

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN



Final Examinations Summer 2007

June 8, 2007

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 The Credit Manager of one of your audit clients has left without giving any notice. His responsibilities included maintenance and distribution of management information reports and participation as a member of credit committee.

The said client has requested your firm to allocate one of your staff members, for a period of two months, to take up the responsibilities of Credit Manager. Your firm deals in such kind of assignments for non-audit clients.

Mr. RMP, the Risk Management Partner, has been requested to advise the firm on the above stated engagement.

Required:

Draft a memo on behalf of Mr. RMP clearly indicating whether and under what conditions the firm can accept the above assignment under each of the following situations:

- (a) the client is an unlisted company;
- (b) the client is a listed company.

(10)

Q.2 The Management of Fine (Pvt) Limited sent a letter to the statutory auditor of the company along with following statement and notes:

**Statement of Receipts and Payments
For the year ended 31 December 2006**

	Rs. in million
Bank balance as 1 January 2006	50
Add: receipts from customers and shareholders	150
	200
Less: - Payment against purchases	90
- Salaries paid	50
- Other expenses paid	20
	160
Bank balance as 31 December 2006	40

Notes to the Statement of Receipts and Payments:

1. During the year company issued further shares of Rs. 100 million.
2. Payments against purchases and other expenses are made through cheques and nothing was outstanding at the end of the year.
3. All goods purchased have been sold and all debts have been collected before the year end.

The audit firm has appointed you as job in-charge to audit the financial statements of the company. Following information has also been made available to you:

- (i) There are only five shareholders in the company having close family relationship with each other and they are supervising the entire business activity themselves.
- (ii) The company is engaged in sales and after sale services of a large number of products.
- (iii) Payments against purchases and other expenses are made through cheques except the payments of some insignificant amounts.
- (iv) The system of accounting and management information is reasonably sophisticated. However, the management does not apply some of the important internal controls due to its direct involvement in business operations.

The chief executive of the company has requested that since management lacks accounting knowledge, the receipt and payment statement may be treated as the financial statements or alternatively, a summary balance sheet and profit and loss account may be prepared by the auditor. He has justified his request on the ground that user group is extremely limited and is itself involved in the management of the company.

Required:

Discuss the following with appropriate explanations:

- (a) What should be the response to the Chief Executive's request;
- (b) Essential matters to be dealt at engagement stage; and
- (c) Internal controls of the company.

(12)

Q.3 During the audit of financial statements of Shine Limited, a member of audit team has developed the following differences of opinion with her job in-charge:

- (i) She believes that an incorrect working of obsolete stock provided by the client, which was superseded by a revised working given subsequently, should be kept in the working paper file as there was material difference between the earlier and final workings. Job in-charge wishes to discard the working since it was revised by the client management themselves after discovering the error. An explanatory note describing the error and how it was corrected has already been included in the file.
- (ii) She performed risk assessment procedures related to sales and concluded that the risk of material misstatement is high. While making such an assessment she tested the risk of material misstatement due to error but did not consider material misstatement due to fraud as she relied on the assessment and documentation made by the job in-charge at financial statement level. Job in-charge does not agree with her approach but he is not sure as to how she should have approached the issue.
- (iii) She noted that a sales officer of the company had sold many products at exorbitant prices to a customer and earned handsome commission thereon. She suspects possibility of fraudulent collusion between sales officer of the company and employees of the customer. However, the difference between normal and abnormal prices is of below material amount. Job in-charge identifies it as a significant risk of fraud and wants to communicate the same to those charged with governance. She does not agree with the job in-charge.

Required:

- (a) Resolve the above differences arising between the team member and job in-charge, giving proper explanation in each case.
- (b) Draft a policy statement and narrate the guidelines relating to difference of opinion within the engagement team.

(09)

(05)

- Q.4 While going through the newspaper, Mr. Akram came to know that the Ministry of Health had issued show-cause notices to those pharmaceutical companies which had not yet started their own manufacturing within a period of two years from the issuance of permission of toll manufacturing, as the said permission was subject to this condition.

