions of financial statements relevant to the audit of intangible non-current assets and state one audit procedure which provides appropriate evidence for each assertion. (8 Marks)
- b) Briefly state and explain the role and responsibilities of the audit committee. (10 Marks)
- c) Explain meaning of control environment and state the implication of weak control environment to an external auditors work. (5 Marks)

QUESTION SIX (23 MARKS)

You are responsible for the audit of Oak Ltd, and you are currently reviewing the working papers of the audit for the year ended 28 February 2014. In the working papers dealing with payroll, the audit junior has commented that ‘several new employees have been added to the company’s payroll during the year, with combined payments of Ksh 1.25 million being made to them. There does not appear to be any authorization for these additions. When you questioned the payroll supervisor who made the amendments, she said that no authorization was needed because the new employees are only working for the company on a temporary basis. However, when discussing staffing levels with management, it was stated that no new employees have been taken on this year. Other than the tests of controls planned, no other audit work has been performed.’

Required:

- a) In relation to the audit of Oak Ltd payroll explain the meaning of the term ‘professional skepticism’. (4 Marks)
- b) ISA 500 Audit Evidence requires audit evidence to be reliable. List and explain three factors that influence the reliability of audit evidence. (9 Marks)
- c) Recommend the principal audit procedures to be performed in respect of the staff benefit costs (10 Marks)