GC Consultants

ADVANCED AUDITING (MODULE : F)

			W-13	S-13	W-12	S-12	W-11	S-11	W-10	S-10	W-9	S-9	W-8	S-8	W-7	S-7	W-6	S-6	W-5	S-5	W-4	S-4	W-3	S-3	W-2	No of Qs	Marks	% of Total
Detailed Knowledge																												
Framework		11																								1	11	0.4%
ISA - 200													9													1	9	0.4%
ISA - 210			10			13				19																3	42	1.7%
ISA - 220				13							11	12		12		25		9		10		10	10		15	10	127	5.1%
ISA - 230																								10		1	10	0.4%
ISA - 240			6	6													13	16	10		11		12		10	8	84	3.4%
ISA - 250		10																5							5	3	20	0.8%
ISA - 260					17																					1	17	0.7%
ISA - 300	17	12						23		12	25					11					13			20		8	133	5.3%
ISA - 315		17							16				12			12	18		8	10		10	35		10	10	148	5.9%
ISA - 320															8									9		2	17	0.7%
ISA - 330	15	23	18	16	12	19	22	20	20	16	26	24	15	10	7						15					16	278	11.1%
ISA - 402																										-	-	0.0%
ISA - 500		13	16	16								12					6		6	13	16					8	98	3.9%
ISA - 501																									5	1	5	0.2%
ISA - 505					17								12			9			10		9					5	57	2.3%
ISA - 510								16					10				10									3	36	1.4%
ISA - 520	10								20										12							3	42	1.7%
ISA - 530														7	5				12	12						4	36	1.4%
ISA - 540														8					10							2	18	0.7%
ISA - 545																5		9								2	14	0.6%
ISA - 550															9			11				12	10		5	5	47	1.9%
ISA - 560	7				6		20						6	16				4			10			10		8	79	3.2%
ISA - 570			10	20				14				10											8			5	62	2.5%
ISA - 580															10		9	10	8							4	37	1.5%
ISA - 600					15																					1	15	0.6%
ISA - 610															10			7								2	17	0.7%
ISA - 620						7																10			10	3	27	1.1%
ISA - 700																										-	-	0.0%
ISA - 701	31	14	9	10	4	17	22	12	13	6	15	10		11	13	10	6	8	8	26	10	22		21	28	23	326	13.0%
ISA - 710															7											1	7	0.3%
ISA - 720																										-	-	0.0%
ISA - 800																8			8							2	16	0.6%
General Awareness																												
IAPS - 1000																										-	-	0.0%
IAPS - 1004																										-	-	0.0%
IAPS - 1005																										-	-	0.0%
IAPS - 1006																										-	-	0.0%
IAPS - 1010																										-	-	0.0%
IAPS - 1012																		9				6				2	15	0.6%
IAPS - 1013							20																			1	20	0.8%
IAPS - 1014																					10					1	10	0.4%
Sufficient Knowledge																												
ISRE - 2400																										-	-	0.0%
ISRE - 2410									11		12			16						12	6					5	57	2.3%
General Awareness																												
ISAE - 3000																										-	-	0.0%
ISAE - 3400			18			16				16			16				10						15			6	91	3.6%
ISRS - 4400																										-	-	0.0%
ISRS - 4410																	10									1	10	0.4%
Special Reports																												
Break Up Value					16																					1	16	0.6%
Bonus Share Certificate																						8				1	8	0.3%
Statutory Report (Sec:157)																							10			1	10	0.4%
Book Value Report												15														1	15	0.6%
Compilation Report												7														1	7	0.3%
Special Audits																												
Specialised Audit i.e. Bank, Insurance, NBFC, Retirement Funds																										-	-	0.0%
Non-Statutory Audits i.e. cost, management, operational, forensic, due diligence, money laundering, internal audit													10												12	2	22	0.9%
Professional & Ethical Considerations	20		13	19	13	28	16	15	20	31	11	10	10	20	31	20	18	12	8	17		12		20		21	364	14.6%
Corporate Failure (ENRON)																								10		1	10	0.4%
Expectation Gap																						10				1	10	0.4%
	100	**###**	**100**	**###**	**100**	**###**	**100**	**###**	**100**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**###**	**100**	**192**	**2,500**	**100%**

The Institute of
Chartered Accountants
of Pakistan

Final Examination
Module F
3 December 2014
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Auditing

Q.1 ABC and Company, Chartered Accountants, have been appointed as the auditor of Neptune Limited (NL). During the audit it has been revealed that:

(a) The previous auditor's working papers are available; however, they are not of required standards. **(08)**

(b) NL's operation involves significant and frequent transactions with related parties. **(09)**

Required:
Discuss the overall audit approach and related audit procedures to address the above issues. Also state the possible implications on the audit report.

Q.2 You are the engagement partner on the audit of Mars Limited, for the year ended 30 September 2014.

On commencement of the review of working paper file, the audit manager has informed you that the audit report would need modification. The following draft modification is available in the file:

> "We draw attention to note 10 to the financial statements that fully explains that amount of Rs. 70 million due from Utopia Limited (UL), that is outstanding since September 2013, is not recoverable as UL is in the process of winding up from 20 December 2013. Therefore, the said amount has been fully provided for in the financial statements of the current year due to which the company has incurred loss during the year. As the revenue from UL amounts to 40% of total revenue of 2013, we are of the view that it is fundamental to users' understanding of the financial statements. Our opinion is not qualified in respect of this matter.
>
> The financial statements for the year ended 30 September 2013 were audited by another auditor who expressed an unmodified opinion on those statements on 25 December 2013."

The draft financial statements show a loss of Rs. 92.4 million (2013: Profit of Rs. 16.4 million) and total assets of Rs. 395 million (2013: Rs. 410 million).

Required:

(a) Evaluate all the facts from the information available above and state the actions the auditor needs to take on the basis of evaluation. **(12)**

(b) Making necessary assumptions on the basis of the above information, draft an appropriate modification on any one matter, to be included in the audit report. **(05)**

Q.3 Your firm has been appointed as an advisor to Jupiter Limited (JL) an unlisted public company, which is an assurance client of your firm. JL wants to dispose of its shares in Pluto Limited, to a foreign buyer. As part of the assignment, your firm is required to act as an intermediary between the foreign buyer and JL, negotiate the payment terms, receive payments on behalf of JL and ultimately make disbursement to JL after the transfer of shares.

Required:
Identify the nature of threat(s) involved and explain how you would meet your professional obligations and responsibilities while carrying out the above assignment. **(10)**

Q.4 You are the auditor of Reliable Generators Limited (RGL) for the year ended 30 September 2014. RGL is primarily engaged in the business of manufacturing and sale of generators. The generators are supplied all over the country through a network of distributors.

On receipt of order from a distributor, the order is recorded electronically and transmitted to the factory. 100% payment is received in advance. Following are the extracts from draft financial statements provided by the client:

Income statement for the year ended 30 September

	2014 (Draft)	2013 (Audited)
	------------ Rs. in '000' ------------	
Revenue	60,222	59,638
Purchases	42,676	40,848
Gross profit	21,249	19,681

Statement of financial position as at 30 September

	2014 (Draft)	2013 (Audited)
	------------ Rs. in '000' ------------	
Trade payables	1,653	1,895
Provision for warranty claims	1,265	1,193

Other related information is as follows:

(i) Effective 01 October 2013, in order to match its competitors, RGL has increased the warranty period from 3 to 5 years.

(ii) A discount of 20% was offered to address the issue of reduced demand witnessed in the 3rd quarter. As a result of the discount, the situation improved significantly, during the 4th quarter.

(iii) In August 2014, serious defects were discovered in one of the major components. Consequently, significant quantity of such components was returned to the supplier. However, the return was recorded in September 2014 on receipt of supplier's credit note.

(iv) Scanning of the suppliers' ledger accounts revealed various payments for which no satisfactory reply was given by the management. However, said amounts were recovered before the year end.

Required:
Identify and evaluate the audit risks in the above situation and how would you respond to these risks. **(15)**
(Note: Routine verification steps may not be mentioned)

Q.5 (a) An audit client has approached your firm for advice on various issues concerning a financing arrangement. The client has provided you information regarding terms of financing offered by three different financial institutions including draft agreements which the client may be required to sign.

Required:
Identify threats involved in the above case and also suggest related safeguards, if any. **(06)**

(b) Assuming that two of the above financial institutions are audit clients of your firm, explain whether such situation would result in a conflict of interest, under the Code of Ethics for Chartered Accountants. **(04)**

Q.6 You are involved in the audit of Modern Furniture Limited (MFL), for the year ended 30 September 2014. The client has provided you a draft profit and loss account which is as follows:

	30-Sep-2014	30-Sep-2013
	-------- Rs. in million --------	
Sales	223.14	196.54
Cost of sales	(151.74)	(147.40)
Gross profit	71.40	49.14
Operating expenses	(43.78)	(31.52)
Profit before taxation and financial charge	27.62	17.62
Financial charge	(3.82)	(3.04)
Profit before taxation	23.80	14.58
Taxation	(6.80)	(4.96)
Profit after taxation	17.00	9.62

Certain other information obtained from the management is given below:

(i) MFL mainly sells its products through its own retail outlets and franchises. During the period under review, MFL had established five new retail outlets in different cities.

(ii) After a lapse of 18 months, MFL had increased the price of its products by 12% effective 1 April 2014.

(iii) The raw material prices increased by 5% in October 2013.

(iv) Effect of annual increment in salaries was 8%.

(v) Salaries of non-manufacturing employees have increased from Rs. 22 million to Rs. 28.2 million. There were 120 such employees on the payroll on 30 September 2014. 15 new employees were hired for new retail outlets whereas one employee retired during the year.

Required:
Evaluate the above financial data in the context of information provided by the management and specify the matters requiring further explanations from the management. **(10)**

Q.7 The following situations have arisen at different audit clients of your firm. The year end in each case is 30 September 2014.

(a) Galaxy Limited has a policy to carry its building at revalued amounts. In the financial statements for the year ended 30 September 2014, the revalued amounts were stated on the basis of valuation report issued by Buildings Valuation Experts (BVE). However, during the audit it was accidentally discovered that prior to valuation by BVE, another valuation exercise was carried out, which was done by Accurate Valuers Enterprise. **(07)**

(b) The financial statements of Modern Technologies Limited, a company involved in manufacturing of customized machinery and parts, reveal that the company has paid an advisory fee of Rs. 100 million to a non-executive director according to an agreement approved by the board of directors. The advisory services were rendered in connection with an agreement with Burewala Tractors Limited, for supply of customized parts. Total operating expenses amount to Rs. 282 million (2013: Rs. 161 million). The profit before taxation is Rs. 350 million (2013: Loss before taxation of Rs. 120 million) **(07)**

(c) Your firm has issued an audit report on the financial statements of Earth Limited. In the published annual report which was received along with the notice of annual general meeting, you noted that certain disclosures that were agreed to be included in the directors' report were missing. **(07)**

Required:
Discuss the matters which the auditor should consider and the steps that he may need to take, in each of the above situations.

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination	4 June 2014
Summer 2014	100 marks – 3 hours
Module F	Additional reading time – 15 minutes

Q.1 You are the manager responsible for the audit of Health and Beauty Brands Limited (HBBL) for the year ended 31 March 2014. HBBL has been selling its products through its own retail outlets only. However, during the year under review, HBBL had entered into an agreement for sale of its products at JDS, a chain of departmental stores.

Following information is available in respect of the above:

- According to the agreement, JDS would make payments within 30 days of the sale to customers. Any unsold/expired products would be returned to HBBL.
- The stock sheets provided by JDS to HBBL revealed differences as compared to the balances appearing in the HBBL's inventory system. According to JDS these were due to posting errors in the system of JDS, and have been subsequently corrected. HBBL's management is of the view that such differences are not material as compared to sales made through JDS.
- There is a significant improvement in the operating results of HBBL. The management considers that the agreement with JDS has played a major role in such improvement.
- The confirmation sent to JDS was not received. Alternatively, the audit team had examined partial payment amounting to 65% of the outstanding balance upto 31 May 2014.

Required:
Discuss with reasons, what course of action you would adopt in the above situation and the possible impact thereof on the audit report. **(14)**

Q.2 You are the quality control partner in a firm of chartered accountants. The following independent situations are under your consideration.

(a) Kamal, a manager in the firm is assigned on deputation for training of the newly hired staff in the accounts department of a brokerage house. The brokerage house is also an audit client of your firm. **(04)**

(b) Your firm has received a proposal from an audit client for implementation of a new IT system which the company has acquired. **(08)**

(c) The client has written a letter of appreciation showing their gratitude for the involvement and guidance provided by an audit manager on various issues regarding application of accounting standards. **(05)**

Required:
Identify and evaluate the threats involved and explain what actions should be taken in the above circumstances including the steps required, if any, to reduce the risks to an acceptable level.

Q.3 Diversified Businesses Limited is a listed company engaged in the business of manufacturing paints, pharma and chemicals. During the planning stage of an audit, the auditor has found that:

(a) The company has advanced a significant amount of Rs. 2.5 billion to a related party, for construction of an office tower. In the notes to the financial statements, it has been stated that transactions with related parties were carried out on arms length basis. **(08)**

(b) The audit committee meetings were not held during the year, because all audit committee members remained out of country. Consequently, the interim financial statements were issued by the company without being reviewed by the audit committee. **(04)**

Required:
Evaluate and discuss how the auditor should deal with the above situations.

Q.4 You are the audit manager responsible for audit of consolidated as well as separate accounts of Five Star Limited (FSL) and its subsidiaries. In the initial meeting, the financial controller has informed you that during the year:

(a) the group has changed its policy for valuation of plant and machinery from cost to revalued amount. The revaluation has been carried out by a global firm of professional valuers, who have been advising FSL for the last several years. **(08)**

(b) one of FSL's subsidiary has incurred substantial losses. Deferred tax has been recognized on these losses. The financial projections prepared by the CFO show that as a result of planned re-structuring, the subsidiary would be able to recoup the losses during the next three years. **(05)**

Required:
Describe the steps that you would take in each of the above situations.

Q.5 (a) You are a partner in a firm of chartered accountants, looking after the audit and advisory services department. One of your clients has approached you for services in relation to certification of compliance with a specific control framework, with regard to their production process.

Required:
What are the different types of reports that you can offer to the client, clearly specifying the key characteristics of each form of report. **(08)**

(b) Your manager has identified that the client should prepare a statement of compliance with the said control framework and your firm can only issue a report on that statement.

Required:
Identify the type of assurance engagement to which the manager is referring to and the key characteristics of such engagement. **(03)**

Q.6 Education For All Foundation (EFAF) is a large charity based organization, engaged in providing education to needy children, at a token fee of Rs. 100 per child. It receives donations for its activities both in cash and through its bank accounts. The major expenditure relates to payment to teachers and petty cash.

