The Institute of Chartered Accountants of Pakistan

Auditing

Intermediate Examination | 5 September 2011
Autumn 2011 | 100 marks – 3 hours
Module D | Additional reading time – 15 minutes

(All questions are compulsory)

Q.1 You are the Manager on the audit of Ghazi Power Limited (GPL), a gas transmission and distribution company, for the year ending 31 October 2011. On the company's request, your firm has agreed to complete the audit by 20 November 2011.

In order to meet the audit deadline, you are considering various measures which include sending requests for negative confirmations related to balances due on 31 August 2011. On 31 August 2011, total debtors aggregated Rs. 45 Million. 50% of the amount is due from 15 major debtors, whereas the total number of debtors is 2,450.

Moreover, GPL's management is not allowing you to send a request for confirmation of balance to SSO Ltd, which is among one of the 15 major debtors, because of certain ongoing legal disputes.

Your previous experience with the client and the results of initial risk assessment procedures suggest that the risk of material misstatement is low.

Required:

(a) Discuss whether it would be appropriate to use the negative confirmations procedure in the above situation. ***(06 marks)***

(b) What audit procedures should be performed at the year end, if requests for confirmation of balances are sent on 31 August 2011? ***(07 marks)***

(c) List the procedures that should be adopted due to management's refusal to send a request for confirmation of balance to SSO Ltd. ***(06 marks)***

Q.2 (a) Differentiate between the following:

(i) An 'emphasis of matter' paragraph and an 'other matter' paragraph.

(ii) 'Applicable financial reporting framework' and a 'general purpose framework.'

(08 marks)

(b) Give three examples each of circumstances which may necessitate the inclusion of the following in the auditor's report:

(i) An 'emphasis of matter' paragraph; and

(ii) an 'other matter' paragraph. ***(06 marks)***

Q.3 Fieldwork for the annual audit of Peach Textile Mills Limited (PTML) has been completed and the financial statements and the audit report are due to be signed next week. During the concluding meeting with the client, the auditor was informed that a fire has destroyed all the raw cloth placed in the warehouse at the mill. About 60% of the destroyed cloth was purchased after the reporting date. However, due to certain defect in the insurance policy, the insurance company settled the claim by paying 80% of the amount of loss.

Required:

Explain the auditor's responsibility and the audit procedures and actions that should be carried out by the auditor in the above situation. ***(05 marks)***

Q.4 Comment on each of the following independent situations in respect of appointment of auditors, with reference to the applicable rules and regulations:

(a) Guava and Company, Chartered Accountants, have received a request for appointment as auditor of Orange Bank Limited (OBL). Most of the partners of Guava and Company maintain their accounts with OBL and are enjoying credit card facilities from them. The maximum outstanding balance on the credit card facility, due from any partner is Rs. 399,000.

(b) Apricot and Company, Chartered Accountants, have received an offer for appointment as auditor of Banana Limited. Mr. Pumpkin who is a nominee director of the Government on the Board of Directors of Banana Limited holds 25% shares in Water Melon Limited. The spouse of a partner also holds shares in Water Melon Limited.

(c) Mr. Zaheer, a legal practitioner, has received an offer for appointment as external auditor of Lychee (Private) Limited (LPL). The paid up capital of LPL is Rs. 1,500,000 of which 40% is owned by Blue Black Limited, a listed company.

(d) Walnut and Company, Chartered Accountants, have received an offer for appointment as external auditors of Wasim (Private) Limited (WPL), in place of the previous auditors, who were removed before the completion of their term. You may assume that WPL has completed all the legal formalities before removing the previous auditors.

(e) Mr. Sadiq has recently joined your firm as a partner. He has served on the Board of Directors of Strawberry Limited (SL) until 30 June 2009, as a Government nominee. In the Annual General Meeting of SL held on 31 August 2011, a shareholder has proposed the name of your firm for appointment as the external auditors for the year ending 30 June 2012.
(11 marks)

Q.5 As the auditor of a listed company with a number of related parties, what steps would you consider as part of your audit planning to ensure that all related party relationships and transactions are identified and disclosed in the financial statements. ***(13 marks)***

Q.6 You are a part of the team on the audit of Fresh Meat (Private) Limited which sells fresh meat products through 25 retail outlets. Each outlet holds cash at the year end. Sales are made on cash as well as against credit cards. All the accounting records are maintained at the outlets and balances with the Head Office are reconciled on a monthly basis.

Required:
List the audit assertions relevant to the audit of cash in hand and state how you would obtain audit evidence to support those assertions. ***(06 marks)***

Q.7 (a) List the benefits associated with holding timely discussion among the team members in respect of matters susceptible to material misstatements. ***(05 marks)***

(b) Quite often, the risk of material misstatement is greater in case of non-routine transactions and judgmental matters.

Required:
(i) What do you understand by non-routine transactions and judgmental matters?
(ii) State the reasons on account of which risk of material misstatement is increased in case of:
- Non-routine transactions
- Judgmental matters ***(06 marks)***

Q.8 You are the audit manager of MM Electronics (Private) Limited. The company markets its products through retail outlets in nine major cities. The draft financial statements for the year ended 30 June 2011 show a profit after tax of Rs. 20 million and net assets of Rs. 150 million. The audit team has noted the following matters for your consideration:

(a) During the year the company has changed its policy of valuation of property, plant and equipment from historical cost to revalued amount. For this purpose, the services of Professional Valuers (Private) Limited were hired. They have issued valuation reports of three outlets indicating a revaluation surplus of Rs. 10 million, which has been recognised in the financial statements. The management has informed you that the valuation reports of the remaining properties are expected to be issued in December 2011.

(b) The company was sued for breach of contract by a customer claiming damages of Rs. 10 million. The legal advisor has confirmed the management's assertion that no liability existed at the balance sheet date. However, while reviewing the customers' files, you found an email from the Manager (Legal Department) addressed to the Chief Executive in which he has opined that the company will have to pay atleast 50% of the damages claimed.

(c) With effect from 01 July 2010, the company has introduced a policy of providing one year warranty on its television sets. No warranty is provided on the other products. Sales of television sets aggregated Rs. 20 million, whereas the total sales for the year amounted to Rs. 80 million.

The company has a customer support department which provides after sales services on all products. For defects not covered under the warranty, the company bills the customers at 25% above cost. The management has included a note in the draft financial statements stating that no provision has been made in respect of the warranty, as the amount cannot be measured reliably.

(d) The directors have decided not to disclose earnings per share as the same had reduced significantly on account of issuance of 100% bonus shares. The disclosure was however made in all previous financial statements.

Required:
Express your views on each of the above situations and discuss the impact thereof on the audit report. ***(14 marks)***

Q.9 List the circumstances in which it may become necessary to revise the terms of audit engagement for a recurring audit. ***(07 marks)***

(THE END)