The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination | 3 December 2012
Winter 2012 | 100 marks - 3 hours
Module F | Additional reading time - 15 minutes

Q.1 You are the Audit Manager of Mustafa and Company, Chartered Accountants, responsible for the audit of Standard Home Appliances Limited, a listed company.

Extracts from the company's financial statements are presented below:

	30-Sep-2012	30-Sep-2011
Income statement	----------Rs. in million---------	
Revenue	1,190	1,174
Gross profit	509	537
Operating profit	242	227
Finance charges	(77)	(69)
Profit before tax	165	158
Statement of financial position		
Property, plant and equipment	1,054	833
Intangible assets	140	100
Inventory	423	260
Trade receivables	417	250
Cash and bank balances	29	54
Total assets	2,063	1,497
Equity and liabilities		
Share capital	1,000	1,000
Retained earnings	218	233
Long-term borrowings	277	50
Liabilities against assets subject to finance lease	180	-
Bank overdraft	185	52
Trade and other payables	203	162
Total equity and liabilities	2,063	1,497

During the year, the company has introduced various products based on latest technologies. These new products are being manufactured on a new plant which has been acquired under a lease agreement for a period of four years. The plant commenced operations on 01 January 2012. The useful life of the plant is 5 years.

Intangible assets represent cost of software installed and designs which have been acquired from a renowned multinational company.

Required:
Identify and evaluate the audit risks in the above situation. **(12)**

Q.2 Identify and evaluate the threats involved and explain how these threats can be reduced to an acceptable level, in each of the following situations:

(a) During the year, Jamil Limited (JL) had acquired Sarfraz Limited (SL) and the companies were subsequently merged. The due diligence exercise for the acquisition was performed by the same firm which carries out the annual audit of JL. At the time of planning, the auditor found that a significant provision has been made against SL's inventories and accounts receivables. The management informed the auditor that the fact that the value of these assets was impaired came to its knowledge after taking control of SL. JL and SL are unlisted public companies. **(10)**

(b) A limited assurance engagement has been accepted at a fee which is lower than the fee charged by the predecessor auditor. **(03)**

Q.3 (a) The audit report of Bhit Gas Limited (BGL) was qualified on account of recognition of mark-up on delayed payment from Salim Enterprises Limited (SEL) amounting to Rs. 2.7 billion, because at the time of signing of audit report, SEL had not acknowledged its liability towards mark-up due to BGL and the matter was pending in the Court.

After the issuance of the financial statements, the matter was decided by the Court and SEL was ordered to settle the mark-up by paying Rs. 1.5 billion. After the Court's decision, BGL had filed an appeal against the order for the remaining amount of Rs. 1.2 billion and the management has requested the auditor to remove the qualification and issue a revised audit report. The management has also informed the auditor that subsequent to the Court's decision, it has decided to revise the financial statements by making a 25% provision against the remaining amount of mark-up.

Required:
Discuss the factors that the auditor should consider with reference to the above and specify the steps that he should take under each of the following circumstances:

(i) The management and those charged with governance are prohibited by law and regulation from restricting the amendment and approval of the financial statements to the effect of the above event.

(ii) The management and those charged with governance are not prohibited by law and regulation from restricting the amendment and approval of the financial statements to the effect of the above event. **(17)**

(b) Identify and explain the shortcomings in the following paragraph of the draft audit report of Javed Limited:

Emphasis of Matter:
We draw attention to the fact that the company has accumulated losses of Rs. 115,436,540 (2011: Rs. 85,365,479) and certain payments against long term loans were overdue as at the reporting date. As at 30 September 2012, its total liabilities exceeded its total assets by Rs. 15,450,300 (2011: Rs. 11,542,200). These conditions indicate the existence of a material uncertainty that the company may be unable to continue as a going concern. **(04)**

Q.4 The statutory auditor of Mighty Limited (ML) has expressed an adverse opinion in the audit report on the financial statements of ML for the year ended 30 June 2012. After the issuance of the annual report, ML has approached the auditor for reporting on the trade debts of the company as on 30 June 2012. This report is required for submission to the bank which has provided financing facilities to ML. The audit working papers reveal that the trade debts have been reported correctly in the financial statements.

Required:
Discuss what may be the auditor's response in the above situation. **(06)**

Q.5 (a) Describe the implications on the audit report where the prior year's audit has been conducted by another auditor. **(04)**

(b) You are the audit manager of Wasim Limited for the year ended 30 June 2012. The previous year's audit was performed by another firm of chartered accountants who have expressed an unmodified opinion. The following issue has been brought to your notice by the audit team:

The company has written off intangible assets amounting to Rs. 30 million in the current year because the new CEO believes that the expenditure does not meet the criteria for capitalization as per the International Financial Reporting Standards. The said amount was capitalized during the year ended 30 June 2011. The profit before tax for the year ended 30 June 2012 is Rs. 52 million (2011: Rs. 91 million).

Required:
Describe the steps which the auditor needs to take in the above situation and explain the implications on the audit report assuming that the auditor is satisfied with the valuation of intangibles as on 30 June 2012. **(11)**

Q.6 TFL has recently applied for listing on a Stock Exchange in Pakistan. Following information has been extracted from TFL's financial statements for the year ended 30 June 2012.

	Rs. in 000
Issued, subscribed and paid up capital - Ordinary shares	4,000,000
Issued, subscribed and paid up capital - Non redeemable preference shares	600,000
Share deposit money- Non redeemable preference shares	3,000
Un-appropriated profit	30,000
Unrealized gain on re-measurement of available for sale investments (net of tax)	500,000
Surplus on revaluation of fixed assets	120,000
Unpaid dividend on preference shares	75,000

The face value of both types of shares is Rs. 10 each. Preference shares are convertible into ordinary shares at any time after listing of ordinary shares. The conversion price shall be Rs. 10 per ordinary share. For the purpose of conversion, unpaid dividend on preference shares, accumulated up to the date of announcement of conversion by the company, shall also be taken into account for determining the number of ordinary shares to be issued upon conversion.

Required:
On behalf of the auditors of the company, draft a report on factual findings on break-up value of shares for submission to the client **(16)**

Q.7 The audit of Karim Limited (KL) is in progress. The audit team has requested you to advise on the following issues:

(a) The confirmation request sent to a customer who owed Rs. 35 million was responded by an e-mail addressed to KL's CFO.

(b) The management of KL is not allowing auditors to send confirmation to Fareed Limited (FL), on account of certain disputes, as the sending of confirmation will undermine the ongoing negotiations with FL. However, the management has offered to provide specific written representation on the matter.

Required:
Discuss how the auditor should deal with the above situations. **(17)**

(THE END)