



Audit and Assurance

Certificate in Accounting and Finance
Model Paper

100 marks – 3 hours

Q.1 You are the Audit Manager on the audit of Kashif Industries Limited (KIL) for the year ended 30 June 2013. KIL is engaged in the manufacture of a wide range of plastic products. While reviewing the initial work performed by the audit team, the following matters have come to your notice:

- (i) The quantity of material scrapped during the year is materially different from the quantity of scrap sold. The company's records show nil balance both at the beginning and at the close of the year. No reconciliation for the difference has been provided by the company.
- (ii) Sales for the year have increased by 7% over the previous year. However, it has been noted that sales in the last two weeks of June 2013 have been exceptionally high and represent 15% of the annual sales. The audit working papers carry the following observations in respect of the above:
 - 70% of the sales in the last two weeks of June were made to two new customers whose credit assessment has not been formally documented;
 - a significant portion of the goods sold to the above referred customers were returned in the first week of July 2013; and
 - management bonuses are linked to the operating performance of the company.
- (iii) During the year, KIL purchased a machine for Rs. 25 million. The payment voucher is duly supported by the invoice from the supplier. However, the fixed assets schedule provided by the client shows the amount capitalized as Rs. 2.5 million. Depreciation has been charged on this amount. The difference of Rs. 22.5 million is appearing in the Bank Reconciliation Statement.

Required:

- (a) Analyze each of the above situations and assess whether it represents a fraud or an error. (06)
- (b) What action would you take to deal with the above matters? (09)

Q.2 Dolphin Limited (DL) is the holding company of North Limited (NL) and South Limited (SL). There is no common directorship as the holding company has nominated different persons as the directors for each subsidiary. Moreover, there is no inter-company investment among the subsidiary companies.

The following issues are under consideration of the company secretary:

- (i) The directors of NL, which had been incorporated eighty three days back, are considering appointment of Mr. Abid, a chartered accountant, as the first auditor. Mr. Abid holds a very small number of shares in SL.
- (ii) The members of DL have appointed Mr. Fazal, a qualified MBA, as auditor of the company in their annual general meeting at a fee which is less than the fee charged by the previous auditor.

Required:

In the light of relevant provisions of Companies Ordinance, 1984, provide your response to the following:

- (a) With reference to (i) above, discuss whether Mr. Abid is qualified to be appointed as auditor of North Limited.
- (b) With reference to (ii) above, discuss the validity of appointment of Mr. Fazal as auditor of Dolpin Limited. (05)

- Q.3 (a) Explain the term “Sufficient and Appropriate Audit Evidence”. (04)
- (b) You are the Audit Senior on the audit of Abdullah Limited. The company is a trading concern and 70% of its business relates to imported goods. The chief accountant has provided you the bank reconciliation statements of all the bank accounts alongwith the bank statements.

Required:

- (i) State the substantive procedures that you would carry out for the verification of bank balances. (06)
- (ii) Identify any *eight* types of information which you would verify from the confirmations received directly from the bank. (08)

- Q.4 (a) Differentiate between the following:
- (i) Statistical and non-statistical sampling (03)
- (ii) Sampling and non-sampling risk (02)
- (b) You are the audit manager on Sarfaraz Limited. While reviewing the audit planning documentation, you found that the audit team has selected 100 out of a total of 2,550 debtors for balance confirmation. The details are as follows:
- 50 largest debtors constitute approximately 40% of total debtors. Out of these, 10 have been selected.
 - 90 other debtors were selected through haphazard sampling.
 - All debtors below Rs. 5,000 were ignored as immaterial.
 - Balances due from government and some of the related parties were ignored as prior years working papers showed that they never responded to requests for confirmation.

Required:

- (i) Comment on the sampling approach adopted by the audit team. (04)
- (ii) Suggest alternative means of selecting the sample in which the material balances have a greater probability of selection. (04)

- Q.5 (a) Classification of certain items reported in the financial statements is based on the management’s intentions. In such a situation the auditor has to rely on management representations.

Required:

List the factors that the auditor should consider in evaluating the management’s intentions with regard to their future course of action, as stated in their written representations. (04)

- (b) Briefly discuss how the auditor would deal with a situation where he is in doubt regarding the reliability of the written representations provided by the management of the company. (05)

Q.6 As the auditor of a listed company with a number of related parties, what steps would you consider as part of your audit planning to ensure that all related party relationships and transactions are identified and disclosed in the financial statements. (12)

Q.7 (a) Segregate the following into preventive, detective and corrective controls. (03)

- (i) Reviewing credit card bill before payment.
- (ii) Keeping ATM card PIN separate from ATM card.
- (iii) Monitoring expenditures against budgeted amounts.
- (iv) Submitting revised invoices after correction.
- (v) Updating IT access lists if individual's role changes.
- (vi) Review of implemented controls by internal auditor.

(b) Identify any *six* uses of audit trail in a computerized environment. (03)

Q.8 Royal Exchange (RE) is a foreign exchange dealer. Presently RE is using spread sheets to keep record of its transactions and generate operational level reports. However, its business has grown over the years and now it is operating branches in all major cities across the country. The management is planning to acquire integrated software from a local software house to meet its increasing needs.

Required:

Identify any *five* logical access controls that may be embedded in the above software to ensure the security of data and identify *one* type of security breach which each control is expected to cover. (10)

Q.9 ICAP's code of ethics has specified five principles of professional ethics for chartered accountants. The circumstances in which a chartered accountant operates may give rise to specific threats to compliance with these principles.

Required:

(i) Briefly describe each of the fundamental principles of professional ethics. (07)

(ii) Briefly describe different categories of the threats to compliance with the fundamental principles. (05)

(THE END)