

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations Spring 2009



March 2, 2009

AUDITING

(MARKS 100)

Module D

(3 hours)

- Q.1 (a) ICAP's code of ethics has specified five principles of professional ethics for chartered accountants. The circumstances in which a chartered accountant operates may give rise to specific threats to compliance with these principles.

Required:

- (i) Briefly describe each of the fundamental principles of professional ethics. (07)
 - (ii) Briefly describe different categories of the threats to compliance with the fundamental principles. (05)
- (b) Mustansar is the audit manager of a team engaged on the audit of a listed company. During his initial discussion with the chief executive officer (CEO) of the company, he was informed that depressed economic conditions have badly affected the company and its liquidity. Due to uncertainty about the future of the company, certain key employees have left including several staff members of accounting and finance department. Consequently, the accounting records are in a bad shape and the management is making efforts to complete the draft accounts quickly. He therefore requested Mustansir to carry out necessary accounting work and to help prepare the annual financial statements at a fee to be agreed mutually.

Required:

Briefly describe the guidelines contained in the ICAP's Code of Ethics and the extent of support that can be offered by the auditors, in the above situation. (06)

- Q.2 While allocating the audit field work amongst the members of the audit engagement team, your manager has advised the team members to keep each other informed on audit issues that may arise during the course of audit and discuss the impact thereof on the entity's financial statements and their susceptibility to material misstatement.

Required:

Explain the objective and benefits of such discussions among the team members. (06)

- Q.3 The audit field work of STU Limited has been completed and financial statements for the year ended June 30, 2008 have been initialed for the purpose of identification. Two days before the board meeting, following matters have come to the knowledge of the audit manager.

- (i) In a pending case, a lower court has delivered its judgment according to which the company was found guilty and liable for damages of Rs. 10 million.
- (ii) The company has received a dividend warrant issued by an investee company. The dividend was declared by the Board of Directors on June 30, 2008. This amount has not been recognized in the financial statements.

- (iii) The company has received a notice that one of its major customers has gone into liquidation. The amount due from the customer at the balance sheet date has been treated as good.
- (iv) A long term loan has been classified as current liability as loan conditions have been breached during the period. As per agreement, breach of conditions makes the liability payable on demand. However, subsequent to balance sheet date, the lender has agreed not to demand the loan during the next 12 months.

Required:

- (a) Evaluate each subsequent event and discuss whether financial statements need to be adjusted or not.
- (b) What would be your action if management is not willing to revise or amend the financial statements because of time limitation while you consider that revision or amendment is necessary? (12)

Q.4 Distinguish between absolute and reasonable assurance. Identify the type of assurance that is expected in an audit of the financial statements, clearly outlining the reasons to justify your point of view. (08)

Q.5 Shamsuddin a newly qualified chartered accountant has recently established his practice in the name of Shamsuddin & Co., Chartered Accountants. He is continuously trying to expand his practice and in this process he came across the following situations:

- (i) One of his friends, who is the owner of an advertising agency has offered to provide significant discount for publicity of his new practice.
- (ii) Fashion Limited, a private limited company, which has suffered heavily on account of recent financial turmoil, has informed him that it is willing to appoint him in the forthcoming annual general meeting (AGM) of the company in place of the existing auditors, if he can quote a fee below the existing audit fee.
- (iii) Design Limited has contacted Shamsuddin and informed him that they are willing to appoint him as their external auditor in the next AGM at a fee of Rs. 200,000 if he completes the audit in a month. However, in case of delay in the audit work the audit fee will be reduced to Rs.150,000.
- (iv) Shamsuddin receives an offer of appointment as auditors from Style Enterprises, a sole proprietorship, who wants to remove the existing auditors before completion of their term of office.

Required:

Shamsuddin is inclined to accept the above offers. Discuss the options available with him in each of the above situations. (10)

Q.6 (a) Analytical procedures are an important part of the audit process and a tool which the auditor uses during the various phases of an audit.

Required:

- (i) Describe the nature and purpose of analytical procedures used during an audit. (06)
- (ii) Describe the factors that the auditor needs to consider while designing and performing analytical procedures as substantive procedures. (04)
- (iii) Describe the objectives which an auditor expects to achieve while applying analytical procedures at the overall review stage of an audit. (04)
- (b) Representations by management are considered as audit evidence. Describe the basic elements of a management representation letter. (04)

- Q.7 (a) “The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.”
- (i) Briefly explain what do you understand by the risk of material misstatement at financial statement level. **(04)**
 - (ii) List down the risk assessment procedures as referred above. **(02)**
- (b) “The auditor’s assessment of materiality and audit risk may be different at the time of initially planning the engagement from at the time of evaluating the results of audit procedures.”
- Briefly describe the reasons which may lead to such a change in the auditor’s assessment. **(03)**
- (c) Briefly describe the assertions used by the auditors in respect of the following: **(07)**
- (i) account balances
 - (ii) classes of transactions; and
 - (iii) presentation and disclosures
- Q.8 (a) Describe the situations in which an auditor issues a qualified audit opinion. **(07)**
- (b) List down the information which should be included in the qualification paragraph. Where such paragraph should be placed, in the audit report? **(05)**

(THE END)