



**UNIVERSITI KUALA LUMPUR
BUSINESS SCHOOL**

**FINAL EXAMINATION
MARCH 2024 SEMESTER**

COURSE CODE : EAB21103
COURSE NAME : AUDIT 1
PROGRAMME NAME : BACHELOR IN ACCOUNTING (HONS)
DATE : 29 JUNE 2024
TIME : 9.00 AM – 12.00 PM
DURATION : 3 HOURS

INSTRUCTIONS TO CANDIDATES

1. Please **CAREFULLY** read the instructions given in the question paper.
2. This question paper has information printed on both sides of the paper.
3. This question paper consists of **FIVE (5)** questions.
4. Answer **ALL** questions.
5. Please write your answers on the answer booklet provided.
6. All questions must be answered in **English** (any other language is not allowed).
7. This question paper must not be removed from the examination hall.

THERE ARE NINE (9) PAGES OF QUESTIONS, EXCLUDING THIS PAGE.

TOTAL: 100 marks

INSTRUCTION: Answer ALL questions.

Please use the answer booklet provided.

Question 1

- (a) You are a manager in the audit department of Wilbur and Orville. A potential new client, Hughes Bhd, a logistic company, has approached your firm to perform the annual statutory audit in addition to some other non-audit services for the year ending 30 September 2023. Your audit firm was recommended to Hughes Bhd by an existing client, O&P, a shipping company who is also a major customer of Hughes Bhd.

You have been chosen to lead the engagement team as you have experience of auditing logistic companies as you also manage the audit of O&P.

Whilst arranging the initial meeting with the directors of Hughes Bhd you discover that you studied accountancy with the finance director at Exeter University.

Hughes Bhd has not made a profit for the last two years. The directors explain that this is largely because of escalating costs in the industry including fuel price rises. They are confident they have now controlled their costs for the current year. They have also been approached to tender for a large profitable contract going forward. They would like you to assist them with the preparation of this tender and present with them on the day.

The prior year financial statement is being audited by another audit firm. The finance director tells you that the current auditors have identified material misstatements, but the board of directors are refusing to make these adjustments. If adjusted, it would turn the break-even position into a loss.

The current auditors have replied to your professional clearance letter and have informed you that they are still owed fees relating to the prior year.

You calculate that the potential fees from Hughes Bhd would amount to approximately 16% of your firm's total fee income.

Required:

- i. Identify and explain **THREE (3)** threats to independence if Wilbur and Orville accept Hughes Bhd as a new audit client. For each threat, recommend how the threat can be managed with possible safeguards to manage these threats.

Answer in the following format:

No	Threat to independence	Possible safeguards
1.	<i>The threat is...</i>	<i>To reduce this threat...</i>

(6 marks)

- ii. Explain **TWO (2)** matters, other than ethical threats should be considered by Wilbur and Orville prior to accepting audit appointment by Hughes Bhd.

(4 marks)

- (b) Explain **TWO (2)** factors that need to be considered when determining fees to be charged to audit clients.

(4 marks)

- (c) Both internal and external auditors help companies ensure that their financial reporting agrees with accounting principles, that internal controls are working correctly, and that the company is in compliance with relevant laws and regulations. For both types of auditors, risk assessment is a vital consideration, and a keen understanding of the industry and the company is required.

Required:

Explain any **THREE (3)** differences between internal auditor against external auditors. You must answer in the following table. An example has been given to guide you.

Criteria	Internal audit	External Audit
(e.g.) Purpose	Review of financial reporting, operations, processes, internal control systems risk management, corporate governance, and fraud detection	Review of financial statements or other compliance matter
Relationship to company		
Focus		
Audience		
Perspective		
Timing		

(6 marks)

[20 marks]**Question 2**

- (a) The primary goal of substantive testing is to identify any material misstatements (errors or omissions) that could significantly impact the financial statements' fairness and reliability. Auditors perform these tests at the *assertion level*, meaning they focus on verifying the specific claims made by management in the financial statements.

