

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Advanced Auditing	Final Examination - Winter 2007

Overall observation

The overall performance of the students in the paper could be termed below average. The questions were based on practical scenarios and students could have performed well had they read the Auditing standards in reasonable detail and applied their practical knowledge which they gain during the course of audit. However, the majority could not approach the questions logically and provided irrelevant details which were not asked for. Besides knowledge and practical application of the standards, the students also suffered from lack of presentation and communication skills.

Question-wise comments are as under:

- Q.1 (a) This question was aimed to test the knowledge of the students as regards the impact of instances of fraud and error which come to the knowledge of the auditor, on assessment of risk and audit procedures and its eventual reporting to the management and to those charged with governance. Many students poorly approached this question and instead of discussing the matters identified above they wasted their time in stating detailed substantive procedures to overcome the situation. Barring few exceptions, students did not distinguish clearly as to what was the appropriate forum to communicate the matter.
- (b) In this part the majority was able to identify that the auditor will give an emphasis of the matter paragraph in which he shall describe the circumstances that required the change in corresponding figures alongwith reference to appropriate disclosure in the financial statements.
- (c) In this part the majority was able to differentiate correctly that corresponding figures form an integral part of the financial statements whereas prior year's figures contained in comparative financial statements do not form part of the current period financial statements.
- Q.2 Generally the candidates were able to perform well in part (i) and (ii) of this question. They could appreciate clearly the risk carried in exceeding credit limits and when the invoices were not signed. However, it was noticed that students appeared to have little knowledge about the role of IT steering committee and effectiveness of DRP and its relevance to an organization.

- Q.3 This question was set to test the practical approach of the candidates. They were required to assess as to how an auditor can satisfy himself about stock balances in special circumstance and when it is impracticable to attend the stock check. Majority of the students declared that the situation created a scope limitation and accordingly recommended the issuance of a modified audit report. Only about 25% of the students could suggest alternative procedures to verify the stock such as:
- Identifying the packets at random and verifying their contents/use by observing the production process subsequent to year-end.
 - Studying the literature supplied by the supplier to verify the managements claim.
 - Verifying the standard quality by using independent experts/laboratory tests.
 - Discussing the procedure adopted by the management to ensure the existence of material in packed containers and assessing the reliability of the managements procedures.
- Q.4 This question was designed to test the knowledge of students about the non audit services which an auditor can provide to its audit clients and the related potential independence issues. Although it was an easy question but the response was not that good. The following errors were commonly seen:
- Surprisingly very few students could highlight the issue of contingent fee in the context of Chartered Accountants Ordinance which declares such practice as professional misconduct.
 - Some of the students declared that under ICAP's Code of Ethics an auditor cannot render any non audit service to its audit clients.
 - A large number of students did not provide any reason for not accepting the non-audit services. Threats such as self interest, self review, impairment of independence and objectivity etc. were discussed by some of the good students only.
 - Quiet often the reason for refusing a particular assignment were incorrect.
- Q.5 (a) The question was based on ISRS 4410 "Related Services". The examinees were required to give their opinion as to how an accountant should react if faced with certain situations, while carrying out an assignment for complication of financial statements. Most of the examinees were not familiar with the requirement of ISRS 4410. The answers were mostly on either side of the two extremes i.e. some examinees narrated all the steps i.e. even those which are only relevant in case of audit assignments, whereas others gave a blanket permission to the accountant to use the information as provided by the management. Very few of the examinees were able to form balanced opinions as recommended by ISRS 4410. The students are advised to go through para 11 to 16 of the ISRS to become aware of the responsibilities of an accountant, while carrying out an assignment to compile financial statements.

(b) Very few of the examinees were able to point out that an accountant may not issue a report on such assignment if his name is associated with the financial information compiled by him (para 6 of ISRS 4410). Many students gave the standard form of audit report instead of giving the report on Compilation Engagement. The contents of such a report are listed in the above standard and examples of such reports are also available in the appendix to the Standard.

