

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations Spring 2007

March 9, 2007



AUDITING

(Marks 100)

Module D

(3 hours)

- Q.1 (a) “The auditor is responsible to obtain evidence regarding the events occurring after the date of financial statements.”
- Briefly explain the above statement. (02)
- (b) The financial statements for the year ended June 30, 200X of Bakers Limited along with auditor’s report thereon were issued. Subsequently, the auditor became aware of an error, which resulted in overstatement of sales by a material amount.
- (i) What course of action the auditor is supposed to take according to the applicable standards?
- (ii) Under what situation the revision in financial statements may not be necessary? (08)
- Q.2 Cobblers Limited is the holding company of Shoes Limited and Boots Limited. 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 Shoes Limited, which had been incorporated eighty three days back, are considering appointment of Mr. Bright, a chartered accountant, as the first auditor. Mr. Bright holds a very small number of shares in Boots Limited.
- (ii) The members of Cobblers Limited have appointed Mr. Polite, 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.
- 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. Bright is qualified to be appointed as auditor of Shoes Limited.
- (b) With reference to (ii) above, discuss the validity of appointment of Mr. Polite as auditor of Cobblers Limited. (05)
- Q.3 Primarily, the audit engagement partner is responsible for the overall quality of audit. Briefly state the responsibilities of engagement partner in respect of:
- (i) leadership;
- (ii) acceptance and continuance of client relationship;
- (iii) assignment of engagement team; and
- (iv) engagement quality control review. (08)

Q.4 (a) “An unmodified audit report is not a guarantee that the financial statements are free from material misstatements”. Discuss the rationale of this statement. **(06)**

(b) In a meeting before the commencement of a large audit engagement, the engagement partner has emphasized the importance of audit documentation. As an audit manager, you are required to explain to your team, the characteristics which make the documentation self explanatory. **(03)**

Q.5 During the audit of Drapers Limited, following errors were detected by the engagement team by applying tests of details on audit samples:

- depreciation on various assets has been overcharged by an aggregate amount of Rs. 250,000; and
- staff gratuity of various employees has been underprovided aggregating Rs. 300,000.

The materiality level was Rs. 600,000. Therefore, the concerned member of the team did not consider it necessary to discuss them with the management.

In your opinion, what steps should the job in-charge take in the given situation? **(04)**

Q.6 (a) During the verification of ‘repair and maintenance account’, the auditor noted that a repair expenditure of material amount was not supported by proper documentary evidence. According to the management, it was done in haste to avoid an abnormal shut down of plant. The management has offered to give specific representation in this regard.

Discuss the appropriateness of management’s representation as audit evidence in this case. **(03)**

(b) What are the basic elements of a management representation letter? **(03)**

Q.7 Green & Company, Chartered Accountants have been asked to audit the financial statements of Encom Technologies Limited (ETL). ETL’s business is carried out through various branches in different cities. Two such branches constitute nearly 40% of total business, significant portion of which is quite complex. Further, the firm has virtually no experience of auditing the business carried out at these branches, which are audited by other firms of chartered accountants. Moreover, there are certain doubts as regards the competence of the auditors of one of the above branches.

What consideration should be given by the firm while accepting the engagement? **(08)**

Q.8 (a) While applying analytical procedures on an audit, the auditor has predicted direct material consumption of Rs. 1,500 million. The actual cost of direct material consumed as per accounts is Rs. 1,570 million. The auditor has emphasized on production volume and increase in material price, in arriving at the said estimation. The management believes that general increase in material prices is the reason for such deviation.

Describe the course of action the auditor should take in dealing with this situation. **(06)**

(b) An auditor has to rely on various kinds of data while performing analytical procedures. The reliability of data is influenced by a number of factors. List out the main factors with examples. **(04)**

- Q.9 (a) The outcome of an uncertainty depends on future actions or events not under the direct control of the entity but it may have a material effect on the financial statements. Discuss the impact of an uncertainty on the auditor's report. **(03)**
- (b) The date is an important element of audit report. What date should the auditor put on the audit report and what does it represent? **(03)**
- Q.10 (a) Briefly describe the responsibilities of the management and the auditors as described in the audit report of a company given in Form 35A prescribed under the Companies Ordinance, 1984. **(07)**
- (b) The auditors of Porters Limited had a disagreement with the management on application of certain accounting policies. The audit adjustments suggested by the auditors in this respect were refused by the management. Describe with reasons the possible modifications in the audit report of the company. **(06)**
- Q.11 (a) Briefly state the matters an auditor considers while developing overall audit strategy and plan of an initial audit engagement. **(05)**
- (b) Discuss the nature and contents of audit plan. **(07)**
- Q.12 (a) What do you understand by:
(i) Statistical sampling; and **(02)**
(ii) Stratification? **(02)**
- (b) What do you understand by the term "sampling risk"? Briefly describe the two types of sampling risks and the effect thereof on the audit as a whole. **(05)**

(THE END)