Required:
Briefly describe the key controls which you as an auditor expect to find in respect of receipts and payments. **(07)**

Q.7 You have been appointed as a manager in the audit department of Sachal Sarmast & Company, which is a medium size firm of chartered accountants. The audit of Consumer Products Limited has been assigned to you. This audit was previously assigned to another manager who has resigned. The predecessor manager has identified a number of risks. Two such risks alongwith their classification and related assertions are discussed in the working paper files.

The relevant extracts are as follows:

S.No.	Risk factor	Type of risk	Related assertions
(i)	Decentralized operating structure supported by different IT applications	Inherent risk	▪ Presentation and disclosures – occurrence and right and obligation and completeness
(ii)	Financial crisis	Significant risk	▪ Accounts payable – rights and obligations, valuation and completeness; ▪ Property and equipment – rights and obligations; ▪ Accounts receivable – valuation; ▪ Inventory – valuation; ▪ Cash – valuation; ▪ Turnover – occurrence

Required:
Do you agree with the above risk assessments? Discuss. **(10)**

Q.8 Shakeel Foods Limited (SFL) manufactures a variety of food products. The incharge of the audit team at SFL has requested you to advise on the following issues:

(a) During an informal discussion with a company's employee, he came to know that SFL is in litigation with one of its competitors. However, the said case was not included in the list of cases provided by SFL nor was it mentioned by the legal advisor in his confirmation. On being confronted, the management has informed that they are in the negotiation phase with the competitor and intend to settle the dispute through payment of Rs. 150 million. **(10)**

(b) Stock in trade valuing Rs. 65 million is placed in a warehouse owned by Hameed Limited (HL). According to news reports, FIA has recently initiated an enquiry against HL for evading import duties and taxes. HL has confirmed the quantities of stock at year end. **(06)**

Required:
Discuss how the auditor should deal with the above situations.

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination	2 December 2013
Winter 2013	100 marks – 3 hours
Module F	Additional reading time – 15 minutes

Q.1 You are the audit manager of Ravi Pharmaceuticals Limited (RPL) for the year ended 30 September 2013. The draft financial statements disclose a profit before tax of Rs. 200 million (2012: Rs. 150 million) and total assets of Rs. 5 billion (2012: Rs. 4.8 billion).

The following matters arose during the course of audit and are under your consideration:

(a) RPL has been awarded a 20 year patent right for a new drug with a brand name of Dengcol. The drug has been developed at a cost of Rs. 400 million. **(10)**

(b) As part of the Dengue Control Programme, the Government had provided a conditional grant of Rs. 150 million to RPL for development of Dengcol. Under the terms of the grant, RPL was required to sell 40% of the total production to the Government Hospitals subject to a minimum of 1,000,000 vaccines per annum, for the next five years. **(06)**

Required:
Identify the matters that you should consider in the above situations, and state the audit evidence you would expect to find in your review of the audit working papers for the year ended 30 September 2013.

Q.2 Fawad Limited (FL) is a manufacturer of personal care products. FL intends to diversify its operations by entering into the packaged food business. For this purpose it intends to seek a financing of Rs. 2 billion from Ameen Commercial Bank Limited (ACBL). The company's CFO has prepared a five year cash flow forecast and has presented it to the bank. ACBL has requested your firm to review the forecast in consultation with FL and furnish a report thereon.

On reviewing the cash flow projections, you have noted the following:

(i)
- Cash sales constitute 80% of the total sales of the new business.
- Debtors turnover days related to current business are projected to be reduced from 75 days to 30 days.

(ii) In the forecast, 24% of the income is under the head "Income from an associate", which is the management's estimate of the company's share of the associate income. The associated company has confirmed the amounts which are incorporated in the forecast; however no other details are available with FL to support this assumption.

Required:

(a) Comment on the above situations and briefly discuss the steps that you would take in the given circumstances. **(12)**

(b) Assuming that your firm decides to modify the report on prospective financial information, draft the basis for modification paragraph and opinion paragraph to be included in the report. ***(You may assume necessary details and choose to base the modification either on para (i) or para (ii) above)*** **(06)**

Q.3 You are the manager responsible for the annual audit of Tameer Limited (TL) for the year ending 31 December 2013. TL is a listed company and is engaged in the business of construction, renting and selling of apartments and office buildings to individuals, businesses and government departments.

Extracts from TL's draft Profit and Loss Account are as follows:

	2013 (Upto Nov)	2012
	-------Rs. in million-------	
Revenue	1,520	1,883
Operating expenses	(1,165)	(1,470)
Operating profit	355	413
Financial charges	(190)	(225)
Profit before tax	165	188

During the planning stage, the audit team has presented the following points for your consideration:

(i) On 31 January 2014 tenancy agreements of office buildings rented to municipal corporations in 15 small cities in the province of Sindh, are expiring. The concerned departments have informed TL that they would not renew the agreements. These properties are also held as security with the company's bankers.

(ii) In August 2013, an apartment block which was completed and sold in 2009 was severely damaged in an earthquake. The residents have filed a claim for damages against TL amounting to Rs. 400 million. The company denies any liability in this regard. However, to maintain its goodwill TL has agreed to compensate the residents by making a payment of Rs. 100 million in four quarterly instalments and accordingly this amount has been provided in the accounts. The residents have rejected the offer and filed a suit against the company.

(iii) During the year, construction equipment costing Rs. 300 million was acquired on lease. The lease rentals were allocated to the contracts on the basis of time utilized. Lease rentals pertaining to idle time were charged to financial expenses.

(iv) During the year TL sold a two storey office building to Ali Limited. According to the contract of sale, TL is entitled to construct further offices on the third and fourth floors.

Required:
Identify the audit risks that exist in the above scenarios and describe the manner in which you would address those risks. **(18)**

Q.4 Jhelum Machinery (Private) Limited (JMPL) is engaged in the manufacture of customised machinery. Recently a fraud has been discovered which was perpetrated by Salahuddin, the purchase manager. Salahuddin was responsible for approving the suppliers after obtaining and evaluating the competitive quotes and placement of orders. Final approval was made by the managing director.

Salahuddin had set up a private limited company Neelum (Private) Limited (NPL) in which his brother and wife are directors. NPL supplies spare parts to JMPL. The fraud was committed with the help of Karamat, a production supervisor and Farhan, the store keeper. The supplies delivered by NPL contained a large proportion of damaged spare parts. However, full payments were made to NPL as Farhan never raised any objections on the quality of goods received. On the other hand, Karamat issued inflated consumption reports to cover significant part of the damaged spare parts.

The fraud was discovered when Farhan went on leave due to illness. A review of inventory sheets indicates that large quantities of spare parts are still lying in inventory.

Required:
Identify the control weaknesses in the above situation which may have enabled the perpetration of fraud. **(06)**

Q.5 (a) Dynamic (Private) Limited (DPL) is a client of your firm. At the finalization stage of annual audit, it was discovered that a senior member of the assurance team is the co-owner of a property, for the possession of which DPL has filed a legal case. On investigation, the member informed that the said case is pending for the last three years and he did not consider necessary to disclose it at the time of commencement of audit.

Required:
Discuss the matters that should be considered and the course of action which may be followed in the above situation. **(07)**

(b) Murree Limited (ML) and Bhurban Limited (BL) are listed assurance clients of your firm. BL has filed a claim of Rs. 50 million in the court in respect of low quality of goods delivered by ML. Upto last year ML had not acknowledged the claim of BL. However, in the planning phase, you were informed by ML's management that in order to avoid bad reputation in the market and to continue its business relationship with BL, ML intends to settle the dispute by making a payment of Rs. 20 million to BL. The debt of Rs. 50 million is fully provided in the books of BL.

Required:
Being the auditor of both the companies, identify and evaluate the threats for the firm and explain how these can be reduced to an acceptable level. **(06)**

Q.6 Kabul (Private) Limited (KPL) has advanced Rs. 100 million to Qandhar Limited (QL), one of its suppliers of raw material. KPL and QL have recently signed an agreement whereby the above advance has been converted into a loan and QL has agreed to pay mark-up on the outstanding balance at prevailing market rates. QL has confirmed the amount of loan and the interest accrued thereon. However, you have acquired some information which suggests that QL is facing financial difficulties.

Required:
Discuss how you would deal with the above situation and possible implications thereof on the audit report. **(10)**

Q.7 (a) ABC and Company, Chartered Accountants, have been requested to give their consent for appointment as the auditor of Sindh Limited (SL), in place of XYZ and Company, Chartered Accountants. The matter of appointment of ABC and Company is to be placed in the annual general meeting of SL.

Required:
(i) Explain the responsibility of ABC and Company and the steps that it needs to take before acceptance of the audit. **(05)**
(ii) What would be the retiring auditor's responsibilities with respect to the above and the responsibility of ABC and Company, in case the retiring auditor does not fulfil its responsibility? **(05)**

(b) Assume that in (a) above XYZ and Company had qualified the previous year's audit report because it was unable to physically verify the factory building and to observe physical inventory count, due to law and order situation. However, during the course of current year's audit, ABC and Company was able to observe the physical inventory count and also carry out physical verification of the factory building as the law and order situation has improved.

Required:
Discuss the matters which you would consider in the above situation and the possible impact thereof on the audit report. **(09)**

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination	3 June 2013
Summer 2013	100 marks – 3 hours
Module F	Additional reading time – 15 minutes

Q.1 Qasmi Steels Limited (QSL) is a manufacturer of steel and iron products. During the year the company has incurred a net loss of Rs. 306 million. The following information is also available:

(i) At the year end, the company's accumulated losses amounted to Rs. 17 million whereas its net equity was Rs. 283 million.

(ii) During the year, QSL has defaulted in repayment of a loan. The management is however quite hopeful that the lender would agree to a rescheduling.

(iii) The management believes that the company's profitability has been hampered on account of soaring electricity prices along with a fall in demand for steel which have had a negative impact on the prices of its finished products. Moreover, its production has also suffered on account of the prevailing energy crisis. Consequently, the management has decided to discontinue its operations temporarily.

(iv) To counter the impact of high electricity prices, the company intends to convert its plant to run on gas as well.

(v) The management has informed you that it would need to install a gas converting unit which would be imported at a cost of Rs. 30 million. However, as the process of installing the gas conversion unit and completing the necessary formalities would take at least a year, therefore the management is negotiating to lease the plant to Nadeem Enterprises for a period of one year.

Required:

(a) Evaluate the above situation and state the procedures which you would perform as an auditor in the above situation. **(10)**

(b) Describe the implications of the above issues on the audit report. **(10)**

Q.2 You are the manager responsible for the audit of Dilawar Paints Limited (DPL). The draft financial statements for the year ended 31 March 2013 show revenue of Rs. 1,250 million (2012: Rs. 1,175 million), profit before taxation of Rs. 100 million and total assets of Rs. 1.2 billion.

The audit incharge has noted the following points for your consideration:

(i) In May 2012 a chemical leakage from one of the tanks in the factory caused a fire which damaged the plant and machinery and the premises. DPL has incurred Rs. 3 million in cleanup costs, Rs. 10 million for modernisation of tanks to prevent future leakages and a fine of Rs. 500,000 to a regulatory agency. The fine has been expensed whereas the remaining costs have been capitalised. **(08)**

(ii) While the tanks in the factory were undergoing modernisation, DPL had made arrangements with a nearby factory for storage of its chemicals. At the time of stock check you were informed that it is not possible to segregate DPL's stock from that of the other factory. According to DPL's record, the value of its stock of chemicals as at 31 March 2013 which is lying in the nearby factory is Rs. 200 million. The value of stock of chemicals as at 31 March 2012 was Rs. 120 million. **(08)**

Required:

Discuss the matters that you would consider and how would you obtain the necessary audit evidence.

Q.3 The following matters relating to different clients are under the consideration of Mr. Jameel, who is the engagement partner:

(a) The management of Muneer Limited had been illegally dumping its chemical waste in the neighbouring plot of land. When confronted, the chief financial officer, instead of providing an assurance to address the issue, informed the audit senior that the management is least bothered about the minor fines that may be levied by the regulatory agencies. **(07)**

(b) Abdullah was the audit senior assigned to the audit of Insha (Private) Limited. During the course of the audit, Abdullah had resigned from the firm. While reviewing the audit files Mr. Jameel has noticed that the audit fieldwork was completed in almost half the time than is usually required. **(06)**

Required:
Evaluate each of the above situations and briefly describe what course of action the engagement partner would be expected to adopt.

Q.4 You are the quality control partner of Nasir and Company, Chartered Accountants (NCC) and presently following matters are under your consideration:

(a) Your firm has issued an unmodified opinion on the financial statements of Salim Limited (SL) for the year ended 31 December 2012. The tax authorities have recently launched an investigation against SL, alleging that SL has under declared its income for the year ended 31 December 2012. NCC is also acting as the tax advisor of SL. **(09)**

(b) While appreciating the services rendered by your firm, the managing director of a client has informed the engagement partner that an audit trainee has helped him in the purchase of a plot of land. On investigation, the engagement partner was able to establish that the trainee works part-time in an estate agency and receives 0.5% commission on all deals. **(05)**

(c) Josh Limited (JL), an unlisted audit client of your firm has approached your firm to recruit a chartered accountant for the position of finance director in JL. In response to an advertisement published in the newspaper, NCC received various applications which include individuals working at some of your clients and some of your ex-employees. **(05)**

Required:
Identify and evaluate the threats involved and explain what actions you would take in the above circumstances including the steps required, if any, to reduce the risks to an acceptable level.

Q.5 Zubair & Shahid Limited is a distributor of personal care products. Its sales manager had committed a fraud by making sales to fictitious customers. Cheques received from various genuine customers were credited to these fictitious accounts to keep their balances within reasonable limits. The sales manager had the outstanding amounts, appearing against fictitious and genuine customers, written off by convincing the sales director that those customers were unable to pay their remaining balances. A total of 38 invoices amounting to Rs. 7.2 million were issued over a period of seven months. The fraud was detected when the sales manager had left the company's employment.

Required:
Identify the usual controls which may have been lacking in the aforementioned situation. **(06)**

Q.6 You are the job incharge on the audit of Ghalib Petroleum Limited (GPL) for the year ending 30 June 2013. GPL is engaged in the exploration and production of crude oil. The last year's audit file contains the following information:

- In 2005, GPL had entered into an agreement with the Government for exploration and production of oil for fifteen years. The licence for exploration was granted at a fee of Rs. 600 million.
- Under a separate agreement Mir Petroleum Limited (MPL), a 100% government owned entity, had guaranteed the purchase of all crude oil to be produced by GPL for a period of ten years from the start of commercial production i.e. 2008.
- The plant and equipment was imported in 2006 at a total cost of Rs. 6 billion which includes a decommissioning provision of Rs. 500 million. The cost of the plant was financed by GPL's parent company by way of a long-term foreign currency loan.

During the current year's planning stage, you have observed the following conditions:

(i) The problem of circular debts has become severe and as a result GPL as well as MPL have accumulated huge receivables and payables.

