THE PROFESSIONALS' ACADEMY OF COMMERCE

Auditing

Referral 4
Module: D

Topic: ISA 700,705,706,2410,550

Date: 27/12/2012
33 marks – 1 hour

Question no 1

(i) In January 2010, Jupiter Ltd. received a government cash grant of Rs.1.6 million in respect of assistance with the acquisition of tangible non-current assets which have estimated useful economic lives of between five and ten years. The Rs.1.6 million has been credited directly to the Income statement for the year ended 31 March 2010. The directors insist on continuing with this treatment despite having been informed that this is not in accordance with the relevant accounting standard, which requires such grants to be credited to the income statement over the useful economic lives of the assets to which the grant relates. The pre-tax profit of Jupiter Ltd. for the year ended 31 March 2010 is Rs.950,000.

(Marks 5)

(ii) On 5 April 2012, a liquidator was appointed at Majeed Ltd (Majeed), a customer of NJS. The liquidator has indicated that there are insufficient funds to pay unsecured creditors. The balance due from Majeed on 31 March 2012 is Rs.180,000. In addition, work in progress includes Rs.380,000, the cost of customized work relating to Majeed. The directors of NJS refuse to make provision for the debt on the grounds that the liquidator was appointed after the year end. They also refuse to write down work in progress because they are planning to convert it into finished goods at an additional cost to complete of Rs.265,000. Another customer has agreed to buy the finished goods for Rs.525,000.

The total assets of NJS at 31 March 2012 are Rs.13.4 million and the profit before tax for the year ended 31 March 2012 is Rs.3.9 million. (Marks 5)

Required:

For each of the situations outlined above, state whether you would modify the audit opinion. Give reasons for your conclusions and describe the modification(s), if any, to each audit report.

Question no 2

The financial statements of a company, Waleedale, for the year ended 30 September 2010, are audited by another firm. Profit before taxation of Rs.0.4 million and total assets of Rs.34.1 million have been included in its draft financial statements. The notes to Waleedale's financial statements as at 30 September 2010 disclose a contingent liability for a pending legal matter estimated at Rs.0.2 million.

In November 2010, the courts found Waleedale to be liable for costs and damages amounting to Rs.1.1 million. However, Waleedale's directors have refused to make a provision, for any amount, as they have lodged an appeal against the judgment.

Required

State what effect this matter would have on the audit report if the directors (i) refuse to disclose the liability, (ii) agree to disclose the liability. (Marks 6)

Question no 3

Babu and Ali Bengal have a sister, Faree, who runs an interior design company, Desi Co. During a review of board minutes, performed as part of the planning of Bilal Co's audit, it was discovered that Bilal Co has paid Rs.225,000 to Desi Co during the year, in respect of refurbishment of development properties. On further enquiry, it was also found that Desi Co leases an office space from Bilal Co, under an informal arrangement between the two companies.

Required

Explain the inherent limitations which mean that auditors may not identify related parties and related party transactions.
(Marks 4)

Question no 4

You are responsible for answering technical queries from other managers and partners of your firm. An audit partner left the following note on your desk this morning:

(i) 'I am about to draft the audit report for my client, Seena Co. I am going on holiday tomorrow and want to have the audit report signed and dated before I leave. The only thing outstanding is the written representation from management – I have verbally confirmed the contents with the finance director who agreed to send the representations to the audit manager within the next few days. I presume this is acceptable?'

(Marks 4)

(ii) 'We are auditing Seena Co for the first time. The prior period financial statements were audited by another firm. We are aware that the auditor's report on the prior period was qualified due to a material misstatement of trade receivables. We have obtained sufficient appropriate evidence that the matter giving rise to the misstatement has been resolved and I am happy to issue an unmodified opinion. But should I refer to the prior year modification in this year's auditor's report?'
(Marks 3)

Required

Respond to the audit partner's comments.

Question no 5

a) In terms of audit reports, explain the term 'modified'. **(Marks 2)**

b) State the types of modified audit reports and briefly explain the situation in which each is given.
(Marks 4)

(The End)