Akram is involved in the audit of Dine Pharma Limited (DPL) as engagement partner. The audit is expected to be finalized within one month. DPL's products are manufactured under toll manufacturing arrangements and it has three to five years non-cancelable agreements with five manufacturing units. Akram has approached you as the firm's Technical Director for consultation on the above matter.

Required:

Briefly advise Akram about impact of the above matter on the financial statements disclosure as well as auditors' report. (10)

- Q.5 Mr. Dar is the Chief Financial Officer (CFO) of a medium sized limited company engaged in sale of consumer goods through a number of distributors. These distributors collect and deposit the sale proceeds in collection accounts opened in more than 100 branches of a commercial bank situated in urban and rural areas all over Pakistan. These accounts are non-checking accounts (i.e. the company cannot issue cheque or transfer the amount to any account other than the designated sales collection control account). Under an agreement with the bank, the branches transfer the amounts collected on next working day to the designated sales collection control account.

The auditor of the company intends to obtain direct confirmations from all branches and intends to use positive as well as negative confirmations. Considering that such audit procedures would take considerable time and may delay the finalization of accounts, the Chief Executive Officer (CEO) is of the opinion that Mr. Dar should ask the auditor to omit this procedure. CEO believes that according to International Standards on Auditing management has a right to ask the auditor not to send direct confirmations.

Required:

Prepare an explanation for CEO on behalf of CFO explaining him the guidelines laid down in International Standards on Auditing in respect of external confirmation in the above case. (09)

- Q.6 You are an Audit Manager in a large firm of chartered accountants which is also a member of a global firm. You have recently completed the audit of one of your clients. Your firm has already been appointed as auditors of the company for the following year. Soon after the appointment, you came to know that the chief executive of the company was involved in some illegal practices and he is about to face some investigation.

Required:

Discuss the various possibilities arising out of the above situation and what action would you take in each case. (10)

- Q.7 You are the statutory auditor of Critical Limited. The company has asked you to submit a special purpose audit report for onward submission to a regulatory authority. The report has to be submitted on a format prescribed by the regulatory authority, the substance and wording of which does not conform to the requirements of International Standards on Auditing.

Required:

- (a) Describe the essential contents of a special purpose audit report as required by the International Standards on Auditing.
- (b) Explain how you would respond to the above situation. (08)

- Q.8 Mr. Ali has recently joined as Audit Partner of ABC & Co., Chartered Accountants. On assuming the responsibility he discovered that the firm does not have comprehensive guidelines for “Engagement Quality Control Review”. He wants to bring this issue to the notice of Managing Partner.

Required:

Prepare discussion points for Mr. Ali explaining the following:

- (a) The basis of selecting engagements for review;
- (b) Nature and timing of review; and
- (c) Criteria for eligibility of engagement quality control reviewer.

(11)

- Q.9 SK is the engagement senior on the audit of PK Limited. One of his team members has been assigned the task of verifying the fair values of various assets in the financial statements. He is perplexed by the fact that out of various valuation methods available under the company’s financial reporting framework, the management has used a particular method, except in one case where the management has changed the valuation method in the current year. The team member is confused and has approached SK for guidance.

Required:

Describe the procedures that should be performed in the above situation.

(05)

- Q.10 You are the job in-charge on the audit of Globe Industries Limited (GIL) which is the holding company of a large group of companies engaged in production and marketing of consumer items, food products and textiles. The net worth of the group is approximately Rs. 89 billion whereas profit for the year ended December 31, 2006 is Rs. 6.4 billion (2005 : Rs. 4.8 billion).

During the planning phase of the audit, you have gathered the following information:

- (i) GIL holds 25% shares in Multan Industries Limited (MIL), at the beginning of the year. GIL purchased further 30% shareholding in MIL on April, 2006. MIL is audited by a large firm having international affiliation.
- (ii) One of the group companies i.e. Karachi Industries Limited has incurred serious losses during the year. Company had to discontinue two of its main products after facing litigations on a copy right issue. The auditor of the company has expressed serious doubts about the status of the company as a going concern and has issued a disclaimer of opinion.

Required:

Describe the important aspects that you would consider at the planning stage.

(11)

(THE END)