(ii) An environmental control agency has filed a suit alleging that at the time of abandoning one of its oil wells, GPL has failed to restore the site in accordance with the prescribed standards. The company believes that it has met all its obligations and plans to contest the case strongly.

(iii) Due to law and order situation the Government has not been able to provide infrastructure facilities as were agreed in the exploration agreement.

(iv) The management had budgeted a profit of Rs. 200 million for the current year but latest estimates suggest that the profit would be somewhere between Rs. 100 to Rs. 120 million.

Required:
Identify and evaluate the audit risks in the above situation and specify the audit procedures that you would perform to address those risks. **(16)**

Q.7 (a) Haali Limited has a policy to carry its buildings at revalued amounts. At the balance sheet date i.e. 31 December 2012, the valuer had finalised the valuation reports of only 3 out of a total of 8 properties. According to these reports these properties were assigned a valuation of Rs. 50 million as against the carrying amount of Rs. 62 million.

Required:
Evaluate the above condition and discuss the impact on the audit report in each of the following situations:

(i) The impairment of Rs. 12 million is recorded in the financial statements.

(ii) The impairment is not recorded. **(06)**

(b) During the year ended 31 December 2012 Chiragh Limited has changed its policy for valuation of investment in a subsidiary from the 'fair value' to 'cost'. Had the company continued with its previous policy for valuation of investment at 'fair value', the subject value would have been reduced by Rs. 50 million.

Required:
Discuss the matters which you should consider in respect of the above situation and the possible impact thereof on the audit report. **(04)**

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination — 3 December 2012
Winter 2012 — 100 marks - 3 hours
Module F — Additional reading time - 15 minutes

Q.1 You are the Audit Manager of Mustafa and Company, Chartered Accountants, responsible for the audit of Standard Home Appliances Limited, a listed company.

Extracts from the company's financial statements are presented below:

	30-Sep-2012	30-Sep-2011
Income statement	----------Rs. in million---------	
Revenue	1,190	1,174
Gross profit	509	537
Operating profit	242	227
Finance charges	(77)	(69)
Profit before tax	165	158
Statement of financial position		
Property, plant and equipment	1,054	833
Intangible assets	140	100
Inventory	423	260
Trade receivables	417	250
Cash and bank balances	29	54
Total assets	2,063	1,497
Equity and liabilities		
Share capital	1,000	1,000
Retained earnings	218	233
Long-term borrowings	277	50
Liabilities against assets subject to finance lease	180	-
Bank overdraft	185	52
Trade and other payables	203	162
Total equity and liabilities	2,063	1,497

During the year, the company has introduced various products based on latest technologies. These new products are being manufactured on a new plant which has been acquired under a lease agreement for a period of four years. The plant commenced operations on 01 January 2012. The useful life of the plant is 5 years.

Intangible assets represent cost of software installed and designs which have been acquired from a renowned multinational company.

Required:
Identify and evaluate the audit risks in the above situation. **(12)**

Q.2 Identify and evaluate the threats involved and explain how these threats can be reduced to an acceptable level, in each of the following situations:

(a) During the year, Jamil Limited (JL) had acquired Sarfraz Limited (SL) and the companies were subsequently merged. The due diligence exercise for the acquisition was performed by the same firm which carries out the annual audit of JL. At the time of planning, the auditor found that a significant provision has been made against SL's inventories and accounts receivables. The management informed the auditor that the fact that the value of these assets was impaired came to its knowledge after taking control of SL. JL and SL are unlisted public companies. **(10)**

(b) A limited assurance engagement has been accepted at a fee which is lower than the fee charged by the predecessor auditor. **(03)**

Q.3 (a) The audit report of Bhit Gas Limited (BGL) was qualified on account of recognition of mark-up on delayed payment from Salim Enterprises Limited (SEL) amounting to Rs. 2.7 billion, because at the time of signing of audit report, SEL had not acknowledged its liability towards mark-up due to BGL and the matter was pending in the Court.

After the issuance of the financial statements, the matter was decided by the Court and SEL was ordered to settle the mark-up by paying Rs. 1.5 billion. After the Court's decision, BGL had filed an appeal against the order for the remaining amount of Rs. 1.2 billion and the management has requested the auditor to remove the qualification and issue a revised audit report. The management has also informed the auditor that subsequent to the Court's decision, it has decided to revise the financial statements by making a 25% provision against the remaining amount of mark-up.

Required:
Discuss the factors that the auditor should consider with reference to the above and specify the steps that he should take under each of the following circumstances:

(i) The management and those charged with governance are prohibited by law and regulation from restricting the amendment and approval of the financial statements to the effect of the above event.

(ii) The management and those charged with governance are not prohibited by law and regulation from restricting the amendment and approval of the financial statements to the effect of the above event. **(17)**

(b) Identify and explain the shortcomings in the following paragraph of the draft audit report of Javed Limited:

Emphasis of Matter:
We draw attention to the fact that the company has accumulated losses of Rs. 115,436,540 (2011: Rs. 85,365,479) and certain payments against long term loans were overdue as at the reporting date. As at 30 September 2012, its total liabilities exceeded its total assets by Rs. 15,450,300 (2011: Rs. 11,542,200). These conditions indicate the existence of a material uncertainty that the company may be unable to continue as a going concern. **(04)**

Q.4 The statutory auditor of Mighty Limited (ML) has expressed an adverse opinion in the audit report on the financial statements of ML for the year ended 30 June 2012. After the issuance of the annual report, ML has approached the auditor for reporting on the trade debts of the company as on 30 June 2012. This report is required for submission to the bank which has provided financing facilities to ML. The audit working papers reveal that the trade debts have been reported correctly in the financial statements.

Required:
Discuss what may be the auditor's response in the above situation. **(06)**

Q.5 (a) Describe the implications on the audit report where the prior year's audit has been conducted by another auditor. **(04)**

(b) You are the audit manager of Wasim Limited for the year ended 30 June 2012. The previous year's audit was performed by another firm of chartered accountants who have expressed an unmodified opinion. The following issue has been brought to your notice by the audit team:

The company has written off intangible assets amounting to Rs. 30 million in the current year because the new CEO believes that the expenditure does not meet the criteria for capitalization as per the International Financial Reporting Standards. The said amount was capitalized during the year ended 30 June 2011. The profit before tax for the year ended 30 June 2012 is Rs. 52 million (2011: Rs. 91 million).

Required:
Describe the steps which the auditor needs to take in the above situation and explain the implications on the audit report assuming that the auditor is satisfied with the valuation of intangibles as on 30 June 2012. **(11)**

Q.6 TFL has recently applied for listing on a Stock Exchange in Pakistan. Following information has been extracted from TFL's financial statements for the year ended 30 June 2012.

	Rs. in 000
Issued, subscribed and paid up capital - Ordinary shares	4,000,000
Issued, subscribed and paid up capital - Non redeemable preference shares	600,000
Share deposit money- Non redeemable preference shares	3,000
Un-appropriated profit	30,000
Unrealized gain on re-measurement of available for sale investments (net of tax)	500,000
Surplus on revaluation of fixed assets	120,000
Unpaid dividend on preference shares	75,000

The face value of both types of shares is Rs. 10 each. Preference shares are convertible into ordinary shares at any time after listing of ordinary shares. The conversion price shall be Rs. 10 per ordinary share. For the purpose of conversion, unpaid dividend on preference shares, accumulated up to the date of announcement of conversion by the company, shall also be taken into account for determining the number of ordinary shares to be issued upon conversion.

Required:
On behalf of the auditors of the company, draft a report on factual findings on break-up value of shares for submission to the client **(16)**

Q.7 The audit of Karim Limited (KL) is in progress. The audit team has requested you to advise on the following issues:

(a) The confirmation request sent to a customer who owed Rs. 35 million was responded by an e-mail addressed to KL's CFO.

(b) The management of KL is not allowing auditors to send confirmation to Fareed Limited (FL), on account of certain disputes, as the sending of confirmation will undermine the ongoing negotiations with FL. However, the management has offered to provide specific written representation on the matter.

Required:
Discuss how the auditor should deal with the above situations. **(17)**

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination	4 June 2012
Summer 2012	100 marks – 3 hours
Module F	Additional reading time – 15 minutes

Q.1 You have been appointed as the auditor of Tee Pharmaceuticals Limited (TPL) for the year ended 31 March 2012. An extract from the draft financial statements is presented below:

Income statement	**2012**	**2011**
	Rs. in million	
Revenue	48,970	47,500
Finance charges	3,000	1,200
Profit after tax	70	600

Statement of financial position	**2012**	**2011**
	Rs. in million	
Intangible assets	7,000	3,000
Stocks	27,000	15,500
Trade receivables	13,800	11,500
Share capital (Rs. 10 each)	20,000	20,000
Retained earnings	1,170	1,100
Long term loans	10,500	3,000
Short term loans	27,000	15,000

During the planning process, you have gathered the following information:

(i) TPL's operations were highly successful until 2008. However, due to increased competition the profitability has reduced significantly over the last four years. Consequently, the company has embarked upon an ambitious plan whereby it has taken the following steps:

- Three new products have been introduced for which patent rights have been purchased. The new products were introduced in the market in December 2011.
- A new plant has been acquired which is expected to reduce the cost of production significantly.
- The above measures have been financed through a bank loan against hypothecation of stocks and trade receivables.

(ii) TPL has had a dispute with a major distributor who alleges that products were delivered in damaged packets and the quantities therein were short as compared to the numbers mentioned on the packets.

(iii) A franchisor has initiated a legal action against the company on grounds of infringements of patent rights.

(iv) TPL had entered into a one year agreement with a foreign supplier for supply of raw material. On 20 April 2012 the government of the country in which the supplier is registered, has initiated legal proceedings against that supplier for breach of quality standards. Consequently, the government of the country in which TPL is operating has banned all imports from that supplier.

Required:
Identify the audit risks that exist in the above scenario and the manner in which you would address those risks, during the audit under the following headings:

(i) Raw materials
(ii) Trade receivables
(iii) Intangibles
(iv) Liquidity issues

(19 marks)

Q.2 The following situations have arisen at different audit clients of your firm:

(a) Zafar Technology Limited (ZTL), a listed company, is engaged in the manufacture of compressors used in electrical appliances. During the conduct of the audit for the year ended 31 March 2012, a team member has discovered a letter dated 18 March 2012 from Sartaj Electronics Limited (SEL) which states that SEL will not pay the current outstanding invoices as according to it the compressors supplied by ZTL are of an incorrect specification.

ZTL's Technical Director believes that the problem arose due to changes in the design of appliances produced by SEL and not because of faulty production by ZTL. However, both the companies have agreed to refer the matter to arbitration.

Sales to SEL account for approximately 25% of the revenue of ZTL and the balance due from SEL as at 31 March 2012 amounted to Rs. 3.12 million. The profit after taxation of ZTL is Rs. 25 million with an asset base of Rs. 150 million. ***(07 marks)***

(b) The directors' report of XCP Limited states without any further explanation that the 20% increase in profit as compared to the previous year is due to increase in sales and austerity measures introduced by the management. The income statement for the year shows an increase in profits and sales amounting to Rs. 20 million and Rs. 8 million respectively whereas the costs have reduced by Rs. 12 million. A review of your working papers however indicates that costs have reduced mainly on account of reduction in import duty on certain raw materials. ***(04 marks)***

(c) IPL is a manufacturer of diversified products and has factories in seven major cities of the country. The demand for some of its products has been falling and the company wants to concentrate on its core products only. Consequently, it has decided to close three of its factories and has made a provision of Rs. 30 million in respect of redundancies and restructuring. The directors' report for the year ended 31 May 2012 comprehensively discusses the restructuring plan and states that the factories in Lahore and Multan would be closed in the months of July and September 2012 respectively. The third factory will be closed before December 2012 however, the location of that factory will be decided in November 2012.

The profit after taxation of IPL according to its draft financial statements for the year ended 31 May 2012 is Rs. 80 million. ***(06 marks)***

Required:
Discuss the matters which the auditor should consider for each of the above situations and the possible impact thereof on the respective audit reports.

Q.3 You are the quality control partner in Wiew and Company, Chartered Accountants. You have been assigned additional responsibilities for assessment of risks associated with the firm's existing and proposed clients. At present, the following matters are under your consideration:

(a) The government has invited 'expression of interest' for selling its strategic shares in Iqbal Limited (IL). One of your clients' Zain Limited is interested in the deal and has requested your firm to carry out a due diligence exercise. Mian Limited has also approached your firm for carrying out a business valuation of IL.

(b) JKL Limited, a listed audit client of your firm, has been in dispute with a supplier. JKL is of the view that it has suffered losses on account of breach of contract by that supplier. JKL intends to file a suit in a civil court and has asked you to estimate the amount of damages that may be claimed and provide a detailed calculation thereof.

Required:
Discuss the categories of threats involved in each of the above situations and advise the partners as regards the possible course of action that may be followed. ***(16 marks)***

Q.4 (a) XYZ Company Limited intends to seek a financing of Rs. 250 million from their bankers in order to implement the board's latest expansion proposal. The company's CFO has prepared a five years 'cash flow forecast' based on management's estimates for presentation to the bankers. The company has requested your firm to review the forecast and furnish a report thereon.

Required:
Explain the matters which your firm would consider before accepting the above engagement. ***(10 marks)***

(b) Assuming that your firm has accepted the above engagement and during the course of the review, a significant reduction in the cash outflows on account of income tax has been noted in the years 3, 4 and 5. The management has informed that the taxation authorities have principally agreed to reduce tax rates for companies operating in the 'industrial zone' in which the company is situated and the announcement of the reduction in tax rates will be made in the next budget. However, the management has not provided any evidence to support their claim. The impact of this assumption is Rs. 5 million for each year.

The management has justified its stance by stressing that the assumption related to the tax rates has been clearly disclosed in the prospective financial information.

Required:
Evaluate the above situation and briefly discuss the steps that your firm should take. ***(06 marks)***

Q.5 A regulatory body has recently revised certain requirements pertaining to the information to be disclosed in the financial statements of one of your existing clients. These requirements may be in conflict with the financial reporting framework being followed by the client.

You have informed the client that in view of the possible conflict, the audit report may require a modification. However, the client has expressed its reservations over the issue and requested you to avoid modifying the report.

Required:
(i) Based on the requirements of the relevant International Standards on Auditing draft an appropriate response to the client, explaining the possible reasons for modification and the circumstances in which such a modification may be avoided. ***(07 marks)***
(ii) Assuming that you decide to modify the audit report, on grounds as you consider appropriate, draft the basis for modification paragraph to be included in that report. ***(06 marks)***

Q.6 You are the audit manager of Paidar Tameerat Limited (PTL) for the year ended 31 May 2012. PTL is a listed company and is engaged in the construction of high rise buildings including residential and commercial complexes.

