BACHELOR OF COMMERCE
BACHELOR OF BUSINESS LEADERSHIP
END OF TERM EXAMINATION

DEPARTMENT: BUSINESS
COURSE CODE: CAC 401
COURSE TITLE: AUDITING II (ONLINE)
TIME:

INSTRUCTIONS

- This examination script consists of **FIVE (5)** questions.
- Read all questions carefully before attempting.
- Question **One** is compulsory and Answer any **THREE (3)** questions.
- Write your **student number** on the answer booklet provided.

SECTION A: COMPULSORY

QUESTION ONE

a) You have been auditing Fruitly Ltd., a large national grocery store chain for the first time. Towards the end of the audit, your audit manager demands that you seek a letter of representation from the management of the client company. Upon follow up with the client's management, you are informed that the management is unwilling to sign the letter of representation.

Required:

(i) Discuss the need for seeking a letter of representation from the client's management. (6 Marks)

(ii) Explain SIX matters that you expect the management of Fruitly Ltd. to include in the letter of representation. (6 Marks)

b) International Standard on Auditing (ISA): 560 - Subsequent Event defines subsequent events as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Required:

Discuss FOUR audit procedures that an auditor should perform as near as possible to the date of the Auditor's Report. (4 Marks)

c) Brenda Tuli is the petty cashier for Bahari Ltd. On 20 July 2023, Brenda was short of cash for her travel for the week. She took out a small amount of cash from the petty cash at work to cover her fare. She had intended to return this amount at the end of the month, as soon as she was paid. Brenda had not obtained permission from her supervisor to pick the cash and she forgot to replace the cash when she received her salary.

Required:

(i) Indicate the type of fraud that Brenda Tuli was involved in. (1 Mark)

(ii) Explain FOUR steps that Bahari Ltd. could take in order to improve controls over petty cash. (4 Marks)

d) After completing the audit of Maneno Company Ltd. for the year ended 31 December 2023, the auditor identified several material misstatements in the financial statements that management has refused to correct. Some of these misstatements could lead to a qualification of the audit opinion.

Required:

(i) Explain TWO types of audit opinion that the auditor is likely to give in this case. (2 Marks)

(ii) Describe FOUR ways on how the auditor would communicate the misstatements in his audit report. (4 Marks)

e) An organization that you have been auditing has approached your audit firm to review its interim financial information before it releases to the public on quarterly basis as required by the regulations governing its operations.

Required:

In reference to International Standards on Review Engagements (ISRE) 2410, describe THREE general principles that your firm would have to apply in performing the review engagement. (3 Marks)

QUESTION TWO

You have been the partner in charge of the audit of Bora Ltd., a company dealing with the sale of electronic items countrywide. During the year ended 30 September 2024, the company made a profit before tax of Sh.80,000,000. The following matters were identified by the audit team during the audit:

1. The company has been sued in court for breach of a warranty. The case has been ongoing and is unlikely to be resolved until the year ending September 2025. The estimated legal penalty of losing the case is Sh.40,000,000. The company management has not recognized this figure in the financial statements stating that they have adequate evidence to enable them win the case.
2. There was an attack on the system by a computer virus that resulted to the loss of supporting documents on all non-current assets. The company had not maintained a backup and therefore reconstruction of the data is impossible.
3. The company's goodwill has not been tested for impairment for the last four years. The management feel that testing for impairment is an exercise in futility since the value of impairment is not material. On your team's assessment you discover that impairment is only material to a portion of the financial statements.
4. There has been a loophole in the internal controls over wages and salaries. There are suspicions that there may be ghost workers. Further investigations need to be undertaken to establish the extent of misstatements over wages and salaries. However, no misstatements in the salaries and wages were discovered during the audit.

Required:

For each of the matters raised above, discuss the audit opinion you would issue. (10 Marks)

QUESTION THREE

Usafi Enterprises is an organization that provides home cleaning services. The organization's policy is that 50% of the charged fee is paid in advance before the cleaning service is provided and the other 50% is paid after the service has been completed. The customers pay by cheque or mobile money. The cheques are supposed to be delivered by the customers to Usafi Enterprises office during working hours. However, some customers have been paying the cleaners by cash and at times giving cheques to cleaners to deliver to the office on their behalf. Usafi Enterprises' accountant has noted that the accounts receivable balance in the books has been increasing while revenue collection has been declining in the past few months. The organisation has also lost many customers due to disagreements on payment for services rendered. Usafi Enterprises has approached you as an audit firm to advise them on how they can improve their operations and manage receivables.

Required:

(i) Discuss FOUR weaknesses in Usafi Enterprises' internal control system. (4 Marks)

(ii) Propose and explain THREE controls that the management of Usafi Enterprises could implement to address each deficiency. (6 Marks)

QUESTION FOUR

a) Discuss using an illustrations FOUR factors that an auditor should consider in determining whether to use Computer Assisted Auditing Techniques (CAATs). (4 Marks)

b) International Standards on Auditing (ISA) 570 Going Concern, highlights both the auditor's and the management's responsibility with regard to the company's going concern.
Required:
Distinguish between the responsibility of the management with that of the auditor in the assessment of the going concern of a company. (6 Marks)

QUESTION FIVE

Haki Yangu is an ordinary shareholder in Mizani Ltd. He has instituted a criminal liability case against the auditors of Mizani Ltd. as a result of his reliance on the information presented in the company's audited financial statements.

Required:

(i) Discuss FOUR actions by an auditor that could make him criminally liable under the Companies Act in Kenya (4 Marks)

(ii) Describe THREE circumstances that Haki Yangu is required to prove against the auditors for a successful criminal liability case under the Companies Act. (6 Marks)