

THE PROFESSIONALS' ACADEMY OF COMMERCE



Auditing

Referral 1
Module : D

Topic: Appointment, Ethics, ISA 530

Date: 06/12/2012
33 marks – 1 hour

Question no 1

(i) The audit engagement partner for Pappy Co has been in place for approximately six years and her son has just accepted a job offer from Pappy Co as a sales manager; this role would entitle him to shares in Pappy Co as part of his remuneration package. If AD & Co is appointed as internal as well as external auditors, then Pappy Co has suggested that the external audit fee should be renegotiated with at least 20% of the fee being based on the profit after tax of the company as they feel that this will align the interests of AD & Co and Pappy Co.

Required

Explain the ethical threats which may affect the independence of AD & Co in respect of the audit of Pappy Co, and for each threat explain how it may be reduced. (Marks 6)

(ii) The finance director of Fir Co has requested that a certain audit senior, Mina Nees, be assigned to the audit team. This senior has not previously been assigned to the audit of Fir Co. On further investigation it transpired that Mina Nees is the sister of Fir Co's financial controller.

Required

Assess the ethical and professional issues raised and recommend any actions necessary in response to the above matters. (Marks 7)

Question no 2

You have been offered to be auditor of Ali Manufacturing Company Ltd., subsidiary of Noman Ltd. and holding of Mir Group of Industries Ltd.. Amjad Concerns Ltd. is a subsidiary of Noman Ltd. Bahir is son of your partner Mirza. Bahir holds 20,000 preference shares and 15,000 shares having voting rights in Mir Group. The authorized share capital of Mir Group is 2,000,000 shares and 80% of it is paid up. The company has also issued 300,000 preference shares. Mr. Mirza's spouse also holds 20,000 shares in Noman Ltd. Mr. Mirza's daughter is director in Amjad Concerns Ltd.

Required

Discuss according to Companies Ordinance, 1984, whether you can accept the engagement or not. (Marks 5)

Question no 3

You are the senior member of the audit engagement team auditing the financial statements of Doce Company. Your job in charge is on leave and now you have to independently plan the most appropriate methods of sampling for various accounts/areas and to identify the areas where sampling need not be applied.

You are well aware of the fact that sampling is the key to an effective and efficient audit and for all practical purposes without adequate application of sampling techniques an audit can either become inefficient because of utilization of more time and wastage of efforts on insignificant matters, or on the contrary, it may become ineffective as the results of audit work may not be termed adequate.

Required

With this perspective in mind, for each of the following, identify an appropriate method of sampling or describe as to whether sampling would not be appropriate and some other approach needs to be applied:

- A. Substantive testing for additions to fixed assets (population size: 100 items/Rs.70 million);
- B. Compliance testing for revenue cycle –goods dispatch function (population size: 100,000 dispatches/Rs 550 million)

(Marks 6)

Question no 4

You are the audit manager of a client whose annual sales are Rs.640 million. During review it came into your notice that only 400 debtors have been selected out of total of 10,200 debtors for balance confirmation. The details are as follows:

Category A	200 largest debtors constitute 52% of sales. Out of these only 40 were selected.
Category B	360 other debtors were selected through haphazard selection
Category C	Debtors owing less than Rs.5,000 all were ignored as immaterial.

No confirmation was obtained regarding supplies to government and some related parties.

Required

- A. Explain how audit efficiency could be improved by using the above information
- B. List other ways in which the population may be categorized and what precaution should be taken while carrying out such categorization
- C. Suggest alternative means of selecting sample in which material balances have a greater probability of selection.

(Marks 9)

(The End)



Referral 2
Module : D

Topic: ISA 240,315,520

Date: 13/12/2012
33 Marks – 1 hour

Question no 1

Umair was assigned to work on the audit of M.K. Sons Clothing Ltd. because he has been auditing similar companies for 3 years and is considered to be knowledgeable about the clothing retail industry in Pakistan. His employer audited M.K. Sons Clothing Ltd. in 2009 for the first time and had difficulty verifying opening inventory number. This year, in 2010, Umair has audited the ending balance from 2009 so he does not expect problems with the inventory account. However, while doing the preliminary work for the audit, he calculated the gross profit margin and was surprised by his findings. Umair thinks the gross profit margin may indicate that the ending inventory for 2010 may be incorrect.

	2009	2010
Sales	10,000,000	9,000,000
Cost of goods sold	7,000,000	5,500,000
Inventory	1,800,000	6,200,000

38.58%

61.11%

25.71%

112.72%

Required:

Explain whether you agree with Umair. Support your answer with least four points.

(Marks 5)

Question no 2

At the planning phase of the audit of prudent limited, a listed company, senior auditor of your team submitted the following information;

1. The board of directors of the company has recently appointed Mr. Eagle as new chief executive whose remuneration is mostly based on efficiency bonus and stock options.
2. Mr. Eagle is reputed as a seasoned business executive and has been a very good friend of the chairman of the audit committee.
3. Since his joining he has proved to be main decision maker and the board appears to be relying considerably on Mr. Eagle and less interested in day to day operations of the company.
4. Board's main concern is now growth in net earnings estimated for the next year, which Mr. Eagle strongly believes, will be 30 % at the minimum.
5. There are number of instances of lack of segregation of duties and Mr. Eagle being cost conscious has allowed the situation to continue.
6. There is a big lay off plan in place and employees are expecting such plan although it has been kept as top secret this lay off will help the company to achieve higher growth in earnings.
7. Mr. Eagle has introduced an employees' skill development scheme only for top management personnel's.

Required

Describe the risk factors, if any, that are indicated in the above information.

(Marks 8)

Question no 3

SYM have a marina on the South Coast and a large sales operation dealing in yachts and speedboats. You are responsible for the audit of SYM and have found some potential causes of concern that could indicate fraudulent activity or financial misconduct within the company. In particular:

- 30% of the yachts on sale by SYM are supplied through one of the major international boating companies with a special finance arrangement deal. However, SYM have also obtained separate finance on these yachts, which are therefore in effect being 'double financed'.

- Ten yachts shown as assets by SYM cannot be located, with no explanation other than that they have not been sold. These yachts together are worth approximately Rs.5 million.
- Long delays have occurred in performing reconciliations with the last four months of reconciliations still not completed. At the time of the last reconciliation, material differences had been identified upon which no action appears to have been undertaken.
- Sales have been overstated by Rs.10 million in the current financial statements. The finance director has been off sick with stress for the last five months and therefore has not been available to discuss any of the issues identified.

Required:

- (a) Explain whether the issues referred to above should be categorized as fraud or error. **(Marks 5)**
- (b) Discuss the role of management and the role of the auditor in the prevention and detection of fraud and error. **(Marks 5)**

Question no 4:

- a) ISA 520 Analytical Procedures requires that the auditor performs analytical procedures during the initial risk assessment stage of the audit. These procedures, also known as preliminary analytical review, are usually performed before the year end, as part of the planning of the final audit.

Required

Explain the factors which have to be considered when determining the reliability of data which is used for the purpose of designing substantive analytical procedures.

(Marks 4)

- b) Apply substantive analytical procedures to verify the following items:
1. Sales
 2. Purchases
 3. Payroll

(Marks 6)