



**AFRICA  
UNIVERSITY**

*(A United Methodist-Related Institution)*

**“Investing In Africa’s Future”**

**FACULTY OF MANAGEMENT AND ADMINISTRATION**

**COURSE TITLE: MAC 305: AUDIT PRINCIPLES**

**SEMESTER 1: FINAL EXAMINATION –NOVEMBER 2014**

**LECTURER MR I. RARAMI**

**TIME: 3 HOURS**

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### ***INSTRUCTIONS***

Answer all questions in **Section A** and any **3** questions from **Section B**

Section A carries **40** marks and each question carries **20** marks in section B

The marks allocated to each question are shown at the end of the question

Credit will be given for presentations that are neat, logical and grammatically well constructed.

## **SECTION A**

### **QUESTION 1**

- a). What is an audit? **[3 marks]**
- b). State six advantages of an audit. **[3 marks]**
- c). State three disadvantages of an audit. **[3 marks]**
- d). Explain the concept of TRUE and FAIR presentation. **[4 marks]**
- e). List three classes of evidence that must be considered when assessing the reliability of evidence. **[3 marks]**
- f). What is the difference between a Statutory and a Private audit? **[2 marks]**
- g). State and explain briefly any four fundamental principles of auditors. **[4 marks]**
- h). Auditors have various duties to perform in their role as auditors, for example, to assess the truth and fairness of the financial statements.
- Required: Explain FOUR rights that enable auditors to carry out their duties. **[2 marks]**
- i). What are the duties of the auditor? **[3 marks]**
- j). What is expectation gap? **[2 marks]**
- k). What causes the:
- (i). Communication gap **[2 marks]**
  - (ii). Performance gap **[2 marks]**
- l). What is the purpose of an audit engagement letter? **[2 marks]**
- m). List the six stages in audit planning. **[3 marks]**
- n). State any four factors that affect the form and content of working papers. **[2 marks]**

### **QUESTION 2**

Harahwa and Chembere Home (HCH) is a registered charity with 100 employees and 250 volunteers providing in-home care for elderly persons who are unable to fully take care of themselves. The company structure has no shareholders in a practical sense although a small number of issued shares are held by the sponsors who established the charity many years previously.

HCH is governed by a seven member Board of Directors. The Chief Executive Officer (CEO) chairs the Board which comprises the Chief Financial Officer (CFO) and five independent, unpaid non-executive directors who were appointed by the CEO based on past business relationships.

You are one of the independent members of HCH's Board. The CEO/Chair sets the Board agendas, distributes Board papers in advance of meetings and briefs Board members in relation to each agenda item. At each of its quarterly meetings the Board reviews the financial reports of the charity in some detail and the CFO answers questions.

Other issues that regularly appear as agenda items include new government funding initiatives for the client group, and the results of proposals that have been submitted to funding agencies, of which about 25% are successful. There is rarely any discussion of operational matters relating to the charity as the CEO believes these are outside the directors' experience and the executive management team is more than capable of managing the delivery of the in-home care services.

The Board has no separate audit committee but relies on the annual management letter from the external auditors to provide assurance that financial controls are operating effectively. The external auditors were appointed by the CEO many years previously. HCH's Board believes that the company's corporate governance could be improved by following the principles applicable to listed companies.

**Required:**

i).What is corporate governance? **[2 marks]**

ii),What is an audit committee? **[2 marks]**

iii). Explain how HCH are not currently complying with corporate governance requirements and describe how HCH's board should be restructured to comply with the principles of good corporate governance.

**[16 marks]**

**QUESTION 3**

a).i) What is audit evidence? **[1 marks]**

ii) State and explain briefly five procedures or techniques of obtaining audit evidence. **[5 marks]**

b) State factors influencing the auditor's judgement as to what is sufficient appropriate evidence. **[5 marks]**

c).State and explain any five financial statement assertion that the auditor is concerned with when obtaining evidence during substantive procedures. **[5 marks]**

d).What are the factors that affect the extent of reliance on analytical procedures. **[4 marks]**

#### **QUESTION 4**

Audit risk is very much closely linked to materiality.

- a). Define audit risk. **[2 marks]**
- b). Define materiality. **[2 marks]**
- c). State and define the three components of audit risk. **[6 marks]**
- d). State six Benefits of audit risk assessment. **[3 marks]**
- f). State limitations of audit risk assessment. **[4 marks]**
- g). State any three factors that could minimise audit risk. **[3 marks]**

#### **QUESTION 5**

- a).Define fraud. **[2 marks]**
- b). State how fraud takes place **[4 marks]**
- c). Define error. **[1 mark]**
- d). State how error takes place. **[3 marks]**
- e). The primary responsibility for the prevention and detection of fraud and error rests with management. State how management discharge this responsibility. **[4 marks]**
- f). State the responsibility of an auditor as far as fraud and error is concerned. **[4 marks]**

#### **QUESTION 6**

You are a manager in the audit firm of Roby, Richy, Regy & Co; and this is your first time you have worked on one of the firm's established clients, Kuda Lynny Ltd. The main activity of Kuda Lynny Ltd is providing investment advice to individuals regarding saving for retirement, purchase of shares and securities and investing in tax efficient savings schemes. Kuda Lynny Ltd is regulated by the relevant financial services authority.

You have been asked to start the audit planning for Kuda Lynny Ltd, by Mr Danie, a partner in Rob, Richy, Regy & Co. Mr Danie has been the engagement partner for Kuda Lynny Ltd, for the previous nine years and so has excellent knowledge of the client. Mr Danie has informed you that he would like his daughter Ashy to be part of the audit team this year; Ashy is currently studying for her first set of fundamentals papers for her CA qualification. Mr Danie also informs you that Eliza Guri, the audit senior, received investment advice from Kuda Lynny Ltd during the year and intends to do the same next year.

In an initial meeting with the finance director of Kuda Lynny Ltd, you learn that the audit team will not be entertained on Kuda Lynny Ltd's Intertainment Club this year as this could appear to be an attempt to influence the opinion of the audit. Instead, he has arranged a balloon flight costing less than one-tenth of the expense of using the Intertainment Club and hopes this will be acceptable. The director also states that the fee for taxation services this year should be based on a percentage of tax saved and trusts that your firm will accept a fixed fee for representing Kuda Lynny Ltd in a dispute regarding the amount of sales tax payable to the taxation authorities.

**Required:**

(a) (i) Explain the ethical threats which may affect the auditor of Kuda Lynny Ltd.  
**[6 marks]**

(ii) For each ethical threat, discuss how the effect of the threat can be mitigated.  
**[6 marks]**

(b) State five functions of audit committees and three advantages of audit committees.  
**[8 marks]**