

December 04, 2001

**ADVANCED AUDITING**

**(MARKS 100)**

**PE-1 (PAPER-2)**

**(3 HOURS)**

Q.1 Zaid a fresh qualified chartered accountant has recently established his practice in the name of Zaid & Co., chartered accountants. He is continuously trying to expand his practice and in the process he came across the following situations:

(a) One of the Zaid's close friends, Ahmed, who is in retail business advises him that he should take support of media for the purpose of publicity of his new practice to attract clients. He gave him the example how he managed to increase his sales through media advertisement.

**(02)**

(b) Clever Ltd., an owner managed company asks Zaid that they are willing to appoint him in the forthcoming annual general meeting (AGM) of the company in place of the existing auditors, if he can quote fee which is 50% of the existing audit fee. Zaid believes that keeping in view the estimated time required for audit and the fact that he needs business, it will still be a profitable job.

**(02)**

(c) Zaid receives an offer of appointment as auditors from Famous Limited, a listed company who wants to remove the existing auditors before completion of their term of office.

**(02)**

Keeping in view the sensitivities of the above matters, Zaid seeks your advice. Being a good friend of Zaid, belonging to the same profession, advise him in each of the above keeping professional ethics in view.

Q.2 (a) Throughout the world, audit firms are placing more and more reliance on tests of control instead of substantive procedures. This practice has changed the traditional approach of audit. What do you consider are the reasons behind this approach? Can substantive procedures be eliminated through this approach?

**(05)**

(b) In respect of each of the following internal control techniques, state the underlying Accounting Control Purpose:

i) cancellation of processed documents

**(01)**

ii) avoiding assignments of incompatible duties

**(01)**

iii) periodic physical inventories

**(01)**

iv) use of multiple-copy forms

**(01)**

v) matching of documents

**(01)**

- (c) You have noted the following Intentional Compliance Deviations during your audit:
- i) deliberate by-passing of the credit approval procedures
  - ii) deliberate by-passing of preparation of shipping documents to accommodate an emergency shipment of goods (01)
  - iii) deliberate failure to perform prescribed detailed physical quantity count on incoming shipment of materials (01)
  - iv) deliberate failure of clerk to perform verification of pricing operations previously performed on sales invoices (01)
  - v) deliberate failure of treasury to control keys to cheque-writing machine in accordance with prescribed policy (01)

State the possible motives underlying the above-referred deviations.

Q.3 Ahmed is the audit incharge of Family Limited – a listed company. During the course of audit he realized that management is involved in significant associated company transactions. The Company is purchasing raw materials from Relative (Private) Limited – an associated company and is selling most of its products to Parents (Private) Limited – another associated concern. Through extensive audit procedures, Ahmed comes to know that Family Limited is selling goods to Parent Limited at a price which is much lower than the market price resulting in a substantial loss to the company and payment of less sales tax to the government treasury. The management has made disclosures in the accounts that the transactions with the associated companies are at arm's length. Ahmed views this as a serious non-compliance of laws and regulations.

Required:

- (a) Having discovered the aforesaid non-compliance, what procedures Ahmed should perform? (You are not required to draft audit opinion). (05)
  - (b) What are the reporting responsibilities of the auditor viz-a-viz management, shareholders and regulatory authorities in this respect? (04)
- Q.4 Discuss 'sampling risk' and 'tolerable error' and correlation between 'tolerable error' and 'sample size' during the process of an audit. (08)
- Q.5 (a) Discuss the concepts of Materiality and Audit Risk in evaluating audit evidence. (05)
- (b) If after planning for specific audit procedures, the auditor determines that the acceptable Materiality level is lower, Audit Risk is increased. How does the auditor compensate for this? (05)
- Q.6 (a) Identify the auditing procedures during which Computer Assisted Auditing Techniques (CAATs) could be used. (04)
- (b) List the major steps to be undertaken by the auditor in the application of a Computer Assisted Auditing Techniques. (04)
- Q.7 (a) Why the extent of working papers is regarded as a matter of Professional Judgement? (02)
- (b) What is the specific requirement of International Statement of Auditing in relation to Documentation? (02)

- (c) What kind of Documentation you would consider for the working papers in s Computer Assisted Audit Techniques?
- Q.8 If adequate disclosure is made in the financial statements the auditor should ordinarily express an unqualified opinion and modify the auditor's report by adding on Emphasis of a Matter paragraph.
- (a) What is the objective of adding a paragraph, as referred to above? (01)
- (b) Prepare a draft of 'Matter of Emphasis' paragraph. (04)
- (c) Would you modify your audit opinion by giving a 'Matter of Emphasis' paragraph in case adequate disclosure is not made in the financial statements of the fact that the company has been unable to renegotiate its significant borrowings? Discuss. (04)
- Q.9 Is an auditor responsible for detection of frauds in the financial statements? What an auditor should do when he becomes aware about existence of fraud in the financial statements? (06)
- Q.10 Your firm was engaged by ABC & Company to express an opinion on a Component, that is, on a Schedule of Trade debts of the company. Necessary field work has just been completed and as a result thereof, the Engagement Partner has requested you to prepare a draft of your Report for his review.
- Required: Prepare a draft of your Report on the trade debts of the company, assuming that an unmodified report is warranted. (10)
- Q.11 You have been assigned responsibility to handle a large size audit assignment. Outline various steps that you would consider during various phases of the audit from inception to conclusion. You are not expected to provide details as summary would suffice. (10)

**(THE END)**