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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR FOUR**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: BBM 403**

**COURSE TITLE: AUDITING AND ASSURANCE SERVICES**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 01/04/2021 TIME: 3.00-5.00 PM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of FOUR (4) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

**CASE STUDY**

**Confidentiality – Deloitte, Reliance, and KKR**

1. According to a court filing by the US State of Pennsylvania Insurance Department, within days of Deloitte signing off on an audit of Reliance Insurance Co. indicating sufficient cash reserves in February 2018, the firm told another client, the Kohlberg Kravis & Roberts (KKR) investment partnership, that Reliance was suffering a “seriously deficient” $350 million shortfall in its reserves. (WSJ 2003)

Deloitte told the investment company about the shortfall “in exchange for millions of dollars” in accounting fees, according to the state. Deloitte “exploited the competing interests of [the investment company] and Reliance and benefited financially by receiving payments from clients on opposite sides” of the proposed deal, according to the state. KKR also got another opinion from Am-Re Consultants, of Princeton, an affiliate of American Reinsurance Co. Am-Re estimated Reliance’s reserve shortfall at $500 million, the state reported. (DiStefano 2003)

In 2001 Reliance Insurance Company, an auto and workman’s compensation insurer, defaulted on its stock, bonds and loans, and left policyholders and industry bailout funds with more than $2 billion in unpaid losses. The Pennsylvania Insurance Department was charged with liquidating the assets of the company.

Deloitte issued a short written statement accusing the state of “serious distortion of the facts.” According to Deloitte, Pennsylvania Insurance Commissioner E. Diane Koken was trying to “improperly” fault Reliance’s ex-auditors “for a business and regulatory failure that largely rests with [Koken] herself.” (DiStefano 2003)

**Required:**

1. Does an auditor violate the confidentially of their client by revealing the client’s financial condition to another client? Discuss **[5 Marks]**
2. Why would an auditor report sufficient cash reserves in their audit report and then tell another client that the audited company had a shortfall cash position? Discuss  **[5 Marks]**
3. Restmount Kenya Ltd. was formed on 1 October 2006 in order to export tea and coffee to European markets. The Directors are unsure as to their responsibilities and the nature of their relationship with the external auditors. The audit partner has asked you to visit the client and explain to the directors, the fundamental aspects of the accountability of the directors and their relationship with the auditor.

**Required:**

Explain to the directors of Restmount Kenya Ltd.

1. The need for an audit  **[4 Marks]**
2. Procedures for the appointment of an auditor of a public company under the Companies Act.

**[4 Marks]**

1. Directors responsibilities in relation to the accounting function of the Company. **[4 Marks]**
2. Auditors’ statutory responsibilities in relation to the audit of the company’s financial statements. **[4 Marks]**
3. List the properties of a statutory audit that are different from a private audit. **[4 Marks]**

**QUESTION TWO**

1. The purpose of an external audit and its role are not well understood. You have been asked to write some material for inclusion in your firm’s training materials dealing with these issues in the audit of large companies. **[10 Marks]**
2. Draft explanation dealing with the purpose of an external audit and its role in the audit of large companies, for inclusion in your firm’s training materials. **[10 Marks]**

**QUESTION THREE**

You are a recently qualified Chartered Certified Accountant in charge of the internal audit department of ZX, a rapidly expanding company. Turnover has increased by about 20% p.a. for the last five years, to the current level of Kshs50 million. Net profits are also high, with an acceptable return being provided for the four shareholders. The internal audit department was established last year to assist the board of directors in their control of the company and to prepare for a possible listing on the stock exchange. The Managing Director is keen to follow the principles of good corporate governance with respect to internal audit. However, he is also aware that the other board members do not have complete knowledge of corporate governance or detailed knowledge of International Auditing Standards.

**Required:**

Write a memo to the board of ZX that:

1. Explains how the internal audit department can assist the board of directors in fulfilling their obligations under the principles of good corporate governance. **[10 Marks]**
2. Explains the advantages and disadvantages to ZX of an audit committee. **[10 Marks]**

**QUESTION FOUR**

You are an audit senior responsible for understanding the entity and its environment and assessing the risk of material misstatements for the audit of Rock for the year ending 31 December 2019. Rock is a company listed on a stock exchange. Rock is engaged in the wholesale import, manufacture and distribution of basic cosmetics and toiletries for sale to a wide range of stores, under a variety of different brand names. You have worked on the audit of this client for several years as an audit junior.

**Required:**

* 1. Describe the information you will seek, and procedures you will perform in order to understand the entity and its environment and assess risk for the audit of Rock for the year ending 31 December 2019. **[10 Marks]**
  2. You are now nearing the completion of the audit of Rock for the year ending 31 December 2019. Draft financial statements have been produced. You have been given the responsibility of performing a review of the audit files before they are passed to the audit manager and the audit partner for their review. You have been asked to concentrate on the proper completion of the audit working papers. Some of the audit working papers have been produced electronically but all of them have been printed out for you. Describe the features of those working papers that show that they have been properly completed. **[10 Marks]**

**QUESTION FIVE**

You have been asked by the manager in charge of the audit of Tyranny agencies to consider and describe various aspects of carrying out a debtor’s circularization at its year ending 31st December 2019. The company sells its products on credit and the draft accounts show annual turnover of twenty-five million shillings. The accounts also show debtors of five million shillings. Your compliance test on the sales system has shown that there is only satisfactory division of duties in the sales system and only minor errors were found in compliance tests.

**Required**

1. Consider the reliability of a debtor’s circularization in providing audit evidence and in verifying value of year end debtors. **[16 Marks]**
2. Describe the work you will carry out in auditing the replies to debtor’s circularization where debtor does not reply to circularization **[4 Marks]**