**EGERTON UNIVERSITY**

**BCOM 412: Auditing 2, CAT 1 April 2013: Time Allowed: 2 Hours**

**PART A: Multiple choice questions (2 mks each)**

1. Which of the following is **NOT**a primary purpose of audit documentation?

(a) To coordinate the audit.

(b) To assist in preparation of the audit report.

(c) To support the financial statements.

(d) To provide evidence of the audit work performed. (Placeholder1)

2. During an audit, pertinent data are compiled and included in the audit files. The audit files primarily are considered to be

(a) A client-owned record of conclusions reached by the auditors who performed the engagement.

(b) Evidence supporting financial statements.

(c) Support for the auditor’s representations as to compliance with auditing standards.

(d) A record to be used as a basis for the following year’s engagement.

3. Although the quantity, type, and content of audit documentation will vary with the circumstances, audit documentation generally will include the

(a) Copies of those client records examined by the auditor during the course of the engagement.

(b) Evaluation of the efficiency and competence of the audit staff assistants by the partner responsible for the audit.

(c) Auditor’s comments concerning the efficiency and competence of client management personnel.

(d) Auditing procedures followed and the testing performed in obtaining audit evidence.

4. The permanent file of an auditor’s working papers most likely would include copies of the

(a) Current year financial statements.

(b) Lawyer’s letters.

(c) Bank statements.

(d) Debt agreements.

5. Which of the following best describes the operational audit?

(a) It requires constant review by internal auditors of the administrative controls as they relate to the operations of the company.

(b) It concentrates on implementing financial and accounting controls in a newly organized company.

(c) It attempts and is designed to verify the fair presentation of a company’s results of operations.

(d) It concentrates on seeking aspects of operations in which waste would be reduced by the introduction of controls.

6. The evaluation of audit field work of an operating unit should answer the following questions:

1. What are the reasons for the results?

2. How can performance be improved?

3. What results are being achieved?

What is the chronological order in which these questions should be answered?

(a) 3—1—2

(b) 1—3—2

(c) 3—2—1

(d) 1—2—3

(e) 2—3—1

7. Which of the following is generally considered to be a major reason for establishing an internal auditing function?

(a) To relieve overburdened management of the responsibility for establishing effective systems of internal control.

(b) To ensure that operating activities comply with the policies, plans, and procedures established by management.

(c) To ensure the accuracy, reliability, and timeliness of financial and operating data used in management’s decision making.

(d) To evaluate and improve the effectiveness of control processes.

8. Operational audits generally have been conducted by internal auditors and governmental audit agencies but may be performed by certified public accountants. A primary purpose of an operational audit is to provide

(a) A means of assurance that internal accounting controls are functioning as planned.

(b) A measure of management performance in meeting organizational goals.

(c) The results of internal examinations of financial and accounting matters to a company’s top-level management.

(d) Aid to the independent auditor, who is conducting the audit of the financial statements.

9. In comparison to the external auditor, an internal auditor is more likely to be concerned with

(a) Internal administrative control.

(b) Cost accounting procedures.

(c) Operational auditing.

(d) Internal control.

10. Which of the following best describes the reason why an independent auditor reports on financial statements?

(a) A misappropriation of assets may exist, and it is more likely to be detected by independent auditors.

(b) Different interests may exist between the company preparing the statements and the persons using the statements.

(c) A misstatement of account balances may exist and is generally corrected as the result of the independent auditor’s work.

(d) Poorly designed internal controls may be in existence.

**Part B: Essay questions**

1. The following are a list of possible errors or fraud involving cash receipts and controls that may prevent or detect the errors or fraud:

**Possible Errors or Fraud**

1. Customer checks are properly credited to customer accounts and are properly deposited, but errors are made in recording receipts in the cash receipts journal.
2. Customer checks are misappropriated before being forwarded to the cashier for deposit.
3. Customer checks are received for less than the customers’ full account balances, but the customers’ full account balances are credited.
4. Customer checks are credited to incorrect customer accounts.
5. Different customer accounts are each credited for the same cash receipt.

