THE PROFESSIONALS' ACADEMY OF COMMERCE

Auditing

Referral 3
Module: D

Topics: ISA 700,705,706,2410

Date: 20/12/2012
33 Marks – 1 hour

Question no 1

You have encountered following independent situations in conducting an audit of a manufacturing company. For each situation select the type of opinion you consider suitable and give reasons for your choice. Assume that each situation has a material impact on the financial statements.

a) You were appointed as auditor after the year end date and the accounting records are not sufficiently reliable to ensure accuracy of the yearend inventory balances.

b) Gratuity and pension liabilities recorded on the basis of workings prepared by the client were reasonably close to the liability assessed by the actuary. Small errors found in the data used by the actuary may have impact on actuarial computation to a maximum of 5% of gratuity and pension liability.

c) A term deposit of Rs.10 million with a bank has been carried in the financial statements at cost. The bank has filed a voluntary liquidation petition subsequent to the year-end date and the net realizable value of the deposit is not more than 20% of cost.

d) The company changed its method of inventory valuation from FIFO to average. You concur with the change although it has a material effect on the comparability of the financial statements.

e) Financial statements do not disclose certain long term obligations **(Marks 10)**

Question no 2

a) The auditor should have an understanding of the entity and its environment to enable him to plan the engagement and select the inquiries, analytical and other review procedures.
He is required to review the half yearly financial statements.

Required
Explain:
1) The objectives of such review and how does it differ from audit; and **(Marks 2)**
2) The procedures that are performed while carrying out such review. **(Marks 5)**

b) List the contents of an audit report when the auditor gives a disclaimer and also state what information is stated in those contents. **(Marks 6)**

Question no 3

You are the senior in-charge on the audit of financial statements of Clothes 4 You Limited, for the year ended June 30, 2012. The audit field work has revealed the following issues which are still unresolved:

(a) The company is not charging depreciation on a building which was constructed during the year on freehold land belonging to the company, at a cost of Rs.128 million. The management is of the view that land and building are part of the same class of assets and no depreciation is required to be charged thereon because the value of such assets is expected to increase significantly in the future.

(b) A customer of the company has filed a suit claiming damages of Rs.4.6 million, on account of company's failure to meet a deadline for supply of certain goods. The company has filed a counter claim of Rs.5.5 million, against the same customer on account of the customer's failure to fulfill certain conditions regarding payment of advance. No provision has been made in the books of the company as the company's lawyers are not very sure about the outcome of the lawsuit.

You have discussed these matters with your manager who believes that the amounts involved are material.

Required

Draft a qualification paragraph that may have to be included in the Audit Report. You may assume necessary details. **(Marks 10)**

(The End)