

*Audit*  
**T150**

**ACC – Principles of auditing and  
ethics in accounting**

**T150**

Friday, 23/7/2021

08:30 – 11:30 AM

*E. C. M.*

**TVET NATIONAL EXAMINATION, I**

**OPTION/TRADE: ACCOUNTING**

**SUBJECT: Principles of auditing and ethics in accounting**

**DURATION: 3 hours**

**INSTRUCTIONS TO CANDIDATES: PART II**

The paper is composed of two (2) Sections as follows:

**Section I: Attempt all the Twelve (12) questions (60 marks)**

**Section II: Attempt any Four (4) questions out of Six (6) (40 marks)**

# MARKING GUIDE

**Section I : Attempt all the Twelve (12) questions (60 marks)**

1. What are five roles of ethics in management of the business? **LO1.1**

**Marking scheme: each good role 1mark total five roles=5marks**

It helps the manager to avoid the misuse of company's fund / **1mark**

It helps for better planning, coordinating, organizing,...business activities/ **1mark**

To achieve company success/ **1mark**

To determine the truth or falseness judgment of behavior in society/ **1mark**

To increase communication network/ **1mark**

Others

**2. Explain the key terms:**

i) **Auditing**

ii) **Third party**

**(5 marks)**

**Answer: i) Auditing** is an examination of accounting records undertaken with a view to determine accuracy and reliability of accounting statements and reports.

It may be the independent examination of financial statement covering the transactions over a period of time and ascertaining the financial position of an organization.

**ii) A third party** is defined as any entity that a company does business with. This may include suppliers, vendors, contract manufacturers, business partners and affiliates, brokers, distributors, resellers, and agents.

**Ref.:** ACCPA501, Principles of Auditing, LU1, Describe the legal and professional standards required for an auditor.

**3. Differentiate internal and external auditors.**

**Internal auditors** are people (employees) who are hired and work within an organization and report to its audit committee and/or directors.

**External auditors** are independent or outsider persons who are appointed by a shareholder of the organization they are auditing. **(5 marks)**

**4. Give 5 contents of international auditing standards "ISA 200".(LO 1.3)**

**Marking scheme:**

# T150

- Introduction (scope of the ISA, an audit of financial statement , effective date) / **1mark**
- Overall objectives of the audit/ **1mark**
- Definitions/ **1mark**
- Requirements/ **1mark**
- Ethical requirements relating to audit of financial statement. / **1mark**
- Professional judgment.
- Sufficient appropriate audit evidence and audit risk.
- others

5. Define the materiality of an error and give its importance. (LO 1.5)

**Marking scheme:**

- a) Materiality means the relativity of the size and magnitude of an item as compared to other items / **1mark**
- b) Importance of materiality of error in auditing is:
  - It influences the auditor's time budget on specific items / **1mark**
  - It dictates the auditor's plan. / **1mark**
  - It determines the amount of audit evidence to be gathered. / **1mark**
  - It is required by professional body. / **1mark**

**NB: Good importance 1mark. Total 4 importance=4marks**

6. Explain the following auditing principles: (LO 2.3)

- a) Planning
- b) Honesty
- c) Secrecy
- d) Audit evidence
- e) Skill and competence

**Marking scheme**

- a) Planning: an auditor should plan his work to complete his work efficiently and well within time. / **1mark**
- b) Honesty: the auditor should impartial attitude and should be free from any interest. / **1mark**
- c) Secrecy: an auditor should keep confidential all the information acquired by him during his audit. He should not share information with any one other without the permission of his client. / **1mark**
- d) Audit evidence: is the proof .The auditor should adhere to substantive and compliance procedure for collecting audit evidence before conducting an audit. / **1mark**

## T150

- e) Skill and competence : audit work should done by trained , experienced and competent persons and audit b staff should be updated with all the development in accounting / **1mark**
- f) Others

**NB. One mark each principle. TOTAL 5 principles=5marks**

7. Highlighting 5 consequences based on wrong application of professional boundaries within a business enterprise. **LO2.1**

