

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Auditing	Intermediate Examination - Spring 2008

General:

On an average the candidates performed below satisfactory level though the paper contained a mix of both theoretical and practical questions and both were quite straight forward. The students were generally found deficient in the knowledge and understanding of Auditing Standards. Moreover, many of them could not approach the questions in a logical manner. Presentation and communication skills also warrant some serious attention.

Question-wise comments are as under:

Q.1 This was a straight forward question and tested the role of IAASB and the purpose of pronouncements issued by it. Few students were able to correctly mention about its activities such as development of International Standards on Auditing, Review Engagements and Assurance Engagements. The purpose of the pronouncements issued by it i.e. establishing benchmarks for high quality auditing and assurance standards, providing guidance to auditors and other professional accountants were mentioned by very few of the candidates. A sizeable number of students did not attempt the question at all. Majority of the answers were in the generalized form and addressed irrelevant matters.

Q.2 A practical question a significant part of which could have been answered using just common sense plus general understanding of the subject. The candidates were required to identify audit evidences which they will gather in the specified situations. Although the situations were simple yet most students were unable to mention the related audit evidence such as:

In sub-part (i)

- Legal opinion
- Terms and conditions of the contract
- Documentation of the responses of other customers, to whom similar items have been supplied
- Opinion of independent experts
- Evaluation of the basis of provision and related documentation.

In sub-part (ii)

- Industry standards
- Opinion of independent experts
- The environment (production load, maintenance policies etc.)
- The reasons for sale of equipment (normal or otherwise)

An important issue raised in the question i.e. appropriateness of management representation was not addressed in most of the answers.

- Q.3 (a) In this part of the question an audit report was given which contained emphasis of matter paragraph and also dealt with an issue relating to scope limitation. The students were required to discuss the shortcomings in the report. Very few of the students could highlight the following deficiencies:
- (i) The auditor failed to amend the scope paragraph and did not mention therein, the scope limitation caused because of his inability to observe the physical count of inventory.
 - (ii) The auditor did not qualify the report nor did he give a disclaimer of opinion.
 - (iii) The last paragraph of the report was like an emphasis of matter paragraph on the issue of going concern, but did not contain the following:
 - Cross-reference to any note to the financial statements; and
 - A statement to clarify that the opinion is not being qualified.
- (b) The second part required students to list the steps which a firm will have to take if it wants to issue a revised (unqualified) audit report after the management had finally agreed to make the necessary adjustments. The performance in this part was relatively better as many students discussed the related steps such as reviewing the additional evidence available with the management on account of which it agreed to revise the financial statements, reviewing minutes of important meetings, reviewing legal documentation etc., to verify the appropriateness of adjustments.
- Q.4 (a) In this part, majority of the students were able to specify that aggregate of uncorrected misstatements is the sum of the mis-statements identified by the auditor and the estimate of other mis-statements which could not be identified i.e. projected errors.
- (b) The students were required to discuss the factors which would influence auditor's judgment as to what constitutes sufficient appropriate audit evidence. However, most of them focused on the factors which affect the reliability of the audit evidence rather than factors which influence the auditor's judgment as regards sufficient and appropriate audit evidence.

The better performing students were able to specify at least the following factors i.e. effectiveness of management's response and controls; persuasiveness of the audit evidence and experience gained during previous audits.

However, very few could identify the following factors which also play an important part in determining whether a particular audit evidence is sufficient and appropriate:

- Significance of the potential misstatements and its impact on financial statements
- Results of audit procedures performed
- The environment of the entity.

- Q.5 (a) This was an uncomplicated, easy and bountiful question for the students and was attempted reasonably. Most of the students correctly identified the situations where the auditor may decide to test the controls which had also been tested in the immediately preceding year. Weak control environment, weak monitoring of controls, change in personnel & circumstances are logical examples of situations where the auditor takes such a decisions.
- (b) The response was good and majority of the students scored good marks as they were able to identify and explain the components of internal control as referred to in ISA-315 and appendix 2 of the said ISA.

- Q.6 Three situations were given in the question and in each case the students were required to determine and explain whether the auditor can accept appointment offered by the prospective clients. Although many students were well prepared for such questions, a large number also displayed poor knowledge and understanding of relevant provisions contained in the Companies Ordinance, 1984.