Last year serious differences of opinion had arisen with the management of PTL while determining the stage of completion of certain projects. The matter was ultimately resolved after an independent valuer had rendered a report and on which the auditor had placed reliance. This year the management has employed an engineer to monitor the various projects. The engineer has reported minor discrepancies in the estimates provided by various project managers.

Required:
Assess the above situation and discuss how you would address the related issues during the course of the audit. ***(07 marks)***

Q.7 Mr. Mahmood is the engagement partner for the audit of Khyber Limited (KL), a listed company. In a meeting of the partners of the firm he had declared that Better Life Trust (BLT), in which he is a trustee, intends to purchase fifty thousand shares of KL from the open market.

Required:

(a) State how should the firm deal with the above situation. ***(07 marks)***

(b) What would the firm's response be if Mr. Mahmood inadvertently fails to disclose the above fact before the purchase of shares and it comes to the knowledge of the firm after the shares have been purchased? ***(05 marks)***

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examination	9 December 2011
Winter 2011	100 marks - 3 hours
Module F	Additional reading time - 15 minutes

Q.1 Your firm has recently been appointed as the statutory auditor of Chaudhry Limited (CL) for the year ending 31 December 2011. The previous auditors, from whom your firm has received professional clearance, did not wish to be re-appointed as auditors.

CL is involved in the supply of imported consumer products. The company has its own retail outlets in all major cities. It also supplies goods to large retailers most of whom are allowed 45 days credit.

Time required to import the goods is approximately two months. 50% of the amount is paid at the time of booking of order and the remaining amount is paid at the time of receipt of goods. The goods are required to be insured by CL.

CL's suppliers are mainly based in Middle East. Due to political disturbances, a major supplier has recently ceased its operations.

All imported goods are initially placed in a warehouse in Karachi. Supplies are made against orders which are mostly received over telephone by the sales department. The warehouse in-charge prepares a summary of all dispatches which is approved by the sales manager, on a daily basis. Stock records are computerised. Physical stock taking is carried out on a regular basis, at the warehouse as well as retail outlets. Therefore, a 100% physical count is not undertaken at the year-end.

Day to day expenses of the retail outlets are paid out of cash receipts from customers. Balance cash is deposited into the bank on a daily basis.

The management accounts show that the company has not been able to achieve the sales target for the current year although the sales have increased by 12% as compared with the same period in 2010. Stocks and trade debtors have significantly increased and the management attributes this to be on account of increase in sales.

CL is planning to expand its business and intends to fund the expansion through a bank loan. CL's existing bankers have declined to increase the borrowing limits and therefore, the company has approached another banker for the loan. The management has requested you to complete the audit by 15 February 2012 to enable it to submit the audited financial statements to the new bankers.

Required:
Identify and evaluate the audit risks in the above situation and specify the audit procedures that you would perform to address those risks. ***(22 marks)***

Q.2 You are the engagement partner on the audit of Faraz Industries Limited. The company has recently started using internet to carry out its business activities and the share of business conducted through e-commerce is growing rapidly.

Required:
(a) Identify the matters that you believe would be relevant while updating your knowledge of the company's business. ***(04 marks)***

(b) Identify the business risks related to the company's e-commerce activities. ***(09 marks)***

(c) Identify the matters that need to be addressed in order to ensure the integrity of the transactions carried out through the company's website. ***(07 marks)***

Q.3 You are the quality control partner in Pirzada and Company, Chartered Accountants. The following matters are under your consideration:

(i) Your firm has been approached for appointment as external auditors of Watto Limited (WL), a listed company. Your firm has been providing valuation services to WL.

(ii) To evaluate the network security system of Babar Limited (BL), your firm had acquired the services of a Systems Auditor. The Finance Director of BL has accused the Systems Auditor for compromising information relating to the company's customers and providing their contact details to a competitor.

(iii) Your finance department has issued an invoice to Qamar Software Services (QSS) against referral fees for recommending services of QSS to an assurance and a non-assurance client. Your permission has been sought before sending the bill to QSS.

Required:
Identify and evaluate the threats involved and explain what action would you take in the above circumstances including the steps required, if any, to reduce the risk to an acceptable level. ***(16 marks)***

Q.4 As the audit partner responsible for the audit of Mubashar Limited (ML), you have recently issued an audit report on ML's annual financial statements.

The audit senior involved in the audit of another client Salman Limited (SL) has informed you that SL's records indicate that it has made purchases worth Rs. 37 million from ML. Since the same audit senior was also involved in the audit of ML he knows that SL and ML are associated companies and ML had not disclosed any related party transactions in its financial statements. This fact has also been confirmed from the working papers of both the companies. Payments against these purchases were made in the name of ML by way of crossed cheques.

Required:
Discuss the factors that you will consider with reference to above and specify the action that you would take in this regard. ***(20 marks)***

Q.5 Ghulam Limited (GL) is a listed company. You have issued an audit report on GL's financial statements for the year ended 30 June 2011. In November 2011, the management of GL has approached your firm to provide a report on their summary financial statements for the year ended 30 June 2011.

Following information is available:

(i) The audit report on the annual financial statements had been qualified on account of management's failure to capitalize borrowing costs of Rs. 15 million, on the construction of a building for GL's own use. The building is in use of the company since January 2011.

(ii) Under a local regulation which has recently been introduced, you are required to issue a report on the summary financial statements. However, there are no established criteria for the preparation of summary financial statements. The management has developed the criteria but which is not acceptable to you.

(iii) The summary financial statements include a note which explains the reasons for decline in the profitability of the company. You concur with the reasons given in the note but it did not form part of the annual audited financial statements.

Required:
Evaluate each of the above situations considering them to be independent of each other and discuss what measures would you take in each case. ***(09 mark)***

Q.6 You are the manager responsible for the audit of Hafiz Limited (HL), a listed company, whose fieldwork in respect of the statutory audit is in progress. You are reviewing the following issues which were brought to your attention by the audit team:

(i) HL's parent company is registered in a foreign country and has asked your firm to also provide an audit report on a separate set of financial statements which have been prepared under the accounting framework prevalent in that country.

(ii) HL has paid a substantial amount of consultancy fee to a firm in another foreign country. The management of HL is unable to provide a convincing explanation for such a payment. An employee of HL has unofficially informed the audit senior that the amount was paid to avoid paying a fine. However, the management has denied this allegation.

Required:
Discuss how would you deal with each of the above issues and what may be the implications thereof on your audit report. ***(13 marks)***

(The End)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examinations
Module F – Summer 2011

Reading time – 15 minutes

June 6, 2011
100 marks – 3 hours

Q.1 You are the engagement partner responsible for the audit of Saleem Auto Parts Limited (SAPL), a listed company. SAPL supplies auto parts to three large motor car assemblers which are listed on the Karachi Stock Exchange. Your review of the working paper files has disclosed that the company has been facing liquidity issues for the last few months. You have also been informed that subsequent to the year-end, SAPL has defaulted on one of its long term loan instalments.

SAPL's directors have assured that this liquidity crunch is for a short span of time. To substantiate their assertion they have provided cash flow projections for the next four years. An important assumption in the cash flow projections is that agreements with all the motor car assemblers would continue for the foreseeable future. However, during the year, one of the motor car assemblers, Pannu Motors Limited (PML), has incurred substantial losses and has announced to close down one of its plants.

Required:
(a) State the audit procedures which your firm should perform in the above situation. ***(05 marks)***
(b) Identify and explain the implications of the above issues on the audit report. ***(09 marks)***

Q.2 You are the audit manager responsible for the audit of Laila Pharmaceuticals Limited (LPL), a listed company, for the year ended March 31, 2011. During your initial meeting with the chief executive officer and the chief financial officer of the company the following issues have been brought to your attention:

(i) At the year end, the net assets of LPL have reduced to Rs. 270 million (2010: Rs. 310 million). A comparison of the draft income statement with the declared results for the nine months ended December 31, 2010 is as follows:

	Nine months ended December 31, 2010	**Year ended March 31, 2011**
	------------- Rupees in million	**--------------**
Revenue	500	530
Cost of sales	(400)	(477)
Gross profit	100	53
Operating expenses	(70)	(90)
Financial charges	(15)	(20)
Operating profit / (loss)	15	(57)
Gain on sale of property	-	20
Net profit/(loss) before tax	15	(37)

(ii) On April 1, 2010 LPL had acquired 45% shareholdings in Sohni (Private) Limited (SPL). The spouse of a director of LPL is a director in SPL.

(iii) On May 1, 2010 LPL purchased new office premises from SPL for Rs. 40 million. In January 2011 these premises were sold to Anarkali Limited (AL), an associated undertaking of LPL, for Rs. 60 million. Subsequent to the sale, LPL signed a five years' agreement with AL to acquire the office premises on a rent of Rs. 12 million per annum.

Required:
Assess the above matters and discuss how you would address the related implications during the course of the audit. ***(20 marks)***

Q.3 Your firm has been appointed as the auditor of Jugnu Limited (JL), which is a manufacturer of consumer products. The auditor's report on the preceding year's financial statements was unmodified. The draft financial statements for the year ended April 30, 2011 disclose a profit before taxation of Rs. 75 million (2010: Rs. 155 million) and total assets of Rs. 2,100 million (2010: Rs. 1,910 million).

You are the audit manager at JL. The following issues arose during the audit and now require your attention:

(i) JL incurred an expenditure of Rs. 25 million on the development of five new products. It is expected that these new products would generate future economic benefits.

(ii) On July 1, 2008 JL had acquired four high-tech machines for Rs. 200 million which are being depreciated over a period of 10 years on the straight line method. JL did not have the expertise to operate the machines and had entered into an agreement with Umer Limited to operate the machines. The contract is expiring on June 30, 2011 and Umer Limited has shown its inability to continue after the expiry of the contract.

Required:

(a) Describe the principal audit procedures to be carried out for verifying the opening balances of the financial statements of Jugnu Limited for the year ended April 30, 2011. ***(04 marks)***

(b) For each of the above issues, comment on the matters that you should consider and state the audit evidence that you expect to be available. ***(12 marks)***

Q.4 Ranjha Limited (RL), a listed company, is engaged in the manufacture of fast moving consumer goods. The draft financial statements for the year ended March 31, 2011 show a profit before taxation of Rs. 12 million and total assets of Rs. 300 million.

As the audit manager, you are reviewing the following issues which were brought to your notice by the audit team :

(i) On June 1, 2010 RL acquired a plant at a cost of Rs. 50 million. The plant has a useful life of 10 years with no residual value. RL follows the policy to depreciate the plant on the straight line method. On January 1, 2011 the plant suffered physical damage due to a fire in the factory. The technician from the manufacturer has inspected the plant and reported that the damage has affected its production capacity which has now been reduced by 30%.

(ii) During the year a petition has been filed against RL by one of its customers for recovery of Rs. 20 million, alongwith mark-up, damages and compensation, on the ground that materials supplied by RL were defective. RL has filed a written statement in the Court denying the allegations.

RL's legal advisor is of the view that the final liability of the company may range from 0% to 50%. However, at this point of time, it is not possible to determine the amount with reasonable degree of accuracy. No provision in this regard has been made in the draft financial statements.

(iii) In April 2007, RL acquired a high-tech production management software for Rs. 10 million. The useful life of the software is 10 years. During the year it was discovered that in the past the software was erroneously amortised assuming a useful life of 20 years.

The management has decided to adjust the amount short provided, over the remaining useful life of the software.

Required:

Discuss the matters that may be of significance to you as an auditor in respect of each of the above issues. Also explain their implication on the audit report. ***(12 marks)***

Q.5 You are planning the statutory audit of the financial statements of Mahiwal Limited (ML) for the year ending June 30, 2011. ML sells and distributes networking equipment and accessories to corporate and retail customers. Since January 1, 2009 ML has exclusive country-wide distribution rights of 'Bisco' and 'Portel', which are the leading international brands of networking equipment.

Your review of the prior year's working papers has disclosed that ML has expanded its operations significantly after securing the distribution rights of 'Bisco' and 'Portel'. By June 30, 2010 there had been a 60% increase in its customer base whereas the number of its branches had increased from 3 to 10 and the number of employees had risen from 30 to 115. The latest available draft financial statements show that the sales of 'Bisco' and 'Portel' represent 90% of its total sales.

During a recent meeting with the finance director, you have been informed as follows:

(i) ML has shifted its warehouse and customer service centre to larger premises in order to handle the increased inventory level and the rising level of after sales warranty claims.

(ii) ML has witnessed a slight fall in sales of 'Bisco' and 'Portel' because of tough competition from other low priced brands.

A review of the draft financial statements has also disclosed that ML had revalued a property in accordance with the requirements of the International Financial Reporting Standards. The property was acquired many years ago to earn rental income.

Required:
(a) Identify and evaluate the audit risks in the above situation. ***(12 marks)***
(b) Discuss an audit strategy to take into account the identified risks in the overall audit plan. ***(03 marks)***
(c) Enumerate the key audit procedures to be conducted to assess the appropriateness of the revaluation of property and the accounting treatment thereof. ***(08 marks)***

Q.6 You are the audit manager in Farhad and Company, Chartered Accountants. You have specific responsibility for assessing the risks associated with the firm's existing and proposed listed clients. Presently the following matters are under your consideration:

(i) Romeo Supermarket Limited (RSL), a large chain of super markets, has approached your firm to perform financial due diligence of one of your audit client, Juliet Limited (JL), which is a listed company. RSL intends to acquire 80% shareholding in JL.

(ii) Sherbano Limited (SL) has requested your firm to provide a consent letter for acting as its auditors. The wife of a partner in your firm is the Director Marketing in SL.

(iii) One of your assurance clients has requested your firm to provide consultancy services in relation to a proposed transaction with a company based in Singapore. As your firm does not have the expertise to undertake that assignment, it is considering to refer the assignment to Marvi & Company, Chartered Accountants. It is expected that your firm would receive a commission of 15% of the assignment fee from Marvi & Company.

Required:
Discuss the categories of threats involved in each of the above situations and advise the partners as regards the possible course of action that may be followed. ***(15 marks)***

(THE END)

The Institute of Chartered Accountants of Pakistan

Advanced Auditing

Final Examinations – Winter 2010 December 10, 2010
Module F 100 marks - 3 hours

Q.1 You are the manager responsible for the statutory audit of Parrot Limited (PL), a listed company engaged in the business of manufacture and sale of sports goods. It has three factories located at Karachi, Lahore and Sialkot.

Summarized statement of financial position as of September 30, 2010 (unaudited) and 2009 (audited) are as follows:

	2010	2009
	Rupees in million	
Assets		
Property, plant and equipment	1, 960	2,130
Investment in a subsidiary	520	590
	2,480	2,720
Stocks	720	510
Debtors	530	330
Other current assets	280	210
	1,530	1,050
Total assets	**4,010**	**3,770**
Equity and liabilities		
Paid-up capital	1,800	1,800
Accumulated losses	(1,650)	(1,350)
	150	450
Long-term bank borrowings	2,350	2,310
Creditors and other payables	1,510	1,010
Total equity and liabilities	**4,010**	**3,770**

Following further information is available:

(i) PL acquired a subsidiary in 2005 which is engaged in the business of manufacture and export of sportswear. The investment is recorded in PL's financial statements under the equity method. The last dividend was paid by the subsidiary in 2007.