**Marking scheme: 1mark for each**

- Increase professional conflict. / **1mark**  
Business can end up activity. / **1mark**  
Lack of business environment protection. / **1mark**  
Increasing laissez-faire leadership style. / **1mark**  
Reducing business productivity. / **1mark**

8. What are the rights of auditor?

Rights of the auditor

- ✓ Right to access to the books of accounts of the organization at any time
- ✓ Right to call for information and explanations from employees, managing agents, company secretaries, etc.
- ✓ Right to receive a 21 day notice to attend the AGM ,and extraordinary meetings
- ✓ Right to make a statement or to express ideas to the AGM
- ✓ Rights to visit the company's branches
- ✓ Right to take a legal and technical advice
- ✓ Right to remuneration
- ✓ Right to sign the audit report

9. **Justify why business ethics is very important in business professional career. /5MARKS**

**Business ethics is important for the following reasons:**

1. Business organizations are economic and social institutions that serve customers' needs by supplying them right goods at the right place, time and price. This is possible if the institutions engage in ethical practices.

2. **Business ethics help in long-run survival of the firms.** Unethical practices like paying low wages to workers, providing poor working conditions, lack of health and safety measures for employees, selling smuggled or adulterated goods, tax evasion

# T150

etc. can increase short-run profits but endanger their long-run survival. It is important, therefore, for firms to suffer short-term losses but fulfill ethical social obligations to secure their long-term future.

**3. Business houses operate in the social environment and use resources provided by the society.** They are, therefore, morally and socially committed to look after the interests of society by adopting ethical business practices.

**4. Ethical business activities improve company's image** and give it edge over competitors to promote sales and profits.

**5. Legal framework of a country also enforces ethical practices.** Under Consumer Protection Act, for example, consumers can complain against unethical business practices. Labour laws protect the interests of workers against unethical practices. Legal framework of the country, therefore, promotes ethical business behaviour. Business houses want to avoid Government intervention and, therefore, follow ethical practices.

**10. Explain any 10 topics or issues to avoid in the work place. /5MARKS**

**10 topics to avoid in the workplace:**

1. Salary/money/personal finance details
2. Intimate details about your love or sex life
3. Alcohol and drug interest/use
4. Political views
5. Religious views
6. Non-politically correct jokes
7. Your Facebook or other social media accounts
8. Medical details
9. Gossip and negative comments about co-workers
10. That you are looking for a new job

**11. Audit evidence is that piece of information that support the auditor's conclusion on view of business books of accounts and vouchers as to whether they have been presented with true and fair view.**

Clearly explain qualities of audit evidence/**5marks**

**ANSWER:**

Qualities of audit evidence:

- i) Sufficiency: It should be complete and adequate to prove material facts.
- ii) Relevance: It should be relevant for the purpose of which it is required
- iii) Reliability: It should be correct and accurate basing the object under study.

## T150

**12.** Illustrate any five importance of the contract between auditor and his clients/**5marks**

**ANSWER:**

Importance of the contract between auditor and his client:

- It defines the scope of audit
- It is the basis of charging audit fees
- It is the basis of audit report
- It is a piece of audit evidence
- It ensures assurance of the auditor's work during the collection of audit evidences.

**Any good point carries 1mark(1x5=5marks)**

**Section II: Attempt any Four (4) questions out of Six (6) (40 marks)**

**13. Explain the five techniques of auditing.**

**(10marks)**

**(2marks for each well explained)**

**Answer: Vouching:** When the Auditor verifies accounting transactions with documentary evidence, it is called vouching. Through vouching, the Auditor verifies authority and authenticity of records.

**Confirmation:** Confirmation is a technique used by an Auditor to validate the correctness of the transactions; for example, an Auditor obtains written statement directly from debtors to confirm the debtors balance as appeared in the books of client.

