

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations Autumn 2008



September 1, 2008

AUDITING

(MARKS 100)

(3 hours)

Q.1 You are the audit manager on the audit of Gold Limited. During the planning phase of the audit, the audit senior had a meeting with the CFO of the company. While discussing matters such as performance of the company, financial ratios and the overall audit strategy etc., the CFO informed that there were no related party transactions during the year. He also acknowledged that management is responsible for identification and disclosure of related parties. In view of the above, the audit senior feels that there is no need to prepare audit program in respect of related parties.

Required:

- (a) Comment on the conclusion drawn by the audit senior and give brief explanation of the auditor's responsibility in respect of related party transactions. (04)
- (b) What types of transactions may indicate the existence of unidentified related parties? (07)

Q.2 Because of the nature of fraud and the difficulties encountered by the auditors in detecting material misstatements in the financial statements on account of fraud, the management has to play a significant role in assisting the auditors in the performance of appropriate audit procedures. Make a list of representations that the auditor should obtain from the management in this regard. (07)

- Q.3 (a) Explain audit sampling and the risks associated with the use of audit sampling techniques. (10)
- (b) Identify the factors which influence the sample size for:
- (i) Tests of controls (ii) Tests of details. (05)

Q.4 Karim & Company, Chartered Accountants are engaged in the review of interim financial information of Babar Textiles Mills Limited for the half year ended June 30, 2008. The increase in oil and energy prices and current inflationary trend prevailing in the country has resulted in substantial losses and the Company's outlook is negative. Moreover, in view of recessionary pressures being faced by the US and many of the EU economies, some of the large customers in those countries have not renewed their orders and many others are expected to follow. Consequently, the company has decided to lay off 40 percent of its workforce gradually, over the next few months.

The company's management acknowledges the severity of the situation but is reluctant to provide specific details in the interim financial information. However, it has given a note containing general indications about the future prospects of the company.

Required:

Describe how the auditor should address the above issue and the implications it may have on the review report of interim financial information. (09)

Q.5 Mr. Mubarak is the audit senior on the audit of Sky Blue Limited. While comparing the draft financial statements with the previous year, he noted many unusual fluctuations. Briefly explain the procedure he should follow, in the above situation. (06)

Q.6 You are the senior in-charge on the audit of financial statements of Fine Tractors Limited, for the year ended June 30, 2008. The audit field work has revealed the following issues which are still unresolved:

- (a) The company is not charging depreciation on a building which was constructed during the year on freehold land belonging to the company, at a cost of Rs. 128 million. The management is of the view that land and building are part of the same class of assets and no depreciation is required to be charged thereon because the value of such assets is expected to increase considerably in future.
- (b) A customer of the company has filed a suit claiming damages of Rs. 4.6 million, on account of company's failure to meet a deadline for supply of certain goods. The company has filed a counter claim of Rs. 5.5 million, against the same customer on account of the customer's failure to fulfil certain conditions regarding payment of advance. No provision has been made in the books of the company as the company's lawyers are not very sure about the outcome of the lawsuit.

You have discussed these matters with your manager who believes that the amounts involved are material.

Required:

Draft a qualification paragraph that may have to be included in the Audit Report. You may assume necessary details. (10)

Q.7 Direct confirmations from third parties provide independent audit evidence that certain account balances and items in the financial statements are properly recorded and disclosed.

Required:

- (a) Distinguish between positive and negative confirmations. (02)
- (b) Briefly describe the risks associated with each of the above type of confirmation and the steps that an auditor usually takes to avert such risks. (05)
- (c) Explain why and under what circumstances an auditor may decide to use negative confirmation requests. Also, identify the circumstances where the auditor may use a combination of positive and negative confirmations. (06)

Q.8 You are the engagement manager on the audit of Chill Limited. During the course of audit, you have been provided an Actuarial Valuation Report on the Company's Employees Retirement Benefits Scheme. You have noted that the report has been prepared by M/s Saleem and Company which is not well known to you.

Required:

Briefly describe the matters that you would consider before using the report prepared by Saleem and Company. (05)

Q.9 Azeem and Company have been the auditors of Shahid Corporation Limited, a listed company, for the past many years. You have been appointed as the audit engagement manager.

Briefly explain the matters which you would consider while assessing the following:

- (a) acceptance and continuance of client relationship. (05)
- (b) need to send a new engagement letter. (03)

Q.10 (a) Explain the difference between "The Overall Audit Strategy" and the "Audit Plan". (04)

- (b) Identify the matters which are usually discussed / explained in each of the above documents. (12)

(THE END)