

June 02, 2003

ADVANCED AUDITING

(MARKS 100)

[Module 'E' Paper E-14] & [PE-1 Paper 2]

(3 hours)

- Q.1 (a) The role of external auditors in recent corporate failures has been frequently questioned. Discuss the impact of major audit failures such as "Enron" and "World Com" on the audit profession. What in your opinion should be the response of the profession to enhance public perception about the profession. (10)
- (b) The Institute of Chartered Accountants of Pakistan has notified a list of services which external auditors can perform for their listed external audit clients. What are those services? (05)
- Q.2 (a) Your firm has recently won a new audit of a large manufacturing company. However, you noted that prior period's financial statements had not been audited. You are of the view that for current assets and liabilities and non-current assets and liabilities, you could obtain some audit evidence as part of the current period's audit procedures.
As an audit manager, explain your point of view in detail, for the benefit of your staff. (06)
- (b) As a result of audit of the manufacturing company mentioned above, you were unable to obtain sufficient appropriate audit evidence on the opening balance of inventory. You were, however able to obtain sufficient appropriate evidence with regard to the closing balance of the inventory. You are required to draft your opinion, including the qualification, if any. Do not write the whole report but just draft the qualification, if any and opinion paragraph. (05)
- Q.3 (a) When is the auditor's assessment of materiality and audit risk expected to be different? Include in your answer the reason for the same together with an example in support thereof. (06)
- (b) Why would the auditor in planning the audit work intentionally set the acceptable materiality level at a lower level than is intended to be used to evaluate the results of the audit? (03)
- Q.4 (a) What is the responsibility of the external auditor regarding assessment and disclosure of a change in accounting policy made by his client. (05)
- (b) It is often said that working papers should possess certain characteristics. List some of these characteristics. (05)
- Q.5 You are relaxed that the financial statements of MNOP Corporation have finally been issued by its Board of Directors together with auditor's report, when, all of a sudden, the concerned Audit Manager barged in your room to inform you that he has just become aware of a material fact related to the financial statements of the MNOP Corporation, which existed at the date of your report and which if known to you at that date may have caused you to modify your report.
You immediately got on your feet and started wondering about your course of action.
Describe the course of action you will follow in the above referred situation. (10)

- Q.6 During your audit of the financial statements of Triple AAA Insurance Limited for the year ended December 31, 2002, you noted that the company did not comply with the requirements of S.R.O. 938, issued during the current year by the Securities and Exchange Commission of Pakistan, insofar as the valuation of "available for sale" investments in the financial statements was concerned. The company had stated such investments at cost, as opposed to valuing these at the lower of cost or market value (market value to be taken as lower if the fall is other than temporary), as required in the above S.R.O. As a result, you noted that provision amounting to Rs.131.036 million required for valuing such investments on this basis had not been made by the company in the financial statements of the company.
- Further, you noted that although the company had made a provision of Rs.28.929 million for claims "Incurred But Not Reported" (IBNR) in the above referred financial statements, the same fell short by Rs.57.859 million, as a result of which provision in the required amount of Rs.86.788 million was not made on this account.
- Given the materiality of the amounts involved and their effects on the financial statements of the Company, you have decided to express qualifications with regard to these matters in your report.
- Draft qualifications in respect of the above matters in your Report on the financial statements of the Triple AAA Insurance Company Limited, together with the related appropriate wording in the opinion paragraph of your Report. Do not attempt to write the whole report. Draft qualifications and the related wordings of the opinion paragraph. (10)
- Q.7 (a) State the obligations of Chartered Accountants with regard to the Confidentiality of client's information or employer's affairs. (03)
- (b) Is Confidentiality only a matter of disclosure of information? (02)
- Q.8 Discuss the role of audit committees in the light of the requirements laid down in the Code of Corporate Governance. (10)
- Q.9 Sputnik Loan Company has 100 branch loan offices. Each office has a Manager and four or five Subordinates, employed by the Manager. Branch Managers prepare the weekly payroll, including their own salaries, and pay employees from cash on hand. The employees sign the payroll sheet signifying receipt of his salary. Hours worked by hourly personnel are inserted in the payroll sheet from time cards prepared by the employees and approved by the Manager.
- The weekly payroll sheets are sent to the Head Office along with other accounting statements and reports. The Head Office compiles employees earnings records and prepares all tax salary reports from the weekly payroll sheets.
- Salaries are established by Head Office job evaluations schedules. Salary adjustments, promotions and transfers of full time employees are approved by a Head Office salary committee based upon the recommendations of Branch Managers and Area Supervisors. Branch Managers advise the salary committee of new full-time employees and terminations. Part-time and temporary employees are hired without referral to the salary committee.
- (a) Based upon your review of the above referred payroll system, how might payroll funds be diverted? (08)
- (b) Prepare a payroll audit program to be used in the home office to audit the branch office payrolls of the Sputnik loan company. (12)