The Institute of Chartered Accountants of Pakistan

Auditing

Intermediate Examination | 5 March 2012
Spring 2012 | 100 marks - 3 hours
Module D | Additional reading time - 15 minutes

Q.1 Platinum Limited (PL) is a key supplier of raw materials to Zinc Limited (ZL). PL has filed a suit against ZL for breach of terms of an agreement. The amount claimed by PL is Rs. 10 million. ZL has disclosed it as a contingent liability in the draft financial statements for the year ended 31 December 2011. However, ZL is striving for an out of court settlement and recent correspondence indicates that PL is likely to agree and settle the dispute for 50% of the amount claimed by them.

Required:
Describe the audit procedures that ZL's auditor should perform in the above situation. Also discuss the impact, if any, of the above procedures on the audit report. ***(07 marks)***

Q.2 In the planning phase of the audit of Dynamic Limited for the year ending 30 June 2012, you have calculated the following ratios from the management accounts of the company for the eight months ended 29 February 2012:

	Eight months period ended 29 February 2012	**Year ended 30 June 2011**	**Year ended 30 June 2010**
Gross profit percentage	35%	40%	40%
Inventory turnover days	120	105	78
Current ratio	1.5	2.3	2.6
Quick asset ratio	0.78	1.6	1.7
Times interest earned	0.91	1.67	2.1
Debtors turnover days	132	86	68

Required:
Identify the prospective audit risks which the auditor should consider while planning the audit. ***(09 marks)***

Q.3 An auditor may agree to a change in the terms of engagement provided there is a reasonable justification for doing so.

Required:
(a) List the circumstances in which the management may request the auditor to change the terms of an audit engagement.
(b) What factors should be considered by the auditor before accepting a change in the terms of the engagement?
(c) List the steps that the auditor should consider, if he is unable to agree to a change in the terms of engagement. ***(09 marks)***

Q.4 List the substantive procedures that may be performed by the auditor to verify the amount of inventories as appearing in the financial statements of a manufacturing concern. ***(15 marks)***

Q.5 (a) You are the audit manager in a firm of Chartered Accountants. The audit seniors on various jobs have sought your advice in respect of the following independent situations:

(i) The expected rate of deviation based on the auditor's understanding of controls has increased to an extent which is unacceptably high.

(ii) Number of debtors has increased from 4,500 to 5,000 and the amount of debtors as a percentage of total assets has also increased.

(iii) The expected amount of mis-statement has decreased from Rs. 300,000 to Rs. 200,000 whereas the monetary amount in respect of which an appropriate level of assurance is required has increased by Rs. 50,000.

Required:
State with reasons, the effect of each of the above issues on the sample size of:
(i) Tests of controls; and
(ii) substantive procedures. ***(07 marks)***

(b) While determining the sample size for tests of controls, the auditor takes into account the expected rate of deviation. State the factors that are relevant to the auditor's consideration of the expected rate of deviation. ***(04 marks)***

(c) Differentiate between the following:
(i) Fair presentation framework and compliance framework
(ii) Tolerable mis-statement and performance materiality ***(09 marks)***

Q.6 Comment on each of the following independent situations with reference to the applicable rules and regulations.

(a) Waqar is a partner in Sohail and Company, Chartered Accountants, who are the auditors of Wasim Limited for the year 2011. Aqib who was a partner of Waqar in 2008 in his food business, has recently been appointed as a Director of Wasim Limited. ***(02 marks)***

(b) Aleem, Asif and Company (AAC), Chartered Accountants, has accepted an offer for appointment as auditors of Gul Limited (GL). Kamal who is a partner in AAC, held 5000 shares in GL. Within thirty days of acceptance, he gifted the shares to his son Kamran, who is a manager in AAC. ***(06 marks)***

(c) Sajid, Hameed and Company (SHC), Chartered Accountants, are the auditors of Mir Hasan Limited (MHL). Kashif is a senior manager in SHC and is being promoted as a partner. He teaches auditing in a college. The college is owned by a trust whose trustees include two directors of MHL. ***(02 marks)***

(d) You have recently signed the audit report of Sadiq Limited. The management has approached you for reduction in audit fee for the next year because the company has been suffering losses for the past three years. ***(03 marks)***

(e) Saleem is a partner in Orange and Company, Chartered Accountants. He also practices as a sole proprietor and has received an offer for appointment as auditor of ABC Financial Services Limited which is a subsidiary of DEF Bank Limited. The balance outstanding against the credit card issued by DEF Bank Limited to a partner of Orange and Company is Rs. 510,500. ***(02 marks)***

Q.7 As part of the audit process, the management provides written representations to confirm certain matters in connection with the audit.

Required:

(a) State the matters that you will consider as an auditor while assessing the reliability of representations made by the management. ***(05 marks)***

(b) Describe the course of action available to an auditor if the management refuses to provide representation on a particular issue. ***(05 marks)***

Q.8 The following situations have arisen on different clients being audited by your firm. The year end in each instance is 31 December 2011.

(a) The management of Dir Limited intends to present certain unaudited supplementary information, with the audited financial statements, in order to comply with the requirements of the parent company. Before signing the audit report, it has been determined that some of the information is inconsistent with the information in the draft financial statements. ***(07 marks)***

(b) Malakand Industries Limited (MIL) is engaged in the supply of customised machinery to textile manufacturers. On 18 February 2012 one of its customers, who owed Rs. 9.6 million, went into voluntary liquidation. In addition to the above amount, a job was in progress on behalf of that customer and on which MIL had already spent Rs. 13.9 million.

The directors have refused to make a provision against the debt on the grounds that the liquidator was appointed after the balance sheet date. They have also refused to make any provision in respect of the work in process as they are planning to sell the machinery being manufactured to another customer for Rs. 15.7 million.

The profit after tax of MIL is Rs. 85 million. The materiality level is 10% of profit after tax. ***(05 marks)***

(c) Swat Limited has invested Rs. 150 million in a business which is not mentioned in the object clause of its Memorandum of Association. However, the object clause was amended a week before the signing of the audit report. ***(03 marks)***

Required:
In the light of the relevant requirements, discuss how should the auditor deal with the above situations and describe the impact thereof on the audit report.

(THE END)