THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS – FINAL EXAMINATIONS

SUBJECT	**SESSION**
Advanced Auditing	Summer 2007

Q.1 The question was based on the requirements of code of ethics. A situation was given and the examinees were required to advise whether the auditor could accept the assignment if the client was an unlisted company and if it was a listed company.

The part related to listed company was simple and most examinees were able to answer correctly in the light of ICAP's Council's directive 4.16 which was applicable to listed companies only.

However, for the benefit of the students we would like to inform that the directive 4.16 was withdrawn by ICAP on June 07, 2007 and for future examinations they should refer to a negative list of services which now from part of the listing regulations of stock exchanges in Pakistan.

The response to the point related to unlisted company was average. The students were expected to cover the question under three heads:

- Permissibility (It is permissible under the Code of Ethics).
- Identification of the threats to independence mainly the self review threats.
- The safeguards that should be applied in such situations as described in para 9.186 of the Code of Ethics.

Some of the students thought it enough to say that the same is permissible without stating the conditions under which the assignment may be accepted. Some of the students were also of the view that directive 4.16 will also be applicable on unlisted companies which obviously led to a totally incorrect answer.

Q.2 The question related to a small, family owned company with annual receipts of only Rs. 150 million. The question consisted of three parts as discussed below:

(a) In this part almost all the students were able to declare correctly that since the company is a private limited company, it has to prepare its accounts in accordance with the Fifth Schedule and the alternatives suggested by the CEO were not acceptable.

However, very few were able to mention the other two important points i.e. while preparing the accounts as requested by the CEO, the auditor should evaluate the existence of self review threat and take appropriate safeguards and should also avoid taking management decisions.

(b) Most of the students restricted themselves to describing the matters that are generally contained in an engagement letter without reference to the environment in which the company was operating.

It was evident from the given scenario and was also mentioned in the question that the management has compromised on some of the important controls. It was therefore expected that students at this level will highlight this issue and then mention the important matters to be considered at the engagement stage and not just the matters that are generally contained in the engagement letter. However, very few students could approach the question as described above.

(c) The examinees were required to comment on the internal controls of the company. Most of them, restricted their answers to matters such as lack of segregation of duties and supervisory controls by the owners. Very few were able to mention an important point that the totally dominant role of the owner management increases the risk of management override of controls.

Q.3 (a) In this part of the question, three situations were given as discussed below:

(i) This was a simple situation. Most of the students correctly advised that since proper explanatory note about the error has already been provided in the working papers, there was no need to keep the superseded schedules in the working papers file.

(ii) Most of the answers to this part were sketchy. The students were generally able to emphasis correctly that there was a need to assess the risk of fraud at the assertion level. Similarly, they were also able to conclude that in case such a risk was material, the auditor should evaluate the design of the entity's related controls, control activities and their implementation. However, better answers were those which mentioned the fact that according to the International Standard on Auditing, in case of revenue, the auditor should ordinarily presume that there is a risk of material mis-statement due to fraud and where the auditor concludes that such risk is not applicable, he should document the reasons for such conclusion.

(iii) In this case also most of the students were able to conclude correctly that possibility of collusion between the employees of the customers and the sales officer of the client does not cause any material mis-statement in the financial statements and that it was below material level. Some of the good students also pointed out that there may be a possibility of future claims by the customer although it did not change the ultimate conclusion on the issue.

(b) In this part, most of the students were able to give the guidelines relating to difference of opinion between the members of engagement team, which included matters related to identification, resolution, consultation and documentation of the differences of opinion.

While giving policy statement most students were confused and wrote lengthy answers covering various aspects, mostly those which were also covered in the guidelines. What was required was a short statement emphasizing the timely resolution of any difference of opinion at the appropriate level.

Q.4 This was a practical question. According to the given scenario the audit client, a pharmaceutical company expected the issuance of a show cause notice from the concerned authorities, on account of its failure to commence its own manufacturing. Presently its products were being manufactured under non-cancellable toll manufacturing agreements.

Two aspects of the situation were examined i.e.

- Effect on financial statements
- Effect on audit report

The issues that were relevant in the above situation mainly included the following:

- possibility of imposition of fines
- incurrence of damages that may become payable due to discontinuation of contracts
- threat of forced discontinuation of operations
- concerns related to validity of going concern assumption

Most of the candidates were able to identify the above issues and assessed their impact on the financial statements and on the audit report based on the guidance available in the auditing standards.

