

Advanced Auditing

Final Examination Summer 2013 Module F

3 June 2013 100 marks – 3 hours Additional reading time – 15 minutes

- **O**.1 Qasmi Steels Limited (QSL) is a manufacturer of steel and iron products. During the year the company has incurred a net loss of Rs. 306 million. The following information is also available:
 - At the year end, the company's accumulated losses amounted to Rs. 17 million (i) whereas its net equity was Rs. 283 million.
 - During the year, QSL has defaulted in repayment of a loan. The management is (ii) however quite hopeful that the lender would agree to a rescheduling.
 - The management believes that the company's profitability has been hampered on (iii) account of soaring electricity prices along with a fall in demand for steel which have had a negative impact on the prices of its finished products. Moreover, its production has also suffered on account of the prevailing energy crisis. Consequently, the management has decided to discontinue its operations temporarily.
 - (iv) To counter the impact of high electricity prices, the company intends to convert its plant to run on gas as well.
 - (v) The management has informed you that it would need to install a gas converting unit which would be imported at a cost of Rs. 30 million. However, as the process of installing the gas conversion unit and completing the necessary formalities would take at least a year, therefore the management is negotiating to lease the plant to Nadeem Enterprises for a period of one year.

Required:

- (a) Evaluate the above situation and state the procedures which you would perform as an (10) auditor in the above situation.
- (b) Describe the implications of the above issues on the audit report.
- Q.2 You are the manager responsible for the audit of Dilawar Paints Limited (DPL). The draft financial statements for the year ended 31 March 2013 show revenue of Rs. 1,250 million (2012: Rs. 1,175 million), profit before taxation of Rs. 100 million and total assets of Rs. 1.2 billion.

The audit incharge has noted the following points for your consideration:

- In May 2012 a chemical leakage from one of the tanks in the factory caused a fire (i) which damaged the plant and machinery and the premises. DPL has incurred Rs. 3 million in cleanup costs, Rs. 10 million for modernisation of tanks to prevent future leakages and a fine of Rs. 500,000 to a regulatory agency. The fine has been expensed whereas the remaining costs have been capitalised.
- (ii) While the tanks in the factory were undergoing modernisation, DPL had made arrangements with a nearby factory for storage of its chemicals. At the time of stock check you were informed that it is not possible to segregate DPL's stock from that of the other factory. According to DPL's record, the value of its stock of chemicals as at 31 March 2013 which is lying in the nearby factory is Rs. 200 million. The value of stock of chemicals as at 31 March 2012 was Rs. 120 million.

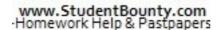
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Required:

Discuss the matters that you would consider and how would you obtain the necessary audit evidence.



- Q.3 The following matters relating to different clients are under the consideration of Mr. Jameel, who is the engagement partner:
 - (a) The management of Muneer Limited had been illegally dumping its chemical waste in the neighbouring plot of land. When confronted, the chief financial officer, instead of providing an assurance to address the issue, informed the audit senior that the management is least bothered about the minor fines that may be levied by the regulatory agencies.
 - (b) Abdullah was the audit senior assigned to the audit of Insha (Private) Limited. During the course of the audit, Abdullah had resigned from the firm. While reviewing the audit files Mr. Jameel has noticed that the audit fieldwork was completed in almost half the time than is usually required.

Required:

Evaluate each of the above situations and briefly describe what course of action the engagement partner would be expected to adopt.

- Q.4 You are the quality control partner of Nasir and Company, Chartered Accountants (NCC) and presently following matters are under your consideration:
 - (a) Your firm has issued an unmodified opinion on the financial statements of Salim Limited (SL) for the year ended 31 December 2012. The tax authorities have recently launched an investigation against SL, alleging that SL has under declared its income for the year ended 31 December 2012. NCC is also acting as the tax advisor of SL.
 - (b) While appreciating the services rendered by your firm, the managing director of a client has informed the engagement partner that an audit trainee has helped him in the purchase of a plot of land. On investigation, the engagement partner was able to establish that the trainee works part-time in an estate agency and receives 0.5% commission on all deals.
 - (c) Josh Limited (JL), an unlisted audit client of your firm has approached your firm to recruit a chartered accountant for the position of finance director in JL. In response to an advertisement published in the newspaper, NCC received various applications which include individuals working at some of your clients and some of your ex-employees.

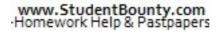
Required:

Identify and evaluate the threats involved and explain what actions you would take in the above circumstances including the steps required, if any, to reduce the risks to an acceptable level.

Q.5 Zubair & Shahid Limited is a distributor of personal care products. Its sales manager had committed a fraud by making sales to fictitious customers. Cheques received from various genuine customers were credited to these fictitious accounts to keep their balances within reasonable limits. The sales manager had the outstanding amounts, appearing against fictitious and genuine customers, written off by convincing the sales director that those customers were unable to pay their remaining balances. A total of 38 invoices amounting to Rs. 7.2 million were issued over a period of seven months. The fraud was detected when the sales manager had left the company's employment.

Required:

Identify the usual controls which may have been lacking in the aforementioned situation. (06)



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- Q.6 You are the job incharge on the audit of Ghalib Petroleum Limited (GPL) for the year ending 30 June 2013. GPL is engaged in the exploration and production of crude oil. The last year's audit file contains the following information:
 - In 2005, GPL had entered into an agreement with the Government for exploration and production of oil for fifteen years. The licence for exploration was granted at a fee of Rs. 600 million.
 - Under a separate agreement Mir Petroleum Limited (MPL), a 100% government owned entity, had guaranteed the purchase of all crude oil to be produced by GPL for a period of ten years from the start of commercial production i.e. 2008.
 - The plant and equipment was imported in 2006 at a total cost of Rs. 6 billion which includes a decommissioning provision of Rs. 500 million. The cost of the plant was financed by GPL's parent company by way of a long-term foreign currency loan.

During the current year's planning stage, you have observed the following conditions:

- (i) The problem of circular debts has become severe and as a result GPL as well as MPL have accumulated huge receivables and payables.
- (ii) An environmental control agency has filed a suit alleging that at the time of abandoning one of its oil wells, GPL has failed to restore the site in accordance with the prescribed standards. The company believes that it has met all its obligations and plans to contest the case strongly.
- (iii) Due to law and order situation the Government has not been able to provide infrastructure facilities as were agreed in the exploration agreement.
- (iv) The management had budgeted a profit of Rs. 200 million for the current year but latest estimates suggest that the profit would be somewhere between Rs. 100 to Rs. 120 million.

Required:

Identify and evaluate the audit risks in the above situation and specify the audit procedures that you would perform to address those risks. (16)

Q.7 (a) Haali Limited has a policy to carry its buildings at revalued amounts. At the balance sheet date i.e. 31 December 2012, the valuer had finalised the valuation reports of only 3 out of a total of 8 properties. According to these reports these properties were assigned a valuation of Rs. 50 million as against the carrying amount of Rs. 62 million.

Required:

Evaluate the above condition and discuss the impact on the audit report in each of the following situations:

- (i) The impairment of Rs. 12 million is recorded in the financial statements.
- (ii) The impairment is not recorded.
- (b) During the year ended 31 December 2012 Chiragh Limited has changed its policy for valuation of investment in a subsidiary from the 'fair value' to 'cost'. Had the company continued with its previous policy for valuation of investment at 'fair value', the subject value would have been reduced by Rs. 50 million.

Required:

Discuss the matters which you should consider in respect of the above situation and the possible impact thereof on the audit report.

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(THE END)

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