Many students failed to explain the following:

- (i) The firm cannot be appointed as auditor of the company unless the lease agreement is terminated and credit card balance of the partners is reduced to Rs. 500,000 or less.
- (ii) A director can be appointed as external auditor of the company three years after the date on which he ceases to be a director of the company. Therefore, it was only possible for the firm to accept the appointment if the concerned partner resigned from the firm.
- (iii) The firm can accept appointment as auditor of a company if a partner of the firm holds shares in the associated undertaking of that company, provided he disposes off the shares within ninety days of appointment.

Some of the students gave reasons because of which the firm may not accept appointment as auditors, but did not explain as to what it should do if it did want to accept the appointment. Many of the students could not produce exact answers i.e. in the third situation they explained that the concerned partners will have to dispose of the shares but did not mention that such disposal can be made within 90 days of appointment.

- Q.7 (a) Students performed well in this part and were able to list down the principal contents of an audit engagement letter enumerated in para 6 of ISA 210.
- (b) Instances were noted where students started listing down all the contents of audit working papers/evidences instead of restricting their answers to significant matters only. The significant matters have been described in para 14 of ISA 230. Students listed the usual components such as planning documents, third party confirmations, enquiry letters etc. as significant matters.

The time allowed for completion of audit file i.e. 60 days from the date of audit report was correctly identified by most of the candidates.

- Q.8 The question focused on two issues i.e. (i) circumstances where the auditor may use the work of an expert and (ii) auditor's responsibilities in this regard.

Most of the students dealt with the first issue correctly i.e. by explaining that opinion of an expert may be required on specific matters, (other than accounting and auditing) such as:

- Valuation of assets like plants, work of art etc
- Determination of quantities such as stockpile, underground minerals etc
- Determination of amount using specialized methods like actuarial valuation
- Measurement of work completed
- Legal opinions.

As regards the second point many candidates discussed the report to be issued by the auditor instead of describing the responsibilities of the auditor such as:

- Evaluating the professional competence and objectivity of the expert
- Evaluating the adequacy and appropriateness of the scope of the expert's work
- Resolving inconsistencies, if any, between the expert's findings and the results of other audit evidence.

- Q.9 The students were required to explain the relevance of specified information to the objective and scope of audit. Barring few exceptions, the performance was not satisfactory.

The students were expected to cover the following aspects in their answers:

- Information on industry performance is required to plan and assess risks. It may also be used for analytical procedures.
- Information about shareholdings of close relatives of the directors in other entities is required to verify disclosures related to transactions with related parties.
- Location of warehouses and production procedure is also required for planning and risk assessment purposes.

- Information on new researches gives the auditor an understanding about the entity's future plans, business viability and expected changes in the business environment.
- Qualification of head of internal audit is one of the factors which the auditor considers in evaluating the degree of reliance which can be placed on the work of internal audit.
- The auditor is required to evaluate the entity's ability to continue as a going concern. In view of huge losses, the auditor is required to review the effectiveness of the management's plans to keep the entity operating as a going concern.

Q.10 This question was designed to test the candidates' ability to analyze the issues and their eventual impact on the audit report. Barring few exceptions, incorrect conclusions were drawn in most situations. The students generally recommended some sort of qualification in every case without considering the materiality and adjusting/non-adjusting nature of the events.

Individual situations and the responses thereto are discussed below:

- (i) Students could not recognize that the amount involved i.e. Rs. 0.5 million was immaterial and would not have any impact on audit report.
- (ii) There was a general misconception that a subsequent change in foreign exchange rate is an adjusting event. Therefore, modification is needed in the audit report. Some of the students were also of the view that the auditor needs to give an emphasis of matter paragraph as regards management's decision of not obtaining a forward exchange cover. They failed to realize that the decision to take or not to take forward cover is based on the management's understanding and assessment of the underlying business environment and the auditor has no right to interfere unless the matter is very material and involves an unduly high degree of risk as regards the viability of the entity.
- (iii) Non-compliance with the International Accounting Standards on revenue recognition is a principle error. The trend among the students to suggest qualifications in all cases enabled them to secure some marks. However, very few of them highlighted the fact that the effect of the error was material i.e. 7% of the net profit before tax.
- (iv) The current profitability does not cast any doubt on the company's ability to continue as a going concern. Students were unable to focus on this aspect. They also failed to realize that ample time (three years) was available with the company to address the issue.
- (v) Most of the students were able to clarify that non-availability of documents in personal file may have some impact on risk assessment but it does not warrant a modification in the audit report.

(THE END)