(ii) During the physical count of stocks at Karachi on September 30, 2010 it has been observed that stocks worth Rs. 100 million is obsolete and would require a provision of 20% to 30% of the carrying value.

(iii) During the year, PL and its bank agreed to reschedule the loan on the following terms:
- Repayment date was extended from 3 years to 6 years.
- Rate of interest was increased from 1-year KIBOR + 3% to 1-year KIBOR + 4%.
- PL shall be required to maintain a current ratio of 1:1. In the event of non compliance of this requirement, the loan would become immediately payable. However, on October 25, 2010, the bank agreed to waive this requirement.

Required:
(a) Identify the risks that may result in material misstatements in PL's financial statements.
(b) Discuss the key areas on which you should place emphasis upon, to address the risks identified in (a) above. ***(20 marks)***

Q.2 Quail & Company, Chartered Accountants has recently been appointed as the external auditor of Penguins Limited (Penguin) for the year ending December 31, 2010. Penguin uses a fully automated integrated accounting system which meets all its operational and financial reporting requirements. Quail & Company is considering to hire a firm of consultants to assist it in evaluating the IT related controls and procedures in order to attain a level of comfort over the IT controls employed by Penguin.

Required:
(a) List any **five** important matters which Quail & Company should consider while deciding upon the need to hire a firm of IT consultants.
(b) Specify the important matters which should be clarified in the agreement with the consultants.

(16 marks)

Q.3 The draft accounts of Kingfisher Pharmaceutical Limited (KPL) for the year ended September 30, 2010 show a profit before taxation of Rs. 115 million and total assets of Rs. 450 million.

Being the audit manager you are currently reviewing the following matters:

(i) The basis of preparation of financial statements states that these have been prepared in accordance with the International Financial Reporting Standards. However, the accounting policy note for borrowing costs states that all borrowing costs are expensed as incurred. Results of audit tests show that borrowing costs expensed during the year include Rs. 15 million which relate to qualifying assets.
(ii) On October 17, 2010 the Income Tax Department issued amended assessment orders for the tax years 2006 to 2009 in which an aggregate tax of Rs. 40 million has been demanded. KPL has filed appeals against the orders before the Income Tax Appellate Tribunal. KPL's tax consultant has advised that it is not possible at this stage to give a reasonably accurate estimate of the amount of tax that the company may ultimately be required to pay but it would range between Rs. 10-35 million. There is no reference of this matter in the draft financial statements.
(iii) The directors' report contains a statement that "current year's increase in profit before taxation by over 10% is primarily due to the improved operating performance of the company". However, the income statement shows that KPL's profit before taxation includes a gain on sale of a factory amounting to Rs. 30 million. In the absence of this gain, the company would have reported a reduction in operating profit by 19%.

Required:
In respect of each of the above matters:
(a) State with reasons what action you would take; and
(b) discuss the implications on the audit report, if any. ***(13 marks)***

Q.4 Vulture Limited (VL) is planning to acquire 100% shares in Sparrow (Private) Limited (SPL) which is a small company and is not required to have a statutory audit. In order to satisfy VL about the company's financial statements, the directors of SPL have appointed your firm, Pigeon & Company, Chartered Accountants, to undertake a review engagement. According to the terms of engagement, your firm is required to review SPL's financial statements for the year ended September 30, 2010 and provide a report to the directors.

While performing the review you have observed that SPL has not carried out a physical inventory count as at September 30, 2010. SPL's inventory records were last updated on August 31, 2010. The valuation of inventory was based on quantities determined by the store manager using the goods receipt and despatch notes that he had kept since the last count. However, he is not confident that all goods receipt and despatch notes have been recorded. Your firm has not been able to verify the quantity of inventory through any other means. The carrying amount of inventory is material to SPL's financial statements.

Required:
Draft a review report on the financial statements, for submission to the directors of SPL. ***(11 marks)***

Q.5 Develop audit programmes in respect of contingent liabilities and taxation (including deferred taxation) stating therein the audit objectives and substantive audit procedures. ***(20 marks)***

Q.6 Eagle Limited (EL) is an unlisted company and operates a chain of 30 restaurants. The management has established effective internal controls especially over cash receipts and payments to employees and suppliers. The internal audit department of EL has been playing an important role in continuous evaluation and monitoring of these internal controls. However, the chief internal auditor (CIA) has recently resigned alongwith his two assistants.

Your firm has been the auditor of Eagle Limited (EL) for the last many years. The CEO of EL has approached your firm for help in resolving the situation and has proposed the following alternatives:

(i) EL would outsource its internal audit department to your firm.
(ii) Your firm would recruit an individual for the position of CIA to fill the vacancy. In consideration, EL would pay a fee equivalent to two months' gross salary of the CIA.
(iii) EL would recruit the CIA and your firm would provide audit staff on secondment for six months to assist the CIA in understanding and accomplishing the tasks. The CEO has showed his inclination to hire Mr. Kiwi, the manager responsible for the audit of EL.

Required:
Comment on each of the above alternatives as follows:
(a) Discuss the threat involved and explain the safeguards, if any, available to the firm which may eliminate or reduce the threat to an acceptable level.
(b) In the light of the Code of Corporate Governance, explain whether you would have accepted the proposals, had EL been a listed company. ***(20 marks)***

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2010

June 11, 2010

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 You are the manager in-charge on the annual audit of Decimal World Limited (DWL) for the year ended December 31, 2009. DWL is a leading manufacturer of electrical appliances. 35% of its shares are held by Binary Pakistan Limited (BPL). However, with the help of some consenting shareholders, BPL has been able to nominate 5 out of 8 directors on the Board.

During the planning phase of the audit you became aware of the following matters:

(a) A foreign investor has made a public offer to purchase 51% shares of DWL at a price of Rs. 13 per share. The share price has ranged between Rs. 12 to Rs. 14 per share during the past six months.

(b) The company's statement of financial position includes a deferred tax asset of Rs. 30 million on account of unutilised tax losses which have accumulated during the loss making period 1999-2004. The management is of the view that future taxable profits would be sufficient to utilise the available tax losses.

(c) DWL has established an e-commerce division to sell its products through internet. This new division is administered centrally by the head office. This step has been quite successful as the online sales have risen to 20% of the total sales during the year.

Required:
Identify and explain the audit risks which the auditor should consider while planning the audit of DWL. Also highlight the key areas on which the auditor should place emphasis upon, to address the above risks. **(12)**

Q.2 You are a chartered accountant in practice. The following situations have arisen in connection with two of your clients:

(a) A multinational company (MNC) which is planning to establish a place of business in Pakistan by forming a public limited company under the Companies Ordinance, 1984, has requested your firm to provide the following services:

(i) Receive the funds remitted by the MNC.
(ii) Make disbursements in accordance with the instructions of the MNC.

Required:
Explain how you would meet your professional obligations and responsibilities while carrying out the above assignment. **(07)**

(b) Your firm is the external auditor of a listed company. Recently the management of the company has requested your firm to provide the following services:

(i) Reconciling the creditors' ledger with the statements submitted by the suppliers.
(ii) Estimating the compensation payable to the employees who were seriously injured while carrying out the trial run of the plant.

Required:
Explain the threats involved in accepting the above assignments and identify the steps the firm should take to fulfill its professional responsibilities and obligations. **(10)**

Q.3 You are the manager in charge on the audit of Hexa Garments Limited (HGL). The company is listed on the Karachi Stock Exchange and has nine directors. It is engaged in the manufacture and sale of fancy garments through its own retail outlets. You are considering the following matters in respect of the audit for the year ended December 31, 2009:

(a) The diluted earnings per share of Rs. 36.60 has been calculated without taking into account the share options held by three directors. To justify the above calculations, these directors have confirmed in writing that they do not intend to exercise the share option. Had the share options been considered, the diluted earnings per share would have been Rs. 35.60. The review of subsequent events revealed that four of the remaining directors had exercised their share options following the balance sheet date. The share options are available upto December 31, 2010.

(b) According to the draft financial statements the total assets of the company are valued at Rs. 375 million. These include value of ten retail outlets amounting to Rs. 175 million. The valuation is based on historical cost less accumulated depreciation. During the year ended December 31, 2009, the management had decided to revalue all the retail outlets. The valuer appointed by the management has not been able to complete the assignment to date. However, he has submitted two interim reports as described below:

	Interim Report	
	First	**Second**
Date of report	31/12/09	20/02/10
Number of shops revalued	3	4
Book value as on 31/12/2009 (Rs. in million)	40	60
Revalued amount (Rs. in million)	70	100

(c) During the year HGL has developed two new brands “Deebal” and “Kalachi” and has launched an aggressive marketing campaign for their promotion. The company has recognised the cost incurred on the campaign amounting to Rs. 10 million as an intangible asset. It is being written off over the estimated useful life of the brands i.e. four years.

Required:
Discuss the matters that may be of significance to you as an auditor, in respect of the above issues. Also explain their implications on the audit report. **(16)**

Q.4 You are the quality control partner in a medium size audit firm and have been asked to give your views on the following situations:

(a) Pentagon Limited, an unlisted assurance client, has requested your firm to assist them in the recruitment of the Chief Financial Officer (CFO) of the company. While short listing the candidates, it was found that the applicants include CFOs of two of your existing assurance clients.

(b) One of your firm’s large clients, a listed company, has requested that the current year’s audit should be carried out by the same team which audited the last year’s financial statements. The request has been justified on the grounds that the accounts department is extremely busy on a special assignment and a new team would take a lot of their time. You have also been informed that Mr. Shams has been the manager in charge of that audit during the last three years.

Required:
Discuss the category of threat involved in each of the above situations. Also explain the safeguards available with the firm which may eliminate or reduce the threat to an acceptable level. **(14)**

Q.5 Sigma Pakistan (Pvt.) Limited (SPPL) manufactures telecommunication accessories. The management of SPPL is negotiating with one of its competitors to acquire a factory, at an estimated purchase price of Rs. 350 million. SPPL intends to obtain financing from a venture capital company (VCC) for the proposed acquisition.

Your firm, Gamma & Co., has been approached by SPPL to provide a report on the following cash flow forecast, which would be provided to VCC:

		Quarter ending			
		Jun. 2010	**Sep. 2010**	**Dec. 2010**	**Mar. 2011**
		-------------**Rupees in million**------------			
Cash inflows					
Cash sales	**(i)**	188	203	210	251
Receipts from credit sales	**(ii)**	870	900	938	1,249
		1,058	1,103	1,148	1,500
Cash outflows					
Operating					
Payments to vendors	**(iii)**	600	635	655	803
Salaries		140	140	140	140
Factory overheads	**(iv)**	263	263	263	263
Others		-	-	-	-
Purchase of fixed assets		-	-	45	54
Dividend		-	120	-	-
Royalty	**(v)**	-	-	-	53
Advance income tax		18	18	20	29
Purchase of factory		-	-	350	-
		1,021	1,176	1,473	1,342
Cash flow for the quarter		37	(73)	(325)	158
Opening cash balance		150	187	114	(211)
Closing cash balance		**187**	**114**	**(211)**	**(53)**

The following information is available:

(i) Cash customers are allowed discount @ 3% when they purchase goods worth Rs. 100,000 or more.

(ii) 60% of the amount billed is collected within one month, 25% by the end of the second month and 13% by the end of the third month. Bad debts are estimated at 2%.

(iii) Payment against purchase of raw material is made within 30 days, in order to avail cash discount @ 5%. Payments for other materials are made within 45 days.

(iv) Factory overheads include property rentals, utility bills, insurance premium and general office expenses.

(v) Royalty is paid to a foreign company, for availing the right to manufacture certain accessories.

Required:

(a) Outline the key procedures that your firm should undertake in order to provide a report on the cash flow forecast. **(16)**

(b) Draft an unmodified report for submission to the Board of Directors. **(06)**

Q.6 Beta Construction Company Limited (BCCL) is involved in the construction of large buildings and shopping plazas. The company commenced its business in 2004 by establishing an office in Karachi and has grown rapidly. It currently has offices in five major cities of the country and as many as 25 projects are in various stages of execution.

A substantial portion of the work is done through sub-contractors. Payment to sub-contractors is based on certificate of work completion which is issued by the supervisor in charge of each project. The certificate is sent through email to the finance department. The payment is credited directly into the bank accounts of the sub-contractors.

Recently, the management has discovered that the project supervisor of a large project had issued a fraudulent work completion certificate. The preliminary investigation indicated that some other sub-contractors have also been paid fraudulently in the past and the practice was ongoing for the past two years.

The management of BCCL has asked your audit firm to conduct an investigation into the matter. Your initial discussion with the client has revealed the following:

(i) For the past four years the external auditors of the company are Alpha & Co., Chartered Accountants. They had issued unqualified audit reports for all those years and had not reported any internal control weakness in their management letters.

(ii) Prior to approaching your firm, BCCL wanted to give this assignment to Alpha & Co. However, they expressed their inability to undertake the investigation work.

Required:

(a) State the matters your firm should consider and the procedures that should be followed prior to the acceptance of this assignment. **(07)**

(b) State the basic objectives of the above investigation. **(03)**

(c) Recommend the controls which the management should put in place, to avoid such frauds in future. **(09)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2009

December 11, 2009

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 Mr. Ansari who represents ABC & Company, Chartered Accountants, is the manager responsible for the first year audit of Stello Limited (SL) for the year ending December 31, 2009. Previously the financial statements were audited by a very well reputed audit firm. ABC & Company has now been appointed as the auditors, in pursuance of SL's policy according to which the statutory auditors are to be rotated after every five years.

While reviewing the working papers at the planning stage, Mr. Ansari became aware of the following facts:

Background
The main business of the company is the operation of smelting plants that produce steel from iron ore. The company was founded almost five years ago by a group of entrepreneurs. Its managing director is Mr. Sami who has vast experience of working in reputed national and international companies. Since inception, the company has experienced exceptional growth. To generate funds for some of its future plans, the management is considering to get the company listed before December 2010. The management expects to raise Rs. 700 million by issuing 50 million ordinary shares at a premium of Rs. 4 per share.

Management Policies
The company has developed a sound system of Corporate Governance. Most of the executive heads are experienced professionals. The company believes in employing a satisfied workforce. In addition to competitive market based salaries, it also offers performance based bonuses at all levels, including the senior management.

System of Accounting and Controls
The review of working papers indicates that the company has developed a sound accounting and reporting system. The company has recently installed a state of the art accounting software. However, as regards the system of disposal of scrap, the concerned engagement team member had made the following observations:

- The sale and disposal of scrap is managed by Mr. Sultan who is an Assistant Manager and reports to the Senior Manager Marketing.
- The scrap generated is collected by a local merchant on a daily basis. The rate is negotiated by Mr. Sultan once every three months.
- Only Mr. Sultan is authorised to sign the gate pass but quite often, in his absence, it is signed by the delivery clerk.