# T150

**Reconciliation:** Reconciliation is a technique used by an Auditor to know the reason of differences in balances. For example, to know the difference in the bank book of the client and the bank balance as appeared in the bank statement or pass book, the Auditor prepares the reconciliation statement. The same method may be used for debtors, creditors, etc.

**Testing:** Testing is a technique of selecting representative transactions out of whole accounting data to draw a conclusion about all items.

**Physical Examination:** Physical examination requires verification and confirmation of the physical existence of tangible assets as appears in the Balance Sheet like cash in hand, land and building, plant and machinery, etc.

**Analysis:** Analysis is technique used by an Auditor to segregate important facts and to further study their relationship.

**Scanning:** By scanning of books of accounts, an experienced Auditor can identify those entries which would require his attention. It is also called scrutiny of accounts.

**Inquiry:** This method is used to collect in-depth information about any transaction.

**Verification of Posting:** To verify posting from books of original entry to ledger account and confirm the balance, an Auditor is required to verify the postings; for example, to verify a sale book, an Auditor may verify postings from the sale register to the sale ledger. He may further calculate balances of the sale register and the sale book.

**Flow Chart:** The Flow Chart technique is used by an Auditor to determine the stages of transaction and the generation of documents at all levels of transactions.

**Observations:** Through observation, an Auditor get an idea about reliability of the process and the procedure of an organization.

## 14. Explain the key features of audit: (LO4.1)

- i) Auditing engagement?
- ii) Audit plan?
- iii) Audit program?
- iv) Audit responsibility competency?
- i) Supervision?

### Marking scheme:

- i) Audit engagement : refers to the initial stage of an audit during which the auditor notifies the client he has accepted the audit work and clarifies his understanding of audit purpose and scope . /3marks
- ii) Audit plan: means the arrangement of the audit work to be performed by the auditor .The audit plan outlines the action and outcomes of the audit work. /3marks

## T150

- iii) Audit program: is a detailed plan of the audit work to be performed specifying the procedures to be followed in verification of each item in the financial statement and giving the estimate time required. **/3marks**
- iv) Audit responsibility competency: refers to the ability of auditor to practice their duties and functions with integrity and transparency and the conduct of professional concerning decision to perform without any influence on the performance, quality and efficiency. **/3marks**
- v) Supervision: involves directing the efforts of assistants who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished. **/3marks**

**15.** Explain the following types of auditor opinion: **(LO 3.3)**

- ii) Unqualified opinion?
- ii) Qualified opinion?
- iii) Disclaimer opinion?
- iv) Adverse opinion?

**Marking scheme:**

- i) Unqualified opinion /report: is that opinion which is positive and satisfactory  
The auditor issues an unqualified report in the following circumstances:
  - Where the proper books of accounts are kept as per requirement of companies act. **/2.5marks**
  - Where the auditor has received all information and explanations necessary for the purpose of his audit.
  - where the financial statement prepared are in agreement with the underlying records.
  - where in the auditor's opinion the profit and loss account and balance sheet shows the true and fair view of the financial position of business.
- ii) Qualified opinion: is that opinion which is negative and it shows that the audit or is not satisfied. **/2.5marks**
- iii) Disclaimer opinion: the auditor states that he is unable to form an opinion as to whether the financial statement gives a true and fair view. **/2.5marks**
- iv) Adverse opinion: is an opinion made by an auditor indicating that a company's financial statements are misrepresented or inaccurate. **/2.5marks**

**16.** Explain the following categories of threats: **LO2.6**

- i) A self-interest threat
- ii) A self-review threat
- iii) Advocacy threat



# T150

- iv) Familiarity threat
- v) Intimidation threat

## Marking scheme:

- i) A self-interest threat: occurs as a result of the financial or other interest of professional. /**2marks**
- ii) A self-review threat: occurs when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment. /**2marks**
- iii) Advocacy threat: occurs when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised /**2marks**
- iv) Familiarity threat: the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interest too accepting of their work /**2marks**
- v) Intimidation threat: occurs when you are deterred from acting. /**2marks**

## 17. Give and explain the main principles of auditing. / 15 MARKS

### Answer:

Briefly the main principles of auditing are classified under:

#### 1. Planning:

It is the basic principle of auditing. The auditor should plan before starting the work. In planning auditor decides accounting about the system and internal control procedure.

