



## Auditing

Intermediate Examination  
Spring 2013  
Module D

6 March 2013  
100 marks - 3 hours  
Additional reading time – 15 minutes

- Q.1 Briefly describe the meaning of professional judgment. Explain its importance in the context of an audit and identify the key decisions/areas where an auditor may need to apply professional judgment. (08)
- Q.2 You are the manager responsible for the audit of Park Hotels Limited (PHL), which operates three hotels in Pakistan. PHL has adopted the revaluation model for the valuation of buildings. In the current year, revaluation has been carried out by a new firm, Farhan Associates (FA). PHL has incorporated the effects of revaluation in the financial statements accordingly.
- Required:**
- (a) Briefly describe the matters that you would consider before using the report prepared by FA. (04)
- (b) Identify and explain the principal audit procedures to be performed on the valuation of the hotel's buildings. (06)
- Q.3 Comment on each of the following independent situations with reference to the applicable requirements of the Companies Ordinance, 1984.
- (a) Jahangir (Private) Limited (JPL) has a paid-up capital of Rs. 2.5 million. Till recently, it was a wholly owned subsidiary of Malik Limited (ML). Recently ML has disposed of 60% of its holding in JPL to Zubair Enterprises (ZE), a partnership firm. All the partners in ZE are on the Board of Directors of ML. JPL intends to appoint Mr. Ahsan as its auditor. Mr. Ahsan is an MBA and his brother is also a partner in ZE. (03)
- (b) A notice for appointment of Kashif and Company, Chartered Accountants (KCC) was received by Khanewal Limited (KL), fourteen days before the AGM. The notice was served by Mr. Iqbal, who is a holder of 500,000 non-voting preference shares. (02)
- (c) Mr. Khan is a partner in a firm of Chartered Accountants. He also holds 70% shares in Khan Limited, (KL). Construction Bank Limited (CBL) has granted a loan of Rs. 10 million to KL. Mr. Khan's firm has received an offer for appointment as auditor of CBL. (02)
- Q.4 Discuss with reasons, the appropriateness or otherwise of the following decisions taken by the audit seniors, on different assignments.
- (a) Sample size of tests of controls was decreased due to increase in the expected rate of deviation. (02)
- (b) In view of the increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population, the audit senior increased the sample size of test of details. (02)
- (c) Sample size of tests of controls was decreased because the sampling was done after stratification of data. (02)
- (d) Sample size of tests of details was increased due to increase in the tolerable rate of deviation. (02)
- (e) As the expected rate of deviation was unacceptably high, the audit senior decided not to perform tests of controls and carried out tests of details on 100% items. (03)

**Q.5** Strong Vehicles Limited (SVL) manufactures heavy vehicles. As the job incharge on SVL's audit, you have come across the following situations:

- (a) The management had provided you with a representation that they had disclosed all the related party transactions and relationships of which they were aware. However, before finalization of the audit, you found that subsequent to the year-end, a payment of Rs. 100 million has been made to Strong Engines Plc (SEP), a company incorporated in a foreign country. On your query, the management has advised you that SEP is a foreign subsidiary of SVL and its name was not disclosed inadvertently because it had been non-operational for the last many years. (05)
- (b) The management has provided you with written representation that lives of fixed assets are realistically estimated. Similar representation was also provided in the prior years. However, SVL has incurred losses on disposal of fixed assets during the year, because of which you are now of the view that the useful lives of fixed assets were not realistically estimated. (04)

**Required:**

Analyse each of the above situations and briefly describe your course of action.

**Q.6** Sher Khan Limited (SKL) had announced a major restructuring in the year 2011 and a provision of Rs. 120 million was made against the cost of restructuring and redundancies. During 2012 all known claims and liabilities relating to the restructuring were settled for Rs. 90 million.

However, as a matter of prudence, the company has not written back the excess amount of provision in view of a suit filed by certain staff members against termination of their employment. SKL's legal counsel is of the view that the possibility of an adverse decision against the company in this matter is remote.

The audit senior does not agree with the management's contention and has drafted the following modification in the audit report:

"An amount of Rs. 30 million has been provided in respect of the expected amount which the company may be required to pay to the employees whose employment was terminated during the year. The management is of the view that in case the company is required to pay the amount to those employees, the said provision would be utilized. In our opinion, the company's decision to make the above provision is not in accordance with International Accounting Standards. Had the liabilities been recognized correctly the profit for the year would have increased by Rs. 30 million. Because of the effects of the matters discussed above, the financial statements do not give a true and fair view of the financial position of the company as at 30 September 2012."

Profit before taxation and net assets of SKL are Rs. 145 million and Rs. 350 million respectively.

**Required:**

Comment on the decision of the audit senior and identify the shortcomings, if any, in the modification drafted by him. (08)

**Q.7** Analytical procedures are an important audit tool for the auditor at the planning stage as well as at the time of finalization.

**Required:**

- (a) Give four examples of different types of analytical procedures. (04)
- (b) State with examples the factors that are relevant in assessing the reliability of data for the purposes of designing substantive analytical procedures. (04)
- (c) Specify the procedures that an auditor may undertake if analytical procedures identify inconsistencies with other information. (02)

Q.8 Discuss the categories of threats that may be involved in each of the following mutually exclusive situations and advise the partners of the concerned firms with regard to the possible course of action that may be adopted in each case:

- (a) Muneer is a Chartered Accountant and employed as a manager in a firm of Chartered Accountants. He has informed the engagement partner that his close relative holds 50,000 shares of a listed company whose audit is to be supervised by Muneer.
- (b) Danial is employed in a firm of Chartered Accountants. He has been a member of the audit team of Malakand Limited for the last few years.

(10)

Q.9 You were the engagement partner on the audit of Bhurban Limited (BL) for the year ended 30 September 2012.

A few days after the issuance of the audited financial statements, the job senior informed you that a long outstanding suit for recovery of Rs. 140 million has been decided in favour of BL and the amount has been recovered. The profit before taxation, as reported in the financial statements for the year ended 30 September 2012 was Rs. 178 million and the above debt had been fully provided for in those financial statements.

**Required:**

Describe what actions you would need to take in this regard.

(12)

Q.10 The following situations have arisen on different clients of your firm. The year end in each instance is 31 December 2012.

- (a) In November 2012, Wazir Limited (WL) entered into a five year contract with Safeer Limited (SL), for supply of specific parts. The supply was to commence on 1 April 2013. In December 2012 WL purchased plant and machinery specifically for the contract with SL at a price of Rs. 150 million with useful life of five years. However, in January 2013 SL incurred heavy losses in a natural disaster and went into liquidation.

During 2012 sale to SL amounted to Rs. 5 million and the amount receivable from SL at the year end was Rs. 450,000.

For the year ended 31 December 2012, WL had earned profit before taxation of Rs. 125 million. The turnover for the year was Rs. 900 million and the net assets as of that date were Rs. 1.2 billion.

(07)

- (b) As the auditor of Mianwali Tracking Company Limited (MTCL), you have noticed that proper cash book has not been maintained by the company due to shortage of staff. However, MTCL has provided you with summaries showing party-wise receipts and payments and you have been able to trace them to the company's bank statements.

(05)

- (c) During the year, Jhelum Limited (JL) paid 10% dividend to the shareholders. On account of an error, Zakat could not be deducted from some of the shareholders. The amount involved was Rs. 22,000 which was deposited by JL in the Central Zakat Fund and charged as other expenses.

(03)

**Required:**

Discuss the impact of each of the above matters on your audit report.

(THE END)