Required:

For each of the following assertions being tested, provide an example of an appropriate substantive test. (Fill in the blank)

No	Substantive test performed	Assertions being tested by auditor
1		Occurrence
2		Completeness
3		Valuation
4		Rights and obligations
5		Segregation of duties

(10 marks)

- (b) Materiality is a major consideration in determining the appropriate audit report to be issued.
- i. Define the meaning of the term 'materiality' as it is used in accounting and auditing.
(2 marks)
 - ii. Briefly explain the relationship between 'materiality' and phrase 'obtain reasonable assurance' used in the auditor's report.
(2 marks)
 - iii. Discuss any **THREE (3)** characteristics of reliable evidence.
(6 marks)
- (20 marks)

Question 3

7th October 2023, Kuala Lumpur

Horizon Property Group, a renowned name in property development, is facing a massive fraud scandal that has jolted the real estate industry and alarmed shareholders. The scandal involves serious breaches of financial integrity, including fictitious sales, undisclosed related party transactions, and unverifiable debtor balances from international projects.

The fraudulent activities were uncovered during an internal audit triggered by anonymous whistleblower tips. Investigations revealed that Horizon's management had been engaging in deceptive practices, primarily facilitated by a significant lack of segregation of duties. This allowed a handful of executives to override established rules and procedures with impunity.

A major red flag arose when auditors were unable to confirm debtor balances from Horizon's key projects in China and Brazil. These projects, previously touted as major revenue generators, were found to have significant discrepancies in their reported figures. The absence of verifiable evidence for these debtor balances has cast serious doubts on the company's financial statements.

Adding to the controversy, the investigation exposed that Horizon Property Group had been fabricating sales under its low-income housing initiative, "Housing for B40." This scheme, which was supposed to provide affordable housing to lower-income families, was used as a

facade to inflate revenue figures. The company recorded numerous fictitious sales, supported by fraudulent documentation, to present an overly optimistic financial outlook.

Moreover, the audit revealed hidden related party transactions involving the Chairman of the company. These transactions were not disclosed in Horizon's financial reports, violating regulatory requirements and ethical standards. The Chairman had been conducting these transactions through entities he controlled, reaping personal benefits at the expense of shareholders and the company's financial health.

In response to these findings, the Securities Commission (SC) has launched an extensive investigation into Horizon Property Group. Key executives, including the Chief Financial Officer and Chief Operating Officer, have been placed on administrative leave pending further inquiry. The company's stock has plummeted by 50% since the scandal broke, reflecting the erosion of investor confidence.

Horizon's board of directors has appointed an interim CEO, Jane Mitchell, who has vowed to restore trust and integrity within the company. "We are committed to addressing these issues head-on and ensuring rigorous adherence to financial regulations and corporate governance," Mitchell said in a press conference. "Immediate steps are being taken to overhaul our internal controls and reinforce transparency across all operations."

Required:

- (a) Explain **THREE (3)** common problem arise due to Agency Theory. (6 marks)
- (b) Justify **TWO (2)** benefits of audit. Cite examples from the given case to demonstrate your points of view. (6 marks)
- (c) Discuss **FOUR (4)** common audit expectation gap which refers to the difference between what the public expects from an audit and what an audit actually delivers. (8 marks)

[20 marks]

Question 4

(a) The following are 4 distinct audit scenarios. You have been task as partner in charge for all the following:

- i. Mariko Sdn Bhd has incurred significant losses in the last two preceding years and having difficulty to fulfil their loan obligation. The company's ability to continue as a going concern is in doubt. Furthermore, adequate disclosure on this matter has been made in the financial statements.
- ii. During field work, the audit assistant is denied access to the minutes of meeting from board of directors. However, the company's secretary had authorised the audit manager to extract material important for auditing.
- iii. A corporation owned by a state government reported a piece of land as non-current assets in its financial accounts. Upon investigation at the Land Office, the land is still registered with the State Government.
- iv. No provision has been made for losses likely to occur on some long-term contracts already in process, since the directors believe such losses should be offset against monies recoverable on other long-term contracts. As an auditor, you believe that a provision for probable losses on particular contracts is necessary.