#### 2. Honesty:

Honesty and sincerity is the second important principle of auditing. The loyalty or faithfulness of auditor to work and profession must be beyond the doubts.

#### 3. Impartiality:

In case of audit the attitude of the auditor must be impartial. Keeping in view this principle his personal views may not be included in the audit report.

#### 4. Secrecy:

Secrecy must be maintained by the auditor during the process of audit. He cannot disclose any information to the third party.

#### 5. Evidence:

During the audit the auditor can collect the evidence through the working papers. He can surround his opinion on the audit evidence. The nature and source of evidence must be kept in view by the auditor.

#### 6. Consistency:

## T150

It is an important principle of auditing. In case of selecting the rates of depreciation and valuation of stock the accountant must follow the rates of the coming years. In this regard there should be consistency and changes are not acceptable.

### 7. Legal Frame Work:

The business activities may run within the rules and legal formalities. To protect the rights of the interested parties' rules must be applied.

### 8. Working Paper Preparation:

The auditor collects documents providing evidence that audit was carried out according the principles. The auditor prepares the working paper and kept in this safekeeping as a proof.

### 9. Internal Control:

The auditor will examine the accounting system and inter control.

### 10. Report:

According the principle of auditing a report will be prepared by the auditor at the end. It may be conditional / qualified or unconditional / unqualified. The auditor can draw conclusion and disclose the facts and figures about the business for general information.

## **18. Justify the fundamental principles of ethical behaviors in accounting.**

**/10 MARKS**

### **• Fundamental principles of ethical behavior in accounting:**

#### **✓ Integrity**

Integrity is the practice of being honest and showing a consistent and uncompromising adherence to strong moral and ethical principles and values. In ethics, integrity is regarded as the honesty and truthfulness or accuracy of one's actions.

#### **✓ Objectivity**

Objectivity is a philosophical concept of being true independently from individual subjectivity caused by perception, emotions, or imagination. A proposition is considered to have objective truth when its truth conditions are met without bias caused by a sentient subject.

#### **✓ Professional competence and due care**

Principle of professional competence and due care comprises two distinct obligations.

1. To maintain the professional knowledge and skills required to ensure that clients or employers receive the advantages of a competent professional service based on

# T150

current developments in practice, legislation and techniques.

This obligation has two parts: (a) qualification as a professional; and (b) continuing professional development.

2. To act with due care: to act diligently in accordance with applicable technical and professional standards when providing professional services. Diligence encompasses a responsibility to act carefully, thoroughly and on a timely basis. Professional accountants are required to decline a job unless they possess the necessary skills to perform it properly.

## ✓ **Confidentiality**

A professional accountant must respect the confidentiality of information acquired as a result of professional and business relationships and not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose.

## ✓ **Professional behavior**

A professional accountant must comply with relevant laws and regulations and avoid any action that discredits the profession. Therefore, accountants also have a responsibility to the profession, in addition to their duty to clients, employers and the public. They must act in a way that promotes the good reputation of the profession

## ✓ **Leadership**

One characteristic of ethical leadership is to influence others. Management expert John Maxwell characterizes leadership this way: **“A leader is one who knows the way, goes the way, and shows the way.”**

The ethical leader understands that positive relationships built on respect, openness, and trust are critical to creating an ethical organization environment. The underlying principles of ethical leadership are: integrity, honesty, fairness, justice, responsibility, accountability, and empathy.

Ethical leaders strive to honor and respect others in the organization and seek to empower others to achieve success by focusing on right action.

## ✓ **Accountability**

A situation in which someone is responsible for things that happen and can give a satisfactory reason for them:

Therefore, each and every organization should focus more on accountability as the primordial principles

The organization suffers from a lack of accountability.