Q.5 This was a straightforward question and most of the students were able to give correct answers based on ISA 505. The main points which the examinees were expected to cover in their answers were as follows:

- The auditor has to use his judgment in evaluating the management's request and consider the alternate procedures that may be available.

- External confirmation is considered more reliable for audit purposes.

- The auditor has the sole authority whether or not to adopt the external confirmation procedure, according to the circumstances.

- The auditor may use negative or positive confirmations or a combination thereof, depending upon the circumstances.

- In case management does not authorize the auditor to use external confirmations and the auditor deems it necessary, he may modify the audit report on the basis of scope limitation.

- The auditor may use other procedures to verify the balances before reaching any conclusion.

Q.6 According to the scenario given in the question, the auditor had discovered, after the audit has been completed, that the Chief Executive Officer of the company was involved in some illegal practices. The various possibilities arising out of the situation were required to be discussed.

The part related to continuation of audit was well covered by most examinees as they discussed the relevant issues such as:

- the quality control policies of the firm.
- quality control policies of the international firm of which the auditor was a member.
- the impact the concerned practice of the Chief Executive Officer will have or may have, on the financial statements of the company.

However, they were also required to consider the impact which the activities of the Chief Executive Officer may have had on the financial statements which were recently audited and give their opinions based on the guidance provided by the auditing standards in respect of subsequent events. This part was mostly ignored by a large number of candidates.

Q.7 (a) This was an easy question and most of the students mentioned almost all the contents of the special purpose audit report as recommended by the International Standards on Auditing-ISA 800. However, many students gave the contents related to the independent auditors report on General Purpose Financial Statements as given in ISA-700, and lost easy marks.

(b) In this part the examinees were required to explain how the auditor will react if a report is to be submitted to a regulatory authority on a format other than the one advised by the International Standards on Auditing.

The Standards suggest three ways of dealing with the situation as follows:

- Reword the format according to the Standard (if possible)
- Attach a separate report; or
- Use the prescribed format without mentioning that ISA's have been complied with.

Only about 20% of the students could mention all the three points.

Q.8 (a) This part was done well by most of the examinees. They were able to state clearly that quality control review should be carried out in case of audit of financial statement of all listed companies whereas other entities shall be selected on the basis of specified criteria.

Most of them were also able to specify that such criteria should be based on matters such as involvement of public interest, presence of unusual circumstances and legal requirements etc.

(b) This part was poorly attempted. It was based on two issues i.e. nature of quality control review and timings of such a review. Very few of the examinees could answer in a concise manner. Lengthy answers were generally given based on the general knowledge of the candidates but the issues involved were not appropriately dealt with.

As far as the nature of review is concerned, the person carrying out the quality control review is required to use his judgment in selecting the areas for review. He usually reviews the selected working papers related to significant judgments and conclusions reached during the audit. Whenever necessary, he discusses the issues with the engagement partner.

As far as the timing is concerned, such review is carried out at appropriate stages during the audit. Most of the students were of the view that the quality control review is only carried out at the end of the audit.

(c) While describing the criteria for eligibility of engagement quality control reviewer, most of the examinees stressed on the qualification and experience of the reviewer. Very few stressed on the position of authority which such a reviewer should hold in the firm. Similarly, the requirement of maintaining objectivity, by selecting such a person, (as the reviewer) who has not been participating in the engagement etc. was mentioned by few students only.

Q.9 The question relating to valuation methods was rather easy for final level students yet the performance was not very encouraging. The examinees at this level are those who have sufficient experience of auditing and they should easily have identified the following, in their responses:

- The auditor should obtain an understanding of the management's rationale in selecting a particular method of valuation.
- He should assess whether the valuation method is appropriate, given the nature of assets and norms of the business and industry.
- In the case where valuation method was changed, the auditor should evaluate whether the new valuation method is a more appropriate basis of measurement or is supported by a change in the circumstances etc.

Q.10 The question pertained to the planning stage of an audit of consolidated accounts. The students were generally able to answer the points related to the company Multan Industries Limited (MIL) which had been converted into a subsidiary, during the year under review. However, most of the students failed to give a proper response as regards Karachi Industries Limited (KIL). KIL was a group company whose status as a going concern was doubtful and its auditor had issued a disclaimer of opinion. Usually, in such a situation, the auditor of the holding company assesses the materiality of the investment and its possible impact on the consolidated accounts and draws up a strategy based on such assessment. Most of the students could not understand the question. They failed to realize that the audit has already been carried out by KIL's auditor and wrote details about the procedures an auditor should follow when the going concern status becomes doubtful.

(THE END)