

June 07, 2001

ADVANCED AUDITING

(MARKS 100)

PE-1 (PAPER-2)

(3 HOURS)

Q.1 A friend of yours, Iqbal, is a qualified Chartered Accountant, practicing as a partner in a firm of Chartered Accountants. Because of your relationship with him, you are aware that he has invested a substantial amount of his savings in a company owned by one of his clients. A common friend, who happens to be a broker by profession, recently took you into confidence and informed you that Iqbal had passed on to him some confidential information about this company where Iqbal had invested his savings. As a result of this information, your broker friend was able to influence the price of the share of this company in the local stock exchange due to which the price escalated, resulting in a considerable appreciation in the value of shares owned by Iqbal.

Iqbal has indulged in such activities more than often and appears to have a reputation of not being straight forward in his dealings with clients and have been careless in rendering services thereto to the point that at times he shows up to work at the last minute to initial his report, generally finalized by his staff.

Recently, he has been accused of being completely out of touch with the latest developments in the profession and is least bothered about it. In fact, he has been found to have openly carried out activities which you regard as highly objectionable.

Required:

Identify and discuss the Fundamental Principles which Iqbal has failed to observe in order to achieve the objectives of the accountancy profession. (10)

Q.2 You are currently in the process of preparing a presentation to your staff which deals with Quality Control for audit work. You are expected to include in your presentation the requirements of On-the-job training during the performance of the audits. Soon thereafter, you are planning to carry out necessary Evaluation of audit personnel and intend to apprise them of the objective of this evaluation.

Required:

- (a) Discuss the requirements of On-the-job training in your presentation. (04)
- (b) List the objectives of Evaluation of audit personnel in your presentation. (06)

Q.3 (a) State the essential reporting differences with regard to Corresponding figures and the Comparative financial statements. (02)

(b) What is included in the auditor's assessment in deciding about the extent of audit procedures with respect to the Corresponding figures? (04)

(c) Discuss the reporting requirements for the auditor when his report on the prior period is modified. (04)

(2)

- Q.4 (a) Identify the two aspects of the accounting and internal control systems about which the auditor would obtain audit evidence.
- (b) When would the auditor regard audit evidence as more persuasive ?
- (c) How does the auditor deal with the situation when inventory is found under the custody and control of a third party ? Include in your answer the considerations which the auditor is likely to take into account in this regard. (05)

Q.5 Zohra, a semi-senior on the audit of Shah Alam Manufacturing Company Limited overheard the Senior-in-charge of the audit saying that there has been an effective operation of internal controls at the company during the current year. You were surprised to hear this assessment as during the course of your interim audit, you had observed some deviations from the prescribed controls and had felt that the system of internal controls was rather ineffective as a result thereof. Zohra intends to discuss this matter with her Senior-in-charge.

Required:

Please explain to Zohra:

- (a) the meaning of “ effective operation of internal controls” and; (03)
- (b) the important fact recognized by the concept thereof. (04)
- (c) some procedures performed by you may not have been specifically planned by you as tests of control but may serve as such. Give Zohra an example in this regard and state when you may use that audit evidence. (03)
- Q.6 Jabeen, being a recently promoted semi-senior on an audit engagement, has been instructed by Afzal, the senior-in-charge, to design and carry out proper Cutoff tests. She is not too sure about certain aspects of Cutoff procedures and has posed the following questions to Afzal:
- (a) How Cutoff errors can occur and when do they take place ? (02)
- (b) What is the objective of Cutoff tests? (02)
- (c) How to perform Cutoffs in respect of (i) sales (ii) sales returns and allowances and (iii) cash receipts? (06)

Afzal has taken on him to sit down with Jabeen and remove her confusion about the Cutoff tests and is, therefore, preparing his presentation for Jabeen.

Required:

Help Afzal in dealing with the above questions. Ensure that answers to each of the above questions of Jabeen are brief and to the point.

Q.7 Discuss the course of action the auditor is expected to follow in a situation when facts are discovered after the financial statements have been issued which if previously known to him would have resulted in the modification of his report. (10)

(3)

Q.8 Rana has just completed the necessary field work in respect of the audit of the financial statements of Akbar Manufacturing Company (Private) Limited for the year ended 31st December 2000 and is currently going through the various issues that arose during the course of the audit, before presenting her files to her Manager for his review. She noted that she was unable to successfully resolve all such issues with the exception of one issue which related to the consolidation of the financial statements. Akbar Manufacturing Company (Private) Limited ceased to consolidate the financial statements of its subsidiary companies because it considered this basis to be inappropriate in view of substantial minority interests. Rana is well aware of the fact that under International Accounting Standards, the existence of such minority interests is not an acceptable reason for not consolidating the financial statements of subsidiary companies with those of the parent. Rana has, therefore, concluded that modification in the Auditor's Report is necessary and, to impress her Manager, she has decided to prepare a draft of the same.

Required:

- (a) Identify the type of opinion which should be expressed and reasons thereof. (04)
- (b) Assist Rana in drafting the required modification and its effect in the opinion paragraph of the Auditor's Report. You are expected to follow the requirements of the relevant ISA in the drafting of the modification and its effects in the Auditor's Report. (06)

Q.9 Faraaz, one of your Manager deputed by you on the audit of the financial statements of Quaid Manufacturing Company Limited for the year ended June 30, 2000, has assembled the following facts in his Review Memorandum for your consideration:

"The recent introduction of a computerized accounts receivable system resulted in errors and, although the system deficiencies causing these errors have now been rectified, the management of the company is concerned about preserving customer goodwill. As a result, I was instructed not to obtain confirmation of certain accounts receivables amounting to Rs.123.98 million and was not able to satisfy myself concerning the validity of these accounts by alternative means. Accordingly, I was not able to determine whether any adjustments might be necessary to accounts receivable, sales, income taxes and working capital".

You immediately knew that your work was cut out for you and, therefore, decided to have an urgent meeting with the top officials of the company. In the meantime, however, you requested Faraaz to prepare the potential reservation in the Auditor's report, assuming that a qualification is the type of reservation required under the circumstances.

Required:

Prepare a draft of the reservation in the Auditor's Report together with the opinion paragraph to be incorporated therein. Ensure that you follow the requirements of the relevant ISA in the preparation of your draft. (10)

- Q.10 (a) What is your understanding of the concept of "Corporate Governance" ? (04)
- (b) List the areas covered by the ICAP's committee on Corporate Governance in its recommendations for the code of Corporate Governance in Pakistan. (06)