Operating Results and Projections
The compound annual growth in company's earnings over the last three years has exceeded 20% per annum and the projected earnings growth for the year ending December 31, 2009 is in excess of 35%. The growth is mainly on account of profitable contracts which the company has secured with two local manufacturers.

Some of the important events that have taken place during the current year are as follows:

Acquisition of Neptune Enterprise
On July 1, 2009 Stello Limited acquired 80% shares of Neptune Limited, a company based in Argentina. This company manufactures steel products that are sold in its local markets. The purchase was financed by means of a foreign currency loan. The loan is repayable in five equal annual installments, commencing on July 1, 2010. The financial year-end of Neptune Limited is June 30.

Major Capital Expenditure
The company has increased the production capacity of one of its plant. Land was acquired for the purpose from a company in which a friend of Mr. Sami is the majority shareholder. Plant and machinery was supplied by Big Manufacturer (Pvt.) Ltd. (BMPL). Although a lower quote was received from another supplier, the Board decided in favour of BMPL as it had a long standing business relationship with Stello whereas the other supplier was considered to be too inexperienced.

Required:

(a) Evaluate the above situation and briefly discuss the key risk areas that Mr. Ansari should consider while planning the audit. **(19)**

(b) List **three key audit procedures** which the auditors may like to undertake, in the above circumstances, in respect of each of the following:
   (i) Foreign currency loan
   (ii) Capital expenditure **(06)**

Q.2 (a) Red Sea Company Limited (RSCL) builds ships and constructs oil rigs for the offshore oil industry. Under one of the contracts with Black Oil Company Limited, RSCL was required to construct a rig for drilling oil, off the coast of Makran. The oil rig should have been completed by April 30, 2009 but on account of delays and technical problems, it is not expected to be completed until February 28, 2010. Consequently Black Oil Company Limited has cancelled the contract and lodged a claim for damages amounting to Rs. 150 million. This claim for damages was lodged by Black Oil Company Limited on August 29, 2009 and it has been disclosed as a contingency, in RSCL's financial statements for the year ended September 30, 2009.

Required:
Describe the work that the auditor should carry out in the above situation, to determine whether the accounting treatment and related disclosures, if any, in the financial statements of Red Sea Company Limited for the year ended September 30, 2009 are appropriate. **(12)**

(b) You are the senior responsible for the audit of Iqra Industries Limited (IIL). During the course of the audit you became aware that a legal action has been instituted against IIL by some of its customers, on account of disputes related to performance of its products. In response to your request for an opinion the company's lawyer has simply stated that "*We are totally unable to give any estimate*".

No provision was made in the financial statements for the possible loss as a result of the claims (which are considered to be material) or for the related legal expenses, although details of those legal claims were fully disclosed in the notes.

Required:
Comment on the implication of the above matter on the auditors' report and the financial statements of IIL. **(04)**

Q.3 Mr. Omar is incharge of the quality control department of an audit firm. While reviewing the working papers relating to some audit engagements of the firm he came across the following situations:

(i) The spouse of a partner in the firm is a legal consultant and is assisting an audit client of that firm in filing its tax return.
(ii) The audit manager engaged on the audit of a company has been offered a job by that company. He has been asked to join on March 1, 2010 when the current CFO would retire. The audit is expected to be completed on December 15, 2009.
(iii) A meeting of the CEO of ABC & Company Limited and the audit engagement partner was held to discuss the draft financial statements of the company for the year ended September 30, 2009. Serious difference emerged between the two sides on the accounting treatment and the disclosures of certain items and consequently the CEO informed the engagement partner that unless the auditors agree to the company's point of view, they would not be reappointed for the next year.
(iv) The engagement partner on the audit of XYZ Limited has been its engagement partner for the past six years.

Required:
Identify the category of threat involved in each of the situations described above and explain how would it affect the objectivity and independence of the auditor. Also explain the responsibility (if any) of the firm and the concerned member of the audit team. **(11)**

Q.4 You are the manager incharge responsible for the audit of Day Pharma Limited, a subsidiary of a multinational pharmaceutical company. One of the drugs being imported/marketed by the company is VITABE. It was introduced a few months back but contributes significantly to the company's revenues. While the audit was in progress, you came across a news item in a well known publication, according to which the authorities in many countries have banned the use of VITABE as some of its ingredients were considered dangerous for human health and required further testing. While going through some files you have discovered that the parent company had informed Day Pharma Limited about the harmful effects of the drug. However, it had not given any further instruction in this regard.

You have discussed this matter with the CEO who has informed you that the company had not called off the medicine nor has it provided any information in this regard to the users of the drug or the general public as the management is of the view that there is very limited risk of any harm being caused by the drug. However, you had discussed this matter with a senior physician who believes that these types of products are also banned in Pakistan.

Required:
Assess the above situation and describe what measures the auditor should take in such circumstances. **(14)**

Q.5 Raza & Company, Chartered Accountants is an old and well reputed audit firm. It has been growing at a rapid pace with the result that the partners of the firm had been unable to devote much time to various important issues. In view of your experience, they have inducted you as a partner, with the primary responsibility of improving the firm's systems and procedures.

The major issues that have attracted your immediate attention relate to human resources, audit documentation and client acceptance and retention procedures.

Required:
(a) How would you evaluate the firm's HR requirements and what steps would you take to ensure that adequate human resources are available within the firm? **(05)**
(b) Identify the situations under which you would recommend declining an assurance engagement or consider resigning from the current engagement. **(03)**
(c) Recommend how an engagement team member should evaluate as to what type of audit documentation is required to be prepared in a particular situation. **(03)**

Q.6 While reviewing the working papers to assess compliance with the Code of Corporate Governance, the auditors of Fair Limited (FL), a listed company, came across the following information:

(i) The Board of Directors of FL comprises of ten directors. Mr. Muneer and Mr. Sualah are the only non-executive directors on the Board. The chairman of the Board is Mr. Saleem, who is also the chief executive of the company.

(ii) During the year, the board met four times. Due to his preoccupation, Mr. Kamal who is the chief financial officer of the company could not attend an important board meeting in which the half yearly accounts were approved.

(iii) One of the directors purchased 16% of FL's shares on March 17, 2009. He communicated this information to the Board of Directors in the meeting held on March 26, 2009.

(iv) FL has an audit committee which comprises of three members, including its chairman, Mr. Waqar. The company's internal audit department is headed by a Chartered Accountant who reports to the audit committee.

Required:

(a) Draft the concluding paragraph of the review report to the members on the company's Statement of Compliance with the Best Practices of the Code of Corporate Governance, including qualifications (if any). ***A full report is not required.*** **(08)**

(b) Give brief reasons to support your point of view, in respect of matters which have not been considered for reporting as a qualification. **(04)**

Q.7 You are the auditor of Blue Sky Limited (BSL). The draft consolidated financial statements of BSL and its subsidiary Sea Green Limited (SGL) for the year ended September 30, 2009 show a profit before taxation of Rs. 10.5 million (2008 : Rs. 9.4 million) and net assets of Rs. 55.2 million (2008 : Rs. 50.7 million). You have performed the audit procedures you considered necessary for the year ended September 30, 2009 and are satisfied with the results of those procedures.

However, your firm is also the auditor of Sea Green Limited (SGL). You were appointed as SGL's auditors for the year ended September 30, 2009 after BSL acquired 90% shares of SGL on June 30, 2008. SGL's draft financial statements for the year ended September 30, 2009 show profit before taxation of Rs. 0.7 million (2008: Rs. 1.7 million) and net assets of Rs. 16.1 million (2008: Rs. 16.6 million). Both the companies are exempt from tax.

The previous auditors' report on SGL's financial statements, for the year ended September 30, 2008 was unmodified. However, during the audit of SGL it was discovered that due to an error, the inventory as appearing in the audited financial statements for the year ended September 30, 2007 was overvalued by Rs. 5.7 million. This amount is now being adjusted by SGL over a period of three years i.e. over the years ended September 2008 to 2010.

You have approached the management advising them to adjust the full amount in the current year. However, the management is not willing to accept your point of view.

Required:

Draft the modification paragraph of the report which you would issue on the consolidated financial statements, in the above situation. ***(A full report is not required)*** **(11)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2009

June 5, 2009

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 You are the senior in charge on the external audit of Brown Limited (BL), a company dealing in consumer products. The draft financial statements for the year ended December 31, 2008 show profit before tax of Rs. 30.1 million and total assets of Rs. 242.4 million. The following issues have been identified during the course of the audit:

(i) On January 10, 2009, a liquidator has been appointed at Express Pakistan Limited (EPL), a major customer of the company. Sales to EPL during the year under review amounted to 35% of BL's revenue and the balance due from EPL at December 31, 2008 was Rs. 5.89 million.

(ii) On January 25, 2009, a direct confirmation was received from BL's lawyers. He had informed that because of the complexity of the issues involved in one of the litigation faced by the company, which was initiated in October 2008, it is not possible to forecast its outcome. However, he has advised that the possible impact of an unfavorable decision (if any), ranges between zero to Rs. 10 million. The draft financial statements do not contain any disclosure in respect of this uncertainty.

(iii) During the year the company incurred costs of Rs. 1.1 million in respect of repairs and maintenance of its machinery. These costs have been capitalized and included in the carrying value of property, plant and equipment. The management has refused to make any adjustments in the financial statement in respect of this matter.

(iv) During the year, the company has commercially imported certain branded products amounting to Rs. 200 million, which are subject to FTR at import stage. The final tax paid at import stage amounted to Rs. 4 million and the entire amount has been recognized as expense, in the current period. However, goods costing Rs. 50 million remained unsold and are included in the stock-in-trade.

Required:
Explain the possible effects of the situations described above, on BL's financial statements for the year ended December 31, 2008 and discuss the implications thereof, if any, on the audit report. **(10)**

Q.2 You are the manager in charge on the audit of financial statements of Haroon Private Limited. During the course of audit you noticed certain conditions which created significant doubts about the validity of the going concern assumptions.

You have discussed the issue with the client which further revealed that the management has developed certain plans to cope with the situation but on the basis of your assessment of their plans, you concluded that the going concern assumption is no more appropriate.

Required:
(a) Advise the client as to what should be done in the above circumstances.
(b) What procedures would you perform if the management agrees to your proposals?
(c) If the management does not agree, draft appropriate modifications for inclusion in the audit report. ***(You may assume necessary details)*** **(10)**

Q.3 Narrow Street Limited is an auto parts manufacturing company. The Company offers product warranty to its customers. You are senior incharge on the audit of the Company for the financial year ended December 31, 2008. While reviewing the draft balance sheet, you have noted that the provision for product warranties has increased to Rs. 150 million as compared to Rs. 85 million in the previous year. The Company's profit after taxation as appearing in the draft profit and loss account is Rs. 50 million. Considering the significance of this change, you have decided to carry out a detailed test to verify the amount.

Required:

(a) Describe the matters that should be discussed with the senior management while carrying out the above verification. **(05)**

(b) State the audit procedures to be performed in order to conclude that product warranty liabilities are fairly stated in the financial statements of the Company. **(10)**

Q.4 You are involved as a senior in auditing the financial statements of Blue Limited (BL), a listed company, for the year ended December 31, 2008. While reviewing draft financial statements you have noted that BL has material investments in two local private limited companies and a joint venture company operating in the UAE. You have identified the following risk indicators:

- the investee companies have different year end than the investor company;
- one of the investee is a foreign operation;
- significant transactions between the investee and investor companies;
- poor operating results and financial condition of one of the investee company;
- the investor has guaranteed the debts of one of the investee company;
- one of the investee's financial statements are audited by another firm.

Required:

In view of the above Risk Indicators, identify the possible implications that might be of significance to the audit team in assessing the risk of misstatements affecting the investments made by the company. **(09)**

Q.5 You have recently completed the audit of Rubi Limited (RL), a multinational company, for the year ended December 31, 2008. The Chief Financial Officer (CFO) of the company has now approached you for a report on book value per share, as of December 31, 2008 for submission to the regulatory authorities.

Following is an extract from the audited balance sheet of RL as at December 31, 2008:

	Rupees
Issued, subscribed and paid-up share capital *(400,000 ordinary shares of Rs. 10 each)*	4,000,000
Accumulated profits	2,000,000
Unrealized gain on revaluation of investments	500,000
Surplus on revaluation of fixed assets – net of tax	600,000

The auditor's opinion on the financial statements for the year ended December 31, 2008 was qualified as deferred tax asset amounting to Rs. 5 million was not recognized in the financial statements.

Required:

Draft a report for submission to the client. Show necessary calculations related to the figures disclosed in the report. **(15)**

Q.6 You have worked as a job in charge on the audit of financial statements of a multinational listed company, engaged in pharmaceutical business. During the course of your audit, you became aware of various facts and details about the company.

It was a long engagement for which you had to move out of the city of your residence. Consequently, a number of people around you, including family, friends and colleagues, are aware of the fact that you were job in charge on the said audit. Some of them are interested in having certain information as discussed below:

(a) One of your close relative has got an offer for appointment as director marketing of the said client. He wants to be aware of the levels of remuneration at comparable positions in order to negotiate his remuneration properly.

(b) A manager in your firm (other than the engagement manager for the said client) has inquired about the internal controls in place, in respect of a specific process. Assuming that the same would be effective, he intends to recommend the same as best practice to a local pharmaceutical client.

(c) Your sister has asked you about the ingredients of a specialized nutritional product for children, being marketed by the company, which she is using for her child. You are aware of all the details about the said product, as you got the opportunity to perform tests on the costing of that product.

(d) One of your friends is working in the Ministry of Health, Government of Pakistan. He has asked you as to whether the company has complied with certain statutory requirements. You are aware of the fact that the company is not complying with the same and you have already included the matter in the management letter. With reference to specific provisions of law, he has convinced you that it is his duty to enquire about the same, and you are responsible to disclose the relevant information to the Ministry. He has also informed you that in case of no response, you may be served with a legal notice.

(e) Your younger brother intends to commence distribution business. He has asked you about the rate of commission and volume rebates being allowed by the said client to its distributors, as he wants to work out the feasibility of business.

(f) Your father invests his surplus funds in the capital market. Being aware of the fact that companies like that always have a five to ten year's plan in place. He has asked you about the trend of earnings per share of the said company for the last five years, and the expected growth in the net profits for the next five years.

Required:
Discuss each situation to conclude as to whether or not you can provide the requisite information and the extent to which the same can be disclosed without compromising the professional ethics. Support your conclusions, with appropriate arguments. **(10)**

Q.7 You are employed as audit manager in Saleem and Company, Chartered Accountants, who have been appointed by Indigo Private Limited to prepare certain financial information. The management has informed that the information would be submitted to prospective private investors in a foreign country and the fact that the information has been prepared by your firm shall also be disclosed therein.

