



December 5, 2008

ADVANCED AUDITING

(MARKS 100)
(3 hours)

- Q.1 Sea view Limited is a manufacturing company. Behroze & Co., Chartered Accountants are their auditors. The audit of financial statements of the Company for the year ended November 30, 2008 is in progress. Sami, the senior in charge on the audit has received the first draft of the financial statements from Kamil, the CFO of the Company. The abridged financial information of the Company for the year ended November 30, 2008 is as follows:

	2008	2007
	Rs. in '000'	
Property, plant and equipment	2,325	1,210
Intangible assets	100	50
Inventories	650	460
Trade debts	210	80
Sales	4,300	6,700
Cost of sales	3,800	5,100
Gross Profit	600	1,600

Sami had a meeting with the CFO of the Company which revealed the following matters:

- (i) The Company's sales have suffered on account of depressed economic conditions in the country;
- (ii) The Company has introduced a new product 'Cherry' during the year in place of 'Merry' and incurred substantial cost in the acquisition of property, plant and equipment; and
- (iii) This year's physical verification of stocks had not been carried out on November 30 on the plea that the relevant staff was on leave. The stock check will now be carried out on December 15, 2008.

Required:

Given the above data and circumstances, identify the following:

- (a) the risks that may result in material misstatements in the financial statements; and
- (b) the implications of the risks identified along with audit procedures that would be most suitable to mitigate those risks.

(15)

- Q.2 During the audit of a manufacturing company, you have noted certain conditions that cast significant doubt on the company's ability to continue as a going concern. You had a meeting with the CEO of the Company to discuss the issue and communicated your decision that at least an emphasis of matter paragraph in the Audit Report is inevitable. The CEO disagreed with your opinion and shared with you the management's plan to deal with the potential going-concern uncertainty. The plan mainly constitutes the following measures:

- (i) the Company is guaranteed a continuous financial support by the parent company;
- (ii) it has recently rescheduled its borrowing facilities;
- (iii) the management has plans to reduce overheads and administrative expenses;

- (iv) the management has decided to discontinue a segment with non-profitable operations;
- (v) the management has plans to increase equity; and
- (vi) the management is expecting profitable operations in the next year.

Required:

Describe the audit procedures that should be performed to gather sufficient appropriate audit evidence to support the validity of the CEO's claims and assess the viability of the above measures being taken by the management. (16)

- Q.3 Your firm has been appointed as the auditors of Star Limited, a well established consumer goods manufacturing company. During the audit you were provided with various oral representations during meetings and discussions. While finalizing the audit you requested the management to provide such representations in writing. The management has however informed you that they are not accustomed to providing any representations to the external auditor in writing.

The management is of the view that it has provided full access to whatever records, documents and evidences were available with it without any exception and that now it is the auditor's responsibility to correlate the same with the oral representations.

The management has further informed that the only signed documents which it will be providing to you would be the signed copy of the financial statements and the certified true copy of the resolution of the BOD approving the financial statements and other significant matters, in line with the requirements of the corporate law.

Required:

You are required to explain the following:

- (a) Is there any relevance of oral representations for the External Auditors?
- (b) What are the situations in which written representation from the management is mandatory?
- (c) What course of action would you like to take in the above circumstances? (12)

- Q.4 The financial statements of Walter Limited (WL) a public unlisted company, for the year ended 30 June 2007 were significantly delayed and were finalized in April 2008. After finalization of financial statements, a meeting of the board of directors (BOD) of WL was held in May 2008 and Annual General Meeting (AGM) was held on June 18, 2008. Due to delay in holding the AGM, the Securities and Exchange Commission of Pakistan (SECP) has imposed a penalty and has advised WL that no such delay shall be entertained in future.

In the AGM, the shareholders of WL appointed your firm as the statutory auditors and the fact has been communicated to you by the Company Secretary through his letter dated June 22, 2008 which was faxed to you on the same date.

The company's financial year is closing on June 30, 2008 and the management wants to commence the audit immediately in order to ensure timely financial reporting and holding of AGM.

Required:

- (a) Explain the client acceptance procedures that you would like to perform in the above situation.
- (b) What other steps would you like to take before commencement of the audit? (12)

- Q.5 Your firm has completed the audit of financial statements of Flora Limited (FL), a public listed company, as of June 30, 2008 and has issued the audit report on September 30, 2008. While preparing to attend the Annual General Meeting (AGM), you noted that a particular sub-note was altogether missing from the published financial statements.

On scrutiny, you found that the original signed copy of the financial statements available in your records did contain the note.

Required:

- (a) Explain the auditor's responsibility in such a situation if the amount involved is considered material.
- (b) What difference would it make if the amount is immaterial? (06)

Q.6 You are the audit engagement partner for Mubarak Limited (ML), a listed company which is the subsidiary of a company registered in USA. You have received an email from your firm's tax partner based in Lahore. He has informed you that in a recent meeting with the Chairman of ML in Lahore, he discussed an opportunity to pursue major assignments for the Company. He strongly urged you to have an urgent meeting with the CEO of ML as the company is in discussion with other firms also and is due to take a final decision soon.

The services include Internal Audit Outsourcing and Corporate Finance Services (CFS). CFS mainly involve negotiating the terms of restructuring / re profiling of long-term borrowings obtained by ML from one of its lenders. However, as the audit engagement Partner of Mubarak Limited you are of the opinion that it would not be possible for you to provide the above services.

Required:

Write a comprehensive letter to the client explaining your point of view, giving appropriate reasons and references to the relevant standards and regulations. (10)

Q.7 You were the engagement partner on the audit of a commercial bank which has a network of more than 200 branches, across the country. During a recent meeting, a member of the audit committee referred to an instance of irregularity in a branch, whereby the Branch Manager had extended credit to a close relative without following the bank's credit disbursement procedures. The member criticized the auditors for their failure to highlight such instances.

Required:

As an engagement partner, write a letter to the audit committee explaining your point of view in detail with specific references to the International Standards on Auditing, wherever applicable. (09)

Q.8 You are employed as the Chief Internal Auditor of MNQ Commercial Bank Limited. Recently the Central Bank has taken serious action against some of the banks for their failure to detect money laundering activities.

Required:

For the guidance of the management and staff, develop a list of situations which may indicate the involvement of money laundering activities. (10)

Q.9 Your firm has been appointed as the auditors of Antarctica Limited for the year ended June 30, 2008. The Company was incorporated in the year 2000. Since then, its financial statements have been prepared in accordance with the approved accounting standards as applicable in Pakistan and have been audited by a highly reputable professional auditing firm. Since the previous auditors had never expressed a modified audit opinion, the audit team feels that there is no risk in respect of comparatives and accordingly did not perform any work in this respect.

Required:

Describe the auditor's responsibility as regards the verification of opening balances and the steps that may be needed in the above situation. (10)