If losses had been recognised in this manner, they would have reduced the carrying amount of contract work in progress, deferred taxes due, profit for the year, and impacted retained earnings as of December 31, 2023. The influence on the financial accounts is regarded significant and widespread.

Required:

Indicate the type of audit report that you would issue and provide appropriate justification. Answer in the following table format.

Audit Opinion	Justification
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(8 marks)

- (b) Ottoman Berhad is a midsize, industrial instrument manufacturer supplying precision equipment to manufacturers in the Midwest. The corporation is 10 years old and uses an integrated Enterprise Resource Planning system. The administrative offices are in a downtown building and the production, shipping, and receiving departments are housed in a renovated warehouse a few minutes away.

Customers place orders on the company's website, by fax, or by telephone. All sales are on credit, freight on board (FOB) destination. During the past year sales have increased dramatically, but 15% of credit sales have had to be written off as uncollectible, including several large online orders to first-time customers who denied ordering or receiving the merchandise.

Customer orders are picked and sent to the warehouse, where they are placed near the loading dock in alphabetical sequence by customer name. The loading dock is used both for outgoing shipments to customers and to receive incoming deliveries. There are ten to twenty incoming deliveries every day, from a variety of sources.

The increased volume of sales has resulted in a number of errors in which customers were sent the wrong items. There have also been some delays in shipping because items that supposedly were in stock could not be found in the warehouse. Although a perpetual inventory is maintained, there has not been a physical count of inventory for two years. When an item is missing, the warehouse staff writes the information down in logbook. Once a week, the warehouse staff uses the logbook to update the inventory records.

The system is configured to prepare the sales invoice only after shipping employees enter the actual quantities sent to a customer, thereby ensuring that customers are billed only for items actually sent and not for anything on back order.

Required:

Identify **FOUR (4)** weaknesses, consequences, and recommendations in terms of Ottoman Berhad revenue cycle procedures. Answer in the following table format:

Weaknesses	Consequences	Recommendations
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(12 marks)

[20 marks]

Question 5

- (a) *ISA 500 Audit Evidence* defines audit evidence as information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained on the accounting records underlying the financial statements and other information.

Required:

- i) Describe **TWO (2)** factors that affect the reliability of confirmations.
(4 marks)
 - ii) Evidence comes in various types and has different degrees of reliability. For each of situation given below, briefly discuss whether the first or the second type of evidence is more reliable.
 - a. A bank confirmation versus observation of the segregation of duties between cash receipts and recording payment in the accounts receivable subsidiary ledger.
 - b. An auditor's recalculation of depreciation versus examination of raw material requisitions.
(4 marks)
- (b) You have recently been appointed as the team leader for a new client, Lotus Tea, which specialises in herbal beverages. This client is currently in its third year of operation and has received inquiries from the Ministry of Health regarding product safety. Additionally, they are facing challenges due to inflation and the depreciation of the Malaysian Ringgit, which are impacting their supply chain. To initiate the audit process, you have received the following Statement of Comprehensive Income for the past two years.

	2023	2022
	RM'000	RM'000
Turnover	3,741	3,182
Cost of Sales	1,760	2,127
Gross Profit	1,981	1,055
Operating expenses		
Administration	618	660
Selling and distribution	491	344
Commission	50	53
Profit/(Loss) before tax	822	(2)

Required:

Using the given financial data, give your assessment regarding Lotus Tea using **FOUR (4)** appropriate financial ratios.

(8 marks)

- (c) Audit risk refers to the possibility that an auditor issues an unqualified opinion on financial statements that are materially misstated. In simpler terms, it's the risk of the auditor signing off on financials that are not entirely accurate.

Required:

Describe any **TWO (2)** components of Audit Risk.

(4 marks)

[20 marks]

END OF EXAMINATION PAPER