While preparing the financial information you identified that current maturity of a long term loan amounting to Rs. 100 million has been shown as a long term liability, in the books of account. The management disagrees with your observations and believes that the amount should be disclosed as a long term liability. To support their point of view they have informed you that their negotiations with the lenders are at the advanced stages and the agreement for restructuring will be signed soon after the date on which the information is due for submission.

Required:
Draft a suitable report to address the above situation. **(07)**

Q.8 You are the partner in charge of your Firm's risk management department and in the said capacity your responsibilities interalia include advising the firm's engagement partners / managers on different aspects of the assurance and non assurance services, in accordance with the applicable regulatory and independence framework. You have been requested for guidance on the following issues:

(i) Olive Limited has approached your firm to act as their advisors to the first public issue of the company which shall be used to finance a new project. Your responsibilities would include drafting the prospectus, assistance in completing listing formalities and negotiations with and appointment of Bankers to the issue. Previously you have also carried out a due diligence exercise in respect of the said project. Olive limited has suggested different fee levels corresponding to the amount of eventual subscription received.

(ii) Crimson Limited, an unlisted audit client has engaged a software company to automate its accounting and finance functions. The company wants to engage your firm to help in the implementation of the system.

(iii) Your firm has availed credit facility from Rose Bank Limited. You have a long association with the bank and it has also been providing various other services to your firm and its partners. The amount of loan to the firm is approximately one percent of the firm's total assets. The management of the bank has approached the firm for appointment as statutory auditors.

Required:

(a) Advise the concerned partners/managers as regards the acceptance of the above assignments.

(b) Suggest possible modification in the scope or terms of engagement or possible safeguards, if any, to avail the opportunities within permissible limits. **(12)**

Q.9 Develop audit work programs in respect of dividend to shareholders stating therein the related assertions, audit objectives and substantive audit procedures. **(12)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2008

December 5, 2008

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 Sea view Limited is a manufacturing company. Behroze & Co., Chartered Accountants are their auditors. The audit of financial statements of the Company for the year ended November 30, 2008 is in progress. Sami, the senior in charge on the audit has received the first draft of the financial statements from Kamil, the CFO of the Company. The abridged financial information of the Company for the year ended November 30, 2008 is as follows:

	2008	2007
	Rs. in '000'	
Property, plant and equipment	2,325	1,210
Intangible assets	100	50
Inventories	650	460
Trade debts	210	80
Sales	4,300	6,700
Cost of sales	3,800	5,100
Gross Profit	600	1,600

Sami had a meeting with the CFO of the Company which revealed the following matters:

(i) The Company's sales have suffered on account of depressed economic conditions in the country;
(ii) The Company has introduced a new product 'Cherry' during the year in place of 'Merry' and incurred substantial cost in the acquisition of property, plant and equipment; and
(iii) This year's physical verification of stocks had not been carried out on November 30 on the plea that the relevant staff was on leave. The stock check will now be carried out on December 15, 2008.

Required:
Given the above data and circumstances, identify the following:
(a) the risks that may result in material misstatements in the financial statements; and
(b) the implications of the risks identified along with audit procedures that would be most suitable to mitigate those risks. **(15)**

Q.2 During the audit of a manufacturing company, you have noted certain conditions that cast significant doubt on the company's ability to continue as a going concern. You had a meeting with the CEO of the Company to discuss the issue and communicated your decision that at least an emphasis of matter paragraph in the Audit Report is inevitable. The CEO disagreed with your opinion and shared with you the management's plan to deal with the potential going-concern uncertainty. The plan mainly constitutes the following measures:

(i) the Company is guaranteed a continuous financial support by the parent company;
(ii) it has recently rescheduled its borrowing facilities;
(iii) the management has plans to reduce overheads and administrative expenses;

(iv) the management has decided to discontinue a segment with non-profitable operations;
(v) the management has plans to increase equity; and
(vi) the management is expecting profitable operations in the next year.

Required:
Describe the audit procedures that should be performed to gather sufficient appropriate audit evidence to support the validity of the CEO's claims and assess the viability of the above measures being taken by the management. **(16)**

Q.3 Your firm has been appointed as the auditors of Star Limited, a well established consumer goods manufacturing company. During the audit you were provided with various oral representations during meetings and discussions. While finalizing the audit you requested the management to provide such representations in writing. The management has however informed you that they are not accustomed to providing any representations to the external auditor in writing.

The management is of the view that it has provided full access to whatever records, documents and evidences were available with it without any exception and that now it is the auditor's responsibility to correlate the same with the oral representations.

The management has further informed that the only signed documents which it will be providing to you would be the signed copy of the financial statements and the certified true copy of the resolution of the BOD approving the financial statements and other significant matters, in line with the requirements of the corporate law.

Required:
You are required to explain the following:
(a) Is there any relevance of oral representations for the External Auditors?
(b) What are the situations in which written representation from the management is mandatory?
(c) What course of action would you like to take in the above circumstances? **(12)**

Q.4 The financial statements of Walter Limited (WL) a public unlisted company, for the year ended 30 June 2007 were significantly delayed and were finalized in April 2008. After finalization of financial statements, a meeting of the board of directors (BOD) of WL was held in May 2008 and Annual General Meeting (AGM) was held on June 18, 2008. Due to delay in holding the AGM, the Securities and Exchange Commission of Pakistan (SECP) has imposed a penalty and has advised WL that no such delay shall be entertained in future.

In the AGM, the shareholders of WL appointed your firm as the statutory auditors and the fact has been communicated to you by the Company Secretary through his letter dated June 22, 2008 which was faxed to you on the same date.

The company's financial year is closing on June 30, 2008 and the management wants to commence the audit immediately in order to ensure timely financial reporting and holding of AGM.

Required:
(a) Explain the client acceptance procedures that you would like to perform in the above situation.
(b) What other steps would you like to take before commencement of the audit? **(12)**

Q.5 Your firm has completed the audit of financial statements of Flora Limited (FL), a public listed company, as of June 30, 2008 and has issued the audit report on September 30, 2008. While preparing to attend the Annual General Meeting (AGM), you noted that a particular sub-note was altogether missing from the published financial statements.

On scrutiny, you found that the original signed copy of the financial statements available in your records did contain the note.

Required:

(a) Explain the auditor's responsibility in such a situation if the amount involved is considered material.

(b) What difference would it make if the amount is immaterial? **(06)**

Q.6 You are the audit engagement partner for Mubarak Limited (ML), a listed company which is the subsidiary of a company registered in USA. You have received an email from your firm's tax partner based in Lahore. He has informed you that in a recent meeting with the Chairman of ML in Lahore, he discussed an opportunity to pursue major assignments for the Company. He strongly urged you to have an urgent meeting with the CEO of ML as the company is in discussion with other firms also and is due to take a final decision soon.

The services include Internal Audit Outsourcing and Corporate Finance Services (CFS). CFS mainly involve negotiating the terms of restructuring / re profiling of long-term borrowings obtained by ML from one of its lenders. However, as the audit engagement Partner of Mubarak Limited you are of the opinion that it would not be possible for you to provide the above services.

Required:

Write a comprehensive letter to the client explaining your point of view, giving appropriate reasons and references to the relevant standards and regulations. **(10)**

Q.7 You were the engagement partner on the audit of a commercial bank which has a network of more than 200 branches, across the country. During a recent meeting, a member of the audit committee referred to an instance of irregularity in a branch, whereby the Branch Manager had extended credit to a close relative without following the bank's credit disbursement procedures. The member criticized the auditors for their failure to highlight such instances.

Required:

As an engagement partner, write a letter to the audit committee explaining your point of view in detail with specific references to the International Standards on Auditing, wherever applicable. **(09)**

Q.8 You are employed as the Chief Internal Auditor of MNQ Commercial Bank Limited. Recently the Central Bank has taken serious action against some of the banks for their failure to detect money laundering activities.

Required:

For the guidance of the management and staff, develop a list of situations which may indicate the involvement of money laundering activities. **(10)**

Q.9 Your firm has been appointed as the auditors of Antarctica Limited for the year ended June 30, 2008. The Company was incorporated in the year 2000. Since then, its financial statements have been prepared in accordance with the approved accounting standards as applicable in Pakistan and have been audited by a highly reputable professional auditing firm. Since the previous auditors had never expressed a modified audit opinion, the audit team feels that there is no risk in respect of comparatives and accordingly did not perform any work in this respect.

Required:

Describe the auditor's responsibility as regards the verification of opening balances and the steps that may be needed in the above situation. **(10)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2008

June 6, 2008

ADVANCED AUDITING **(MARKS 100)**
(3 hours)

Q.1 Wood Limited (WL) is a listed company. SMSF Chartered Accountants have been the auditors of the company for the last three years. In November 2007, with substantial change in shareholding a new Board of Directors was elected. The new Board made significant changes in the senior management within a week of taking charge.

On February 10, 2008, after completing the field work, the auditors sent the financial statements alongwith initialed draft audit report, to WL's board for its approval. On the same date, a senior partner was assigned to carry out an engagement quality control review. During the review he noted the following:

(i) Management representation letter contains a paragraph that "We have taken charge from the previous management on 28 November 2007 and after taking charge, we commenced valuation exercise in respect of plant and machinery in various factories owned by WL. To date, thirty percent of plant and machinery has been valued. The exercise carried out so far shows that fair value of the assets is 20% less than the carrying value, for which an impairment loss has been accounted for. In view of this situation, we are not confident about the fair value of the plant and machinery as presented in the financial statements."

(ii) The valuation is being carried out by the production manager who is a qualified engineer. He had been responsible for year-end valuation review for many years. This is the first time when he has reported an impairment.

(iii) The issue of impairment loss, which is of material amount, was a contentious matter between a team member and the job in charge. On inquiry Mr. Manzoor Nazar, the engagement partner, informed that he had accepted the job in charge's view point.

(iv) This matter was also reported to the stock exchanges on December 5, 2007 resulting in a sharp decline in share prices of WL, which otherwise had a good price-growth history.

(v) Subsequent to year end, WL has been awarded a very profitable long-term supply contract by Timber Limited (TL), a reputable industrial undertaking. No direct confirmation was obtained from TL.

(vi) WL announced a 100% right issue in December 2007 at market price. Because of discouraging response from the minority shareholders, the directors and their associates purchased a large number of right letters from the open market.

(vii) The firm's record reveals that Mr. Manzoor had applied twice for a job in WL during last one and half years. However, there is no current information about his intention.

Required:
Write a review report on behalf of the reviewer indicating the deficiencies noted in the audit as well as the policies of the firm and submit your recommendations. **(16)**

Q.2 You are the engagement partner of a listed company. After completing audit field work, you have provided the draft audit report alongwith the draft financial statements prepared by management to the Board of Directors with a cover letter stating that the firm will issue its audit report after the Board has approved the financial statements.

Your manager has brought to your knowledge that last week the client has published its annual report including Financial Statements and audit report (which had not been signed by the firm). Notice of Annual General Meeting (AGM) has also been published in the newspapers.

Required:
Explain what course of action should the firm take in the above situation. **(06)**

Q.3 On reviewing the published financial statements of RRK Limited, their auditors, Ahmad Mobeen and Company, Chartered Accountants, noted the following:

(i) It has been mentioned in the directors' report that a material amount which was provided as a bad debt had been recovered after year end.
(ii) Director's report states that decline in sales, was due to general economic conditions. However, the auditors' feel that it was due to inappropriate strategies adopted by the management.
(iii) A graph in the published report depicted the value of last year's inventory at Rs. 326 million, which according to the corresponding figures given in audited financial statements amounted to Rs. 250 million.
(iv) Directors' report stated that negotiations for expansion of production facilities by acquiring a sick unit had been finalized, whereas the auditors have definite information that the company could not strike the deal.

Required:
Explain how the auditor should resolve each of the above issues. What steps would the auditor need to take in case the client does not agree with his recommendations? **(10)**

Q.4 You are the audit engagement partner of a listed company, Steel Limited (SL). The firm is currently in the process of completing limited scope review of SL's interim financial statements for the half year ended December 31, 2007. The audit team has recently concluded their work with following findings for your decision:

(i) Inventory is a significant item of the balance sheet but the auditor was not asked to attend the stock count at the end of the period. Consequently, the audit team relied on the count communicated by the management.

(ii) SL has executed many contracts with its customers for long term future deliveries at different prices, amounting to Rs. 1,200 million. To avoid loss on account of price fluctuation, short term futures had been bought in international market against future deliveries valuing Rs. 300 million only. Such futures are carried-over on maturity. Remaining deliveries have been left open.

(iii) A set up of the company in Lahore having carrying value of Rs. 235 million has been sold to an associated undertaking for Rs. 240 million. The minutes of the Board of Directors show that the transaction was carried out at an arm's length price. No explanatory note has been given in the financial statements in this regard.

(iv) As a percentage of total debts the provision for bad debts are in accordance with the previous history of the company. However, due to time constraints the practice of using age-analysis of debtors has not been used this time.

(v) Due to time constraints the review of subsequent event was not carried out by the audit team.

Required:
Discuss the above issues and their implications on your report. **(11)**

Q.5 Trade Limited has been engaged in sales of product X for a long time. In January 2007, it started trading of product Y which was sold with money-back guarantee being exercisable within 120 days of sale. Consequently, the sale of Y far exceeded the company's expectation and eventually constituted 40% of the total sales of the company in the year 2007. An extract from the Trading Account of product Y for the year ended December 31, 2007 is as under:

Particulars	**Rs. *(in million)***
Gross Sales	650
Sales returns and allowance	130
Provision for sales returns-Gross	18
Cost of sales	400

On account of money-back guarantee a provision has been made, for sales return subsequent to year end. The provision is three times the actual sales returns during the first 15 days of January 2008.

As the time available for presenting financial statements is limited, the management has decided to adopt it as a consistent accounting policy to be followed each year.

The audit is to be finalized by February 15, 2008. The team member who was assigned to verify the provisions believes that in such situation the auditor is compelled to rely on management's estimate. Therefore, a simple procedure of recalculation will be appropriate.

Required:
Explain the appropriate audit procedures to verify the provision for sales returns in the light of relevant International Standard on Auditing. **(08)**

Q.6 To ensure the continuity in supply of cement required for development projects in far flung areas, the Provincial Government sought application from cement producers for a three years supply contract. Cement Limited (CL), a relatively new cement producer, was also interested in filing the said application, as it could bring provincial government as a secured and committed customer. CL also has a similar contract with the Local Government for the last two years.

