



# The Institute of Chartered Accountants of Pakistan

## Auditing

Intermediate Examination  
Spring 2014  
Module D

5 March 2014  
100 marks - 3 hours  
Additional reading time - 15 minutes

Q.1 (a) Briefly describe 'Preliminary Engagement Activities' and 'Planning Activities'. (05)

(b) You are the partner of Alamgir and Company, Chartered Accountants and have received an offer for appointment as auditor of Guava Limited (GL). The previous year's audit was carried out by Babur and Company, Chartered Accountants.

**Required:**

State the matters that you would consider:

(i) while deciding about the acceptance of audit of GL. (03)

(ii) in establishing the overall audit strategy, including matters which are to be considered, being the initial audit engagement. (08)

Q.2 Comment on the following independent situations, with reference to the requirements of the Companies Ordinance, 1984.

(a) Mateen has recently joined Humayun and Company (HC), a firm of Chartered Accountants, as a Director with a commitment of being promoted as a partner in due course. HC is the auditor of Strawberry Limited (SL). Mateen was previously associated with SL as a Director. He left that job in 2011 but still holds 1,000,000 shares in SL. (03)

(b) Khawar is a partner in Ghalib and Company, Chartered Accountants. He writes occasionally as a Free Lancer for 'Investment Times', a leading Financial Magazine. Ghalib and Company are the auditors of Financial Press Limited, publisher of Investment Times. Khawar has received a remuneration of Rs. 20,000 for his articles published in the magazine. (02)

(c) Hamid is a partner in a Chartered Accountant firm and holds 100,000 Term Finance Certificates in Sona Fertilizers Limited (SFL). Hamid's firm is considering to accept the audit of SFL. (02)

Q.3 You are the audit manager in a firm of chartered accountants and are currently faced with the following situations at two different clients.

(i) A bank confirmation has not been received despite extensive follow up by the client. As the deadline is close, the client has provided you the original bank statement of 31 December 2013 duly stamped and signed by the Bank Manager. Consequently, the client is of the opinion that confirmation is no more necessary. (06)

(ii) At the planning stage of audit of Orange Limited, the management has refused to send confirmations to three major debtors who constitute 45% of the total debtors. On inquiry, you have been informed that these debtors are partnership concerns and take lot of time in replying to confirmation requests. However, as an alternative the management has offered to send negative confirmation requests. (07)

**Required:**

Discuss how you would deal with the above situations. Also state the possible implications on the audit report.

Q.4 An auditor is required to identify and assess the risks of material misstatements to provide a basis for designing and performing further audit procedures.

**Required:**

- (a) State the factors which an auditor should consider while evaluating the significance of audit risks. (06)
- (b) State the matters which you would include while documenting the risk identification and risk assessment procedures. (06)

Q.5 Discuss the categories of threats that may be involved in each of the following mutually exclusive situations and advise the partner of the concerned firms with regard to the possible course of action which may be adopted in each case:

- (a) The audit of JJ Limited (JJL) is at its completion stage. The meetings of the audit committee and the board of directors are scheduled to be held within a week, to consider and approve the annual financial statements. JJL is facing financial difficulties and has not paid the audit fee of the previous year. The CFO of JJL has committed to pay the previous as well as current year's audit fee, after signing the audit report. (04)
- (b) During the course of audit of HP Limited (HPL), the engagement partner has informed the firm that his brother has acquired 200,000 shares in HPL. (05)

Q.6 List the substantive procedures which may be performed by the auditor to verify the Long Term Bank Loan. (07)

Q.7 While reviewing the audit working papers of Apple Limited (AL), the following matters have come to your attention:

- (i) The audit team was able to ascertain that AL has entered into a number of transactions near the year-end with a new distributor Fruits Limited (FL), which is a related party. On being confronted, the management has informed that since there were no transactions with FL in the past, its inclusion in the schedule of related party transactions was inadvertently omitted. (05)
- (ii) The details of related party transactions provided by the management includes a payment of Rs. 300 million to Mango Limited. The job incharge is of the view that this transaction is not in normal course of business of the company. (04)

**Required:**

Analyse each of the above situations and briefly describe your course of action.

Q.8 The following situations have arisen on different clients being audited by your firm. The year-end in each instance is 31 December 2013.

- (i) During the year Iron Limited has changed its policy for valuation of intangible assets from Cost Model to Revaluation Model. (03)
- (ii) Due to fire in the record room of Titanium Limited, all the records and backup related to the fixed assets, trade debtors and stocks were destroyed and you are unable to perform audit procedures for verification of the balances. (03)
- (iii) During the planning stage of Coal Limited it was noted that the system of internal controls of the company is weak. This aspect was taken into consideration in determining the nature, timing and extent of the audit procedures. (02)
- (iv) One of the plants of Uranium Limited was destroyed subsequent to year-end. Appropriate disclosure thereof has been made in the financial statements. (02)

**Required:**

Discuss the impact of each of the above matters on the audit report.

- Q.9 You are the audit manager of Pineapple Limited. The audit senior has submitted following draft audit report for your review:

#### AUDITORS' REPORT TO THE DIRECTORS

We have audited the annexed balance sheet of Pineapple Limited (the company) as at 31 December 2013 and the related profit and loss account, statement of comprehensive income, cash flow statement and statement of changes in equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

It is the responsibility of the company's management to prepare and present the above said statements in conformity with the approved accounting standards and the requirements of the Companies Ordinance, 1984. Our responsibility is to express an opinion on these statements based on our audit.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the above said statements are free of any material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

- (a) As described in note 16 to the financial statements, trade debtors amounting to Rs. 152 million are outstanding since many years.
- (b) in our opinion, proper books of accounts have been kept by the company;
- (c) In our opinion:
  - (i) the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Companies Ordinance, 1984, and are in agreement with the books of accounts and are further in accordance with the accounting policies consistently applied;
  - (ii) the expenditure incurred during the year was for the purpose of the company's business; and
  - (iii) the business conducted, investments made and the expenditure incurred during the year were in accordance with the objects of the company;
- (d) In our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, statement of comprehensive income, cash flow statement and statement of changes in equity together with the notes forming part thereof conform with approved accounting standards as applicable in Pakistan, and, give the information required by the Fourth Schedule of the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at 31 December 2013 and of the profit for the year then ended; and
- (e) We draw attention to note 25 which indicates that the company has not recognized contingent liability of Rs. 15.8 million. It represents mark-up on a long term bank loan. The bank has waived the mark-up subject to the condition that the company will pay the entire principal amount of Rs. 85 million within two years. The company has defaulted on the last quarterly instalment but the management is confident that it will be able to meet its liabilities in future. The bank has not taken any action against the company.

ABC and Company  
Chartered Accountants

Dated: 05 March 2014  
Karachi

**Required:**

Identify the shortcomings in the above audit report.

(09)

Q.10 Management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appears to be operating effectively.

**Required:**

Determine the audit procedures that may be performed by the auditor to address the risks related to override of controls.

**(08)**

**(THE END)**