Q.6 (a) A large number of students answered this question in a general manner i.e. without giving due consideration to the situation which was presented in the question. Consequently, they simply listed the various factors that are considered by the auditor while assessing the internal audit function and consequently secured very few marks. They were expected to highlight the following issues in their assessment of the Internal Audit Function:

- The Head of Internal Audit (HIA) enjoyed a good position but his close relationship with the top management could impair his objectivity.
- The scope of his functions is wide and his recommendations are given due consideration.
- HIA seems competent but competence of his staff need to be evaluated.
- His actions lack due professional care as his work is not properly planned and documented.
- An overall view as to whether the internal audit function should be taken into account to modify nature, timing and extent of audit procedures.

(b) Surprisingly at this level also many students fully agreed with the approach of the audit incharge and declared that since internal audit function lacks independence it cannot be relied upon altogether. Making such a decision even before making any assessment of the relevance thereof is not justified. It is generally true that internal audit lacks independence yet some of its objectives are similar to those of external audit and hence it may be useful.

Q.7 This was one of the easiest and simple question set by the examiner and candidates performed well and generally secured good marks as they quoted the relevant points based on ISA 550 'Related Parties'.

Q.8 (a) Most of the students were able to identify the factors which the auditor, considers while using specific selection. The factors include, auditors understanding of the entity, the assessed risk and characteristics of the population to be tested.

However, some of the students kept on discussing the materiality issues and how the decision to select high value items may improve the efficiency of the audit.

- (b) In this part the students were generally able to identify that specific selection is subject to non-sampling risk and that the auditor has to obtain evidence regarding the rest of the population, as in case of specific selection, the results cannot be projected to the entire population.

Q.9 This question was based on a short case. At this level of their training, students were expected to grasp the situation well. However, most of them seemed overawed by the situation and could not identify the key issues as required by the question.

Four aspects of the situation were required to be discussed. The expectation of the examiner and the performance of the students, is discussed below:

Corporate Governance Issues

The following deficiencies of the directors of the entity were very much apparent from the case:

- Failure to establish sound internal controls.
- Maintaining significant business policies like those related to business acquisitions/disposals recovery of debts, complex transactions etc.

The conduct of the Audit Committee was also found deficient in many ways including the follows:

- Did not rotate the auditors for so long
- Did not give due importance to the appointment of SIGs and the threats related thereto.

The students were generally able to point out the above points. However, they included a number of irrelevant points also which were not required.

Quality Control at SIG

Most of the students pointed out that Quality Control at SIG was good. To support their view they mentioned that SIG had policies in place for risk evaluation, review of audit by a senior partner, presence of a Research Department for handling complex issues etc. However, very few could point out that on the implementation side there were serious issues which were evident from the following instances:

- When QC partner rated the client 'high risk', appropriate measures were not taken.
- The person responsible for review of audit was also responsible for business development.
- Engagement partner was not rotated for eight years.
- No safeguards were adopted in view of the presence of ex SIGs in the executive team.

Audit Approach of Engagement Partner

Here again the response of the students left much to be desired. Most of the replies were not specific and mentioned general points like failure to detect errors and fraud; failure to qualify the report etc. At this level, the examiner expected the students to include specific issues in their answers such as:

- Failure to carry out proper risk assessment procedures in view of the presence of high risk factors such as pressure on management to show high performance, opportunity available to CEO for material mis-statement and the involvement of highly complex transactions.
- Failure of the engagement partner to adopt proper audit approach in view of the presence of ex SIG employees.
- When QC partner rated the client 'high risk' the response of the engagement partner was not according to the principles of professional skepticism.

Expectation gap between Prescribed Audit Standards and Understanding of the Directors.

This area proved easy and many of the students were able to clarify the following simple points to remove the expectation gap:

- (i) The auditor is not responsible to identify errors unless material.
- (ii) Labour unrest and issues of management inefficiency do not affect fair presentation.
- (iii) Assignments related to designing of internal controls and estimation of bad debts create self review threat on the independence of the auditor and therefore the auditor's refusal to accept such assignments was in accordance with the recommendations of International Standards on Auditing.

(THE END)