

Auditing

Solution Referral 3

Question no 1

- a) This is a case of auditor's inability to obtain sufficient appropriate audit evidence. Auditor is also unable to obtain sufficient appropriate audit evidence from alternative audit procedures. If amount involved is material, auditor will express Qualified Opinion. If amount involved is material and pervasive, auditor will express Disclaimer of Opinion.
- b) This is neither a case of misstatement nor inability to obtain sufficient appropriate audit evidence. Auditor can express unmodified opinion using the report of expert as sufficient appropriate audit evidence. Effect of small errors is considered immaterial.
- c) Realizable amount of term deposit is below cost so company should write-down Rs. 8 million. This is a case of misstatement which relates to amounts in financial statements. If effect of misstatement is material, auditor will express qualified opinion. If effect of misstatement is material and pervasive, auditor will express adverse opinion.
- d) A change in accounting policy should be disclosed in financial statements. Auditor has to mention in auditor's report whether he concurs with the change in accounting policies. Auditor's opinion is not modified if selection and application of accounting policy is adequate.
- e) Company should record all its assets and liabilities on balance sheet. Failing to record certain liabilities is a case of misstatement that relates to amounts in financial statements. If effect of misstatement is material, auditor will express qualified opinion. If effect of misstatement is material and pervasive, auditor will express adverse opinion.

Question no 2

- a) 1) Objective of a review engagement is to enable the auditor to express a conclusion whether, on the basis of the review, anything has come to the auditor's attention that causes the auditor to believe that the interim financial information is not prepared, in all material respects, in accordance with an applicable financial reporting framework.

An audit is designed to give a reasonable/positive/high level of assurance. A review is designed to give a limited/negative/moderate level of assurance.

2) The auditor should make inquiries, primarily of persons responsible for financial and accounting matters, and perform analytical and other review procedures to enable the auditor to conclude on financial statements. A review ordinarily does not require tests of the accounting records through inspection, observation or confirmation.

Nature and extent of inquiries, analytical and other review procedures depend on the auditor's understanding of the entity, risk assessment and materiality, but, ordinarily auditor performs the following procedures:

1. Reading the minutes of the meetings of shareholders
2. Considering matters giving rise to modification in audit/review report in previous periods
3. Inquiries of management about:
 - Whether the financial information has been prepared in accordance with AFRF
 - Whether there have been any changes in accounting principles or in the methods of applying them
 - Whether related party transactions have been appropriately accounted for and disclosed in the interim financial information
 - Significant changes in contingencies and commitments
 - Compliance with debt covenants
 - Any known uncorrected misstatements

- Significant transactions occurring in the last several days of the interim period or the first several days of the next interim period
 - Knowledge of any fraud or suspected fraud affecting the entity
4. Applying analytical procedures to the interim financial information
 - Comparing interim financial information with preceding period and comparative period of last year
 - Comparing interim results with budgets
 - Comparing financial information with non-financial information
 - Comparing ratios and other KPIs with industry
 - Comparing relationships among elements
 - Comparing disaggregated data e.g. by period, by product line, by location
 5. The auditor should obtain evidence that the interim financial information agrees or reconciles with the underlying accounting records
 6. Auditor shall inquire:
 - Whether management has identified subsequent events after B/S date requiring adjustment/disclosure.
 - Whether management has changed its assessment of entity's ability to continue as going concern. If so, auditor shall inquire management about future action and should consider adequacy of disclosure.
- b) The contents of an audit report where the auditor gives a disclaimer of opinion are stated below:
1. Title:
It shall indicate that the report is of an independent auditor.
 2. Addressee:
It shall be addressed to the person(s) as required by the circumstances.
 3. Introductory paragraph:
It shall identify the entity whose financial statements have been audited, state that the financial statements have been audited, identify the title of each statement, refer to the summary of significant accounting policies and other explanatory information, and specify the date or period covered by each statement.
 4. Management's responsibility for the financial statements:
It shall describe the responsibilities of those who are responsible for the preparation of the financial statements. It shall include that management is responsible for preparing financial statements in accordance with applicable financial reporting framework, and for such internal controls as management deems necessary to enable the preparation of financial statements that are free from material misstatement.
 5. Auditor's responsibility:
It shall state that the auditor is responsible to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing, however, they were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and the matter is described in the Basis for Disclaimer of Opinion paragraph.
 6. Basis for Disclaimer of Opinion:
It shall state the item(s) on which the auditor was unable to obtain sufficient appropriate audit evidence and he shall state the amount of the item as stated in the financial statements. It shall state the reason why the auditor was unable to obtain sufficient appropriate audit evidence. It shall also indicate what effect the item has on other account balances or class of transactions, etc.
 7. Disclaimer of Opinion:
It shall state that as we have not been able to obtain sufficient appropriate audit evidence, we do not express an opinion on the financial statements.

8. Auditor's signature
9. Date of the auditor's report
10. Auditor's address:

It shall name the location in the jurisdiction where the auditor practices.

Question no 3

- a) This is a case of material misstatement, hence qualified opinion will be given with following qualification paragraphs:

Basis for Qualified Opinion

As more fully explained in note x to the financial statements, the company's fixed assets include building which was constructed during the year at a cost of Rs.128 million. Management has not charged any depreciation on this building, which constitutes a departure from International Financial Reporting Standards. The company's records indicate that had management recorded the depreciation on this building, an amount of Rs.xxxx would have been required to charge to depreciation. Accordingly, operating expenses would have been increased by Rs.xxxx, and income tax, net income and shareholders' equity would have been reduced by Rs.xxxx, xxxx and xxxx, respectively.

Qualified Opinion

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* paragraph, the financial statement give a true and fair view of the financial position of Clothes 4 You Limited as at June 30, 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Framework.

- b) No provision is required in this situation as the amounts likely to be settled are not probable and measurable. However, a disclosure is required to be made in financial statements (as material uncertainty exists at balance sheet date) and if, in auditor's opinion, this fact is fundamental to user's understanding, an Emphasis of Matter paragraph may be given in auditor's report as follows.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty related to the outcome of the lawsuit filed against the company by XYZ claiming damages of Rs.4.6 million. The company has filed a counter claim of Rs.5.5 million, against the same customer. Our opinion is not qualified in respect of this matter.

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