



Advanced Auditing

Final Examination
Winter 2013
Module F

2 December 2013
100 marks – 3 hours
Additional reading time – 15 minutes

Q.1 You are the audit manager of Ravi Pharmaceuticals Limited (RPL) for the year ended 30 September 2013. The draft financial statements disclose a profit before tax of Rs. 200 million (2012: Rs. 150 million) and total assets of Rs. 5 billion (2012: Rs. 4.8 billion).

The following matters arose during the course of audit and are under your consideration:

- (a) RPL has been awarded a 20 year patent right for a new drug with a brand name of Dengcol. The drug has been developed at a cost of Rs. 400 million. (10)
- (b) As part of the Dengue Control Programme, the Government had provided a conditional grant of Rs. 150 million to RPL for development of Dengcol. Under the terms of the grant, RPL was required to sell 40% of the total production to the Government Hospitals subject to a minimum of 1,000,000 vaccines per annum, for the next five years. (06)

Required:

Identify the matters that you should consider in the above situations, and state the audit evidence you would expect to find in your review of the audit working papers for the year ended 30 September 2013.

Q.2 Fawad Limited (FL) is a manufacturer of personal care products. FL intends to diversify its operations by entering into the packaged food business. For this purpose it intends to seek a financing of Rs. 2 billion from Ameen Commercial Bank Limited (ACBL). The company's CFO has prepared a five year cash flow forecast and has presented it to the bank. ACBL has requested your firm to review the forecast in consultation with FL and furnish a report thereon.

On reviewing the cash flow projections, you have noted the following:

- (i)
 - Cash sales constitute 80% of the total sales of the new business.
 - Debtors turnover days related to current business are projected to be reduced from 75 days to 30 days.
- (ii) In the forecast, 24% of the income is under the head "Income from an associate", which is the management's estimate of the company's share of the associate income. The associated company has confirmed the amounts which are incorporated in the forecast; however no other details are available with FL to support this assumption.

Required:

- (a) Comment on the above situations and briefly discuss the steps that you would take in the given circumstances. (12)
- (b) Assuming that your firm decides to modify the report on prospective financial information, draft the basis for modification paragraph and opinion paragraph to be included in the report. *(You may assume necessary details and choose to base the modification either on para (i) or para (ii) above)* (06)

- Q.3 You are the manager responsible for the annual audit of Tameer Limited (TL) for the year ending 31 December 2013. TL is a listed company and is engaged in the business of construction, renting and selling of apartments and office buildings to individuals, businesses and government departments.

Extracts from TL's draft Profit and Loss Account are as follows:

	2013 (Upto Nov)	2012
-----Rs. in million-----		
Revenue	1,520	1,883
Operating expenses	(1,165)	(1,470)
Operating profit	355	413
Financial charges	(190)	(225)
Profit before tax	165	188

During the planning stage, the audit team has presented the following points for your consideration:

- (i) On 31 January 2014 tenancy agreements of office buildings rented to municipal corporations in 15 small cities in the province of Sindh, are expiring. The concerned departments have informed TL that they would not renew the agreements. These properties are also held as security with the company's bankers.
- (ii) In August 2013, an apartment block which was completed and sold in 2009 was severely damaged in an earthquake. The residents have filed a claim for damages against TL amounting to Rs. 400 million. The company denies any liability in this regard. However, to maintain its goodwill TL has agreed to compensate the residents by making a payment of Rs. 100 million in four quarterly instalments and accordingly this amount has been provided in the accounts. The residents have rejected the offer and filed a suit against the company.
- (iii) During the year, construction equipment costing Rs. 300 million was acquired on lease. The lease rentals were allocated to the contracts on the basis of time utilized. Lease rentals pertaining to idle time were charged to financial expenses.
- (iv) During the year TL sold a two storey office building to Ali Limited. According to the contract of sale, TL is entitled to construct further offices on the third and fourth floors.

Required:

Identify the audit risks that exist in the above scenarios and describe the manner in which you would address those risks.

(18)

- Q.4 Jhelum Machinery (Private) Limited (JMPL) is engaged in the manufacture of customised machinery. Recently a fraud has been discovered which was perpetrated by Salahuddin, the purchase manager. Salahuddin was responsible for approving the suppliers after obtaining and evaluating the competitive quotes and placement of orders. Final approval was made by the managing director.

Salahuddin had set up a private limited company Neelum (Private) Limited (NPL) in which his brother and wife are directors. NPL supplies spare parts to JMPL. The fraud was committed with the help of Karamat, a production supervisor and Farhan, the store keeper. The supplies delivered by NPL contained a large proportion of damaged spare parts. However, full payments were made to NPL as Farhan never raised any objections on the quality of goods received. On the other hand, Karamat issued inflated consumption reports to cover significant part of the damaged spare parts.

The fraud was discovered when Farhan went on leave due to illness. A review of inventory sheets indicates that large quantities of spare parts are still lying in inventory.

Required:

Identify the control weaknesses in the above situation which may have enabled the perpetration of fraud.

(06)

- Q.5 (a) Dynamic (Private) Limited (DPL) is a client of your firm. At the finalization stage of annual audit, it was discovered that a senior member of the assurance team is the co-owner of a property, for the possession of which DPL has filed a legal case. On investigation, the member informed that the said case is pending for the last three years and he did not consider necessary to disclose it at the time of commencement of audit.

Required:

Discuss the matters that should be considered and the course of action which may be followed in the above situation. (07)

- (b) Murree Limited (ML) and Bhurban Limited (BL) are listed assurance clients of your firm. BL has filed a claim of Rs. 50 million in the court in respect of low quality of goods delivered by ML. Upto last year ML had not acknowledged the claim of BL. However, in the planning phase, you were informed by ML's management that in order to avoid bad reputation in the market and to continue its business relationship with BL, ML intends to settle the dispute by making a payment of Rs. 20 million to BL. The debt of Rs. 50 million is fully provided in the books of BL.

Required:

Being the auditor of both the companies, identify and evaluate the threats for the firm and explain how these can be reduced to an acceptable level. (06)

- Q.6 Kabul (Private) Limited (KPL) has advanced Rs. 100 million to Qandhar Limited (QL), one of its suppliers of raw material. KPL and QL have recently signed an agreement whereby the above advance has been converted into a loan and QL has agreed to pay mark-up on the outstanding balance at prevailing market rates. QL has confirmed the amount of loan and the interest accrued thereon. However, you have acquired some information which suggests that QL is facing financial difficulties.

Required:

Discuss how you would deal with the above situation and possible implications thereof on the audit report. (10)

- Q.7 (a) ABC and Company, Chartered Accountants, have been requested to give their consent for appointment as the auditor of Sindh Limited (SL), in place of XYZ and Company, Chartered Accountants. The matter of appointment of ABC and Company is to be placed in the annual general meeting of SL.

Required:

(i) Explain the responsibility of ABC and Company and the steps that it needs to take before acceptance of the audit. (05)

(ii) What would be the retiring auditor's responsibilities with respect to the above and the responsibility of ABC and Company, in case the retiring auditor does not fulfil its responsibility? (05)

- (b) Assume that in (a) above XYZ and Company had qualified the previous year's audit report because it was unable to physically verify the factory building and to observe physical inventory count, due to law and order situation. However, during the course of current year's audit, ABC and Company was able to observe the physical inventory count and also carry out physical verification of the factory building as the law and order situation has improved.

Required:

Discuss the matters which you would consider in the above situation and the possible impact thereof on the audit report. (09)

(THE END)