**EGERTON UNIVERSITY- NJORO**

**BCOM 412: AUDITING II: JANUARY TO APRIL 2012**

**INSTRUCTIONS: ATTEMPT QUESTION 1 AND CHOOSE 3 OTHER QUESTIONS**

1. The following misstatements are included in the accounting records of the Joyce Manufacturing Company:

a. A shipment to a customer was not billed because of the loss of the bill of lading.

b. A sales invoice was miscalculated by Ksh.1,000 as a result of a key-entry mistake.

c. Cash paid on accounts receivable that had been prelisted by a secretary was stolen by the bookkeeper who records cash receipts and accounts receivable. He failed to record the transactions.

d. A material sale was recorded on the last day of the year even though the goods were not shipped until 3 days later.

e. Merchandise was shipped to a customer, but no bill of lading was prepared. Because billings are prepared from bills of lading, the customer was not billed.

f. A sale to a residential customer was unintentionally classified as a commercial sale.

g. The shipping clerk included several additional valuable items to a shipment that were not included in the customer’s order and were not invoiced to the customer.

The shipping clerk has an arrangement with the customer to share the proceeds from sales of the additional items shipped.

h. Cash paid on accounts receivable was stolen by the mail clerk when the mail was opened.

i. Identify whether each misstatement is an error or fraud. (4 mks)

ii. For each misstatement, list one or more controls that should have prevented it from occurring on a continuing basis (8 mks).

iii. For each misstatement, identify evidence the auditor can use to uncover it (8 mks).

1. Discuss the composition and the role of the audit committee, and explain the linkage between the audit committee and the internal and external audit functions (20 mks)
2. ‘Computer emergency readiness team (CERT) shows that 80% of all malicious activity comes from current or former employees, yet most organizations spend over 75% of their IT security budgets to protect against outsiders.’ (**Source:** ISACA JOURNAL, Vol. III, 2010)
3. Discuss three **entity level** controls and two **general controls** that should be put in place to protect against this insider threat. (10 mks).
4. What five **access controls** would you recommend to minimize the threat from employees and other insiders? Discuss (10 mks)

4. a. Nelly Nekesa, CPA, is auditing the financial statements of a manufacturing company with a significant amount of trade accounts receivable. Nelly Nekesa is satisfied that the accounts are correctly summarized and classified and that allocations, reclassifications, and valuations are made in accordance with GAAP. Nelly Nekesa is planning to use accounts receivable confirmation requests to obtain sufficient appropriate evidence as to trade accounts receivable.

i. Identify and describe the two forms of accounts receivable confirmation requests and indicate when each is appropriate. (6 mks)

ii. Under what circumstances would confirmations not be appropriate means of gathering audit evidence? (4 mks)

iii. What are the implications to a CPA if during an audit of accounts receivable some of a client’s trade customers do not respond to a request for positive confirmation of their accounts? (2 mks)

iv. Describe FOUR analytical procedures that you would conduct over the revenue process. (4 mks)

v. Highlight four controls in the revenue process, and how each of the controls you mentioned may be tested. (4 mks)

5. Lew Otieno and Vera Wanjiku are friends who are employed by different CPA firms. One day during lunch they are discussing the importance of internal control in determining the amount of audit evidence required for an engagement. Otieno expresses the view that internal control must be evaluated carefully in all companies, regardless of their size or whether they are publicly held, in a similar manner. His CPA firm requires a standard internal control questionnaire on every audit as well as a flowchart of every transaction area. In addition, he says the firm requires a careful evaluation of the system and a modification in the evidence accumulated based on the controls and deficiencies in the system.

Wanjiku responds by saying she believes that internal control cannot be adequate in many of the small companies she audits; therefore, she simply ignores internal control and acts under the assumption of inadequate controls. She goes on to say, “Why should I spend a lot of time obtaining an understanding of internal control and assessing control risk when I know it has all kinds of weaknesses before I start? I would rather spend the time it takes to fill out all those forms in testing whether the statements are correct.”

a. Express in general terms the most important difference between the nature of the potential controls available for large and small companies. (2 mks)

b. Criticize the positions taken by Otieno and Wanjiku, and express your own opinion about the similarities and differences that should exist in understanding internal control and assessing control risk for different-sized companies. (10 mks)

c. Discuss whether Wanjiku’s approach is acceptable under existing auditing standards for public/ non-public companies. (6 mks)

d. Describe what additional procedures Otieno must perform if auditing the financial statements of a public company. (2 mks).