One of the requirements of the Provincial Government is that CL should submit a report by their independent auditors on CL's compliance with certain covenants of their agreement with the Local Government i.e. those related to capital adequacy, price computation, minimum level of inventory and any other matter directly related to financial reporting. SSZ Chartered Accountants have been the statutory auditors of CL for the last three years. They were appointed to carry out the engagement at a fee of Rs. 100,000. Mr. Sharif, engagement partner of the last annual audit, discussed the scope of work with the management. The discussion revealed the following matters:

(i) The report is supposed to cover the period November 03, 2004 to December 31, 2007.
(ii) The agreement (Referred to as XYZ/2004 dated November 03, 2004) consisted of voluminous annexures and attachments; and contained references to a number of rules and regulations contained in various legislations.
(iii) Certain disputes have erupted over the period, some of which still remain unsettled.
(iv) Mr. Sharif assessed that the assignment would take around twenty working days. The management felt the estimate unreasonable, as the said agreement had already been reviewed by the auditors during the annual audits.

The firm accepted the offer and Mr. Sharif performed the engagement in fifteen working days. He is now preparing the required compliance report with the following information in hand:

(i) Two significant disputes were raised by the Local Government relating to capital adequacy and price computation of 'Quick-set Cement'. Both were resolved through negotiations as confirmed by the officials of the Local Government verbally, however a written confirmation was refused. The records show that CL convinced the Local Government authorities by producing the opinion of a legal expert, based on Regulation JKL of 1961.

(ii) The management is confident that this compliance report will also support their view point in their dealing with the Local Government, although the engagement letter does not contain such an understanding.

(iii) Minimum level of inventory was actually kept by three distributors of CL under binding contracts clearly citing the purpose of the arrangement. The management is of the view that this practice is in conformity with the interpretation given in Regulation referred to above.

(iv) CL was also required to provide a performance guarantee of Rs. 24 million issued by a scheduled bank. However, this facility was not renewed after the first year. As a result, CL is exposed to a general penalty as provided in the agreement.

Required:
Based on International Standards on Auditing and ICAP's Code of Conduct:
(a) Explain how the above issues should be dealt with in the compliance report.
(b) Draft a Report on Compliance with the Agreement.
(c) Explain your view point in response to the management's comments regarding assignment completion time.
(d) Comment on the firm's decision to appoint Mr. Sharif, for carrying out this engagement. **(20)**

Q.7 In 2005 the management of Fiber Limited presented before the Board of Directors, the plan of a new business segment, quite different from existing business of FL. The approval was granted in the same year.

In December 2007, even after over two years of operation, the bottom line of cash flow was negative. Some of the Board members are convinced with the management's explanation that the initial projections were correct, nevertheless, the periodic pattern of cash flows is not according to the expectations. Others, who are in majority, feel that the initial projections were materially misstated. The Board has therefore directed the management to submit prospective financial statements relating to the segment for next five years.

The management submitted the projection with the following assumptions:

(i) The company will be able to sell a large piece of land in the heart of the city, in 2008, to set up a factory in a different city on hired premises.

(ii) The factory will attain 70% capacity within six months of its establishment. Whole production will conveniently be sold in that city and FL will not have to incur any transportation cost.

(iii) The transportation cost, which is one of the main contributors of negative cash flow, will be reduced substantially by using cargo train in place of trucks. Negotiations with railway authorities are in final stage.

(iv) Administrative expenses will grow at 5% per annum.

After examination by an independent auditor, the board intends to publish the abridged form of such financial statements in the news letter of the company which is circulated to shareholders each month.

ABUK Chartered Accountants have been contacted by the Board to examine the prospective financial statements and submit their report within ten days.

Mr. Umer is a partner in the firm and has expertise in such assignments. When asked by the firm to take up the offer as engagement partner, he informed that his wife is the daughter of the Chief Financial Officer of FL and also holds 75,000 shares of the company.

Required:

(a) Discuss the points which the firm should consider while accepting the engagement and assigning the job to Mr. Umer. **(04)**

(b) Assuming that the engagement is accepted, draft an appropriate audit report. **(04)**

(c) Explain how the historical financial statements can be used by the auditor in performing the engagement. **(04)**

Q.8 You have recently joined a medium size chartered accountants firm as their audit manager. While reviewing the firm's audit methodology you have observed that the firm follows a standard set of audit work programs. These work programs have been used by the firm for the last many years and rely extensively on traditional judgment sampling. You are of the opinion that by following the statistical sampling techniques, you would be able to carry out a more effective and efficient audit.

Required:

Briefly narrate the advantages and disadvantages of judgmental and statistical sampling. **(07)**

Q.9 The financial statements of Modern Equipment (Pvt) Limited reveal that the company has paid a donation of Rs. 15 million to a charitable organization where one of the directors of the company is a trustee. The company has earned a gross profit of Rs. 40 million. The selling and administration expenses including the donation amount to Rs. 60 million and as a result the company has incurred a net loss of Rs. 20 million.

Required:

(a) Discuss the significance of the above donation, to the auditor and design appropriate audit procedures to address the issue. **(06)**

(b) Discuss the possible impact of the above issue on the auditor's report. **(04)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2007

December 7, 2007

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 Sukoon Limited is engaged in manufacturing and sale of office equipments. It has appointed you in place of XYZ & Company for the audit of financial statements for the year ended June 30, 2007.

During the audit you noted the following:

- An employee of the company, responsible for after-sales-services, misappropriated cash which he recovered from the customers without raising proper invoices. The amounts were small and much below the materiality level.
- During the last year (ended on June 30, 2006), the middle management in connivance with lower staff booked a sale of material amount which actually pertained to the current year. The higher management has issued warning letters to the concerned employees but is reluctant to take any further action as the company has not suffered any losses. XYZ & Company has given an unmodified report on the previous year's financial statements.

Required:

(a) Describe how each of the above situations will impact the following:
   (i) Assessment of risk and audit procedures; **(03)**
   (ii) Communication with management and with those charged with governance. **(04)**

(b) As a result of material misstatement in sales of previous year, management has agreed on restatement of the corresponding figures in current year's financial statements. What would be the impact on the auditors' report in this case? **(03)**

(c) Explain the difference between corresponding figures and comparative financial statements. **(04)**

Q.2 As the senior in-charge of audit of a listed company, you noted the following matters:

(i) Some of the outstanding balances are in excess of the credit limits.
(ii) Certain sales tax invoices were not signed by the preparer and the reviewer.
(iii) IT Steering committee has not been constituted. However, major decisions regarding IT are discussed in the Management Committee as well as the Board meetings.
(iv) The company does not have an approved Disaster Recovery Plan.

Required:

Prepare a note for inclusion in the Management Letter, covering your observations in respect of the above, the implications thereof and your recommendations. **(10)**

Q.3 Maria Khan, an audit supervisor, has been deputed on an audit client as audit senior of the team attending stock taking exercise. The value of stock at year end is Rs. 250 million and total assets are worth Rs. 400 million. During the stock taking she has come across an item of raw material packed in sealed containers. The containers were few in number but of high value; the total cost being Rs. 24.0 million. She has been informed that the raw material will be used in the production of a very specialized product which the client has recently developed. The raw material needs specialized storage facilities and the containers are required to be opened in specialized conditions.

Management has refused to open the sealed pack containers for physical verification. The field staff has counted the containers and satisfied themselves that raw material as per records was physically available. Maria has approached you, as audit manager, for advice as to what needs to be done.

Required:
What would be your advice to Maria about the procedures that may be undertaken to reduce the audit risk to an acceptably low level. **(08)**

Q.4 Your firm is a member of an internationally recognized network of accountancy firms and provides wide range of professional services. A large multinational company South Union wishes to have a business presence in Pakistan. Having completed the necessary regulatory formalities, the management of the company has approached your firm for appointment as auditors. The management has also requested you to provide the following services in the current year:

(i) Carry out market search to identify the parties engaged in distribution business. The fee will be dependent on the eventual appointment of the distributor by the management;
(ii) Recruit professionals in the position of Head of finance and Internal Audit;
(iii) Provide a general ledger package that has been developed by your firm.

Your firm has decided to accept the appointment as auditor but has refused to carry out the other services.

Required:
Write a letter to the management, briefly explaining the reasons for refusal to accept the other assignments. **(07)**

Q.5 Rufi, a practicing member of the Institute of Chartered Accountants of Pakistan, is engaged in compilation of financial statements of Peshawar Branch of Gamma Limited, a furniture manufacturer and supplier. These will be incorporated in the consolidated financial statements of the company. The fact that the financial statements of the branch have been compiled by Rufi will be mentioned in the annual report of the company.

During the assignment he noticed the following:
(i) The management had ignored an expert's opinion indicating impairment in value of tangible fixed assets and these have been stated at cost less depreciation;
(ii) It was not possible to verify sales made to related parties, as management had not provided the relevant details;
(iii) The management has given a representation that all spares are in good condition. However, during discussion with one of the employees it was revealed that some spares of material amount were damaged and were of no value at the balance sheet date.

Rufi is about to finish the assignment and intends to issue a report on the compiled financial statements. Management wishes to present above financial statements to their auditors without any adjustment.

Required:
(a) How should Rufi deal with the issues referred to in para (i), (ii) and (iii) as given above? **(05)**
(b) Why do you think Rufi is inclined to issue a report? Assuming that Rufi is able to resolve the above issues appropriately, prepare a draft report that Rufi may submit to the management. **(08)**

Q.6 You are a member of the audit team engaged in the audit of a listed company. At the planning stage the audit in-charge paid little attention to the internal auditing activity on the pretext that internal auditor generally lacks independence in performing its duties.

The department is headed by a professional and experienced individual who is a close friend of the Chief Executive Officer and the General Manager of the company. He utilizes such relations very effectively and applies surprise physical checks, unplanned investigations and takes on-the-spot corrective measures on detection of errors or flaws in controls. This approach has reduced the lengthy paper work that is normally seen in internal auditing departments of other companies.

Required:

(a) Assess the internal audit function of the company and its relevance for the external auditors; **(07)**

(b) Comment on the present approach of the audit in-charge and how it would affect the overall audit performance. **(03)**

Q.7 In the audit of Silver Limited you have been provided with a list of related parties alongwith the transactions made with them. Upon comparison of this list with that of the previous year, you are surprised that the number of related parties and values of such transactions have reduced significantly.

Required:

How would you obtain sufficient appropriate audit evidence in respect of the completeness of the information pertaining to related parties? **(09)**

Q.8 When designing audit procedures, the auditor sometimes selects specific items from the population for testing instead of using audit sampling techniques.

Required:

(a) What factors does an auditor take into account while using specific selections? **(03)**

(b) What audit risk emerges in such selection and how is it dealt with by the auditor? **(02)**

Q.9 Gold Blocks Limited a family owned company was formed in 1990 to run a concrete block manufacturing facility. It remained a medium sized and equity based concern for some time and then in 1993, Saleem an enthusiastic family member, took control as its Chief Executive Officer (CEO). He started aggressively by acquiring other manufacturing units through bank financing. In 1997 the name was changed to Gold Limited to align it with the long term plans of diversification. The company's revenues grew at an average of 62% annually during 1993-2000. Besides acquisitions, the CEO also made disinvestments which produced very high capital gains. The company went public in 2001 and generated huge funds. Consequently, three directors representing the other shareholders were appointed on the Board. Equity inflow and high leverage allowed the company to buy-out many established businesses engaged in marble tiles, ceramics and sewerage pipelines. However, the growth rate declined to 28% per annum during 2001 to 2003.

The company used various innovative methods of business promotion, such as:

- Attracting material suppliers to enter into long term contracts at low prices paid upfront or in flexible pattern suitable to the suppliers. Similar kind of schemes were offered to the company's distributors also;
- Shared common sales promotion costs with distributors, established own distribution set ups in untapped areas and transferred own distribution set ups to distributors at different payment plans.

By the mid of 2004 the company started facing many problems such as intense competition, mismanagements and labour unrest, which resulted in sharp decline in revenue growth and severe liquidity crunch.

Since incorporation, IIG Chartered Accountants had been the external auditors of the company. In 2002, IIG merged with SAW and formed SIG Chartered Accountants. Accordingly, Gold Limited appointed SIG as its auditors in 2002. Gold Limited was among the most committed clients of the firm. One of the reasons was that many executives of finance department were ex-SIG people.

In 2007, on the recommendation of the reconstituted Audit Committee, AAQ Chartered Accountants were appointed in place of SIG. The new auditors expressed a disclaimer of opinion in their audit report to the members. They stated that quantification of effects of misstatements in previous years' financial statements was not possible and that the following types of misstatements have occurred:

- Material errors were made in revenue recognitions;
- Certain business disposals in 2000 and 2005 were made to entities which were indirectly sponsored by the company itself and a large portion of the amounts were still outstanding;
- Many receivables from distributors were in fact adjustable from their un-booked claims regarding common advertisements

Apparently, SIG's Quality Control Partner understood the increased audit risk in 2004 and rated the company as 'high risk'. However, the engagement partner, who had been in the position since 1999, claimed that since there was no history of intentional misstatement, there was no need to alter the audit procedures. The audits of last five years have also been reviewed by a senior partner who was also responsible for business promotion of the firm. The Reviewer sent various complicated revenue recognition issues to Research Department of the firm during 2004, 2005 and 2006. Based on the advice of the Research Department, the engagement team suggested certain adjustments, which were refused by the management. The engagement partner and the reviewer considered the amounts immaterial and agreed to issue unqualified reports.

The Board of Directors was extremely upset on the issuance of disclaimer by the new auditors. Besides seeking clarification from the CEO, it wrote a letter to the regulator complaining about the performance of the previous auditors. The letter, among other things, contained the observation that the auditors:

- failed to report/identify errors in revenue recognitions, weaknesses in internal controls, understatement of advertisement expenses, financial losses due to labour unrest and the fact that many business promotion schemes were not beneficial for the company.
- refused to accept certain assignments during their tenure such as designing of internal controls, bad debt estimations, etc. which otherwise could have given them better idea of the company's affairs.

Required:
The regulator has appointed you as the investigation officer. You are required to submit a brief appraisal report discussing the following:

- Corporate governance Issues.
- Quality controls at SIG, Chartered Accountants.
- Audit approach of engagement partner
- Expectation gap between the prescribed standards of an audit and the understanding of the Board of Directors. **(24)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations   Summer 2007

June 8, 2007

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 The Credit Manager of one of your audit clients has left without giving any notice. His responsibilities included maintenance and distribution of management information reports and participation as a member of credit committee.

The said client has requested your firm to allocate one of your staff members, for a period of two months, to take up the responsibilities of Credit Manager. Your firm deals in such kind of assignments for non-audit clients.

Mr. RMP, the Risk Management Partner, has been requested to advise the firm on the above stated engagement.

Required:
Draft a memo on behalf of Mr. RMP clearly indicating whether and under what conditions the firm can accept the above assignment under each of the following situations:

(a) the client is an unlisted company;
(b) the client is a listed company. **(10)**

Q.2 The Management of Fine (Pvt) Limited sent a letter to the statutory auditor of the company along with following statement and notes:

Statement of Receipts and Payments
For the year ended 31 December 2006

	Rs. in million
Bank balance as 1 January 2006	50
Add: receipts from customers and shareholders	150
	200
Less: - Payment against purchases	90
- Salaries