**Internal Controls**

1. Customer orders are compared with an approved customer list.
2. Pre-numbered credit memos are used for granting credit for returned goods.
3. Remittance advices are separated from the checks in the mailroom and forwarded to the accounting department.
4. The cashier examines each check for proper endorsement.
5. Total amounts posted to the accounts receivable subsidiary records from remittance advices are compared with the validated bank deposit slip.
6. Monthly statements are mailed to customers with outstanding balances.
7. An employee, other than the bookkeeper, periodically prepares bank reconciliation.

For each error or fraud, select one internal control that if properly designed and implemented, would be effective in preventing or detecting the errors and fraud. Each response in the list of controls may be used once, more than once, or not at all (10 mks)

1. The Narok County Council operates a game park (The Maasai Mara) for the benefit and enjoyment of the community. Two clerks who are positioned at the entrance collect a Ksh. 500 admission fee from each local tourist and an equivalent of Ksh. 1500 (in U.S.A. Dollars) from each foreign tourist. Members of the park (who pay annual membership fees) are permitted to enter free of charge upon presentation of their membership cards. At the end of each day, one of the clerks delivers the proceeds to the treasurer. The treasurer counts the cash in the presence of the clerk and places it in a safe. Each Friday afternoon, the treasurer and one of the clerks deliver all cash held in the safe to the bank and receive an authenticated deposit slip that provides the basis for the weekly entry in the accounting records. The Park board of directors has identified a need to improve its internal controls over cash admission fees. The board has agreed that the sale of admission tickets must be an integral part of its improvement efforts. You have been asked by the board of directors of the Park to review the internal control over cash admission fees and provide suggestions for improvements.
2. Indicate three deficiencies in the existing internal controls over cash admission fees that you identify, and recommend one improvement for each of the deficiencies identified. Organize the answer as indicated in the following illustrative example (9 mks).

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| **DEFICIENCY IN CONTROLS IDENTIFIED** | **RECOMMENDATION** |
| There is no basis for establishing the number of paying visitors. | Pre-numbered admission tickets should be issued upon payment of the admission fee. |
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1. Indicate which of the deficiencies, if any; increase the likelihood of misappropriation of assets (3 mks).
2. Indicate which of the deficiencies, if any; increase the likelihood of fraudulent financial reporting (3 mks).
3. Otieno and Associates, CPA, of Nakuru, Kenya has a policy of having their audit papers reviewed by both the partner in charge and an independent reviewer.

Required: A.

1. Define “working paper” B. Describe the difference between a regular working paper review and an independent review.
2. What items does the regular reviewer examine? The independent reviewer?
3. Management Assertions and Audit Objectives. The following are management assertions (1 through 9) and audit objectives applied to the audit of accounts payable ((a) through (h)).

Management Assertion: 1 Existence 2 Rights and obligations 3 Occurrence 4 Completeness 5 Valuation and allocation 6 Accuracy 7 Cutoff 8 Classification 9 Understandability

Specific Audit Objective:

(a) Existing accounts payable are included in the accounts payable balance on the balance sheet date.

(b) Accounts payable are recorded in the proper account.

(c) Acquisition transactions in the acquisition and payment cycle are recorded in the proper period.

(d) Accounts payable representing the accounts payable balance on the balance sheet date agree with related subsidiary ledger amounts, and the total is correctly added and agrees with the general ledger.

(e) Accounts in the acquisition and payment cycle are properly disclosed according to IASs.

(f) Accounts payable representing the accounts payable balance on the balance sheet date are valued at the correct amount.

(g) Accounts payable exist.

(h) Any allowances for accounts payable discounts is taken.

Required:

1. Explain the differences among management assertions and specific audit objectives and their relationships to each other.
2. For each specific audit objective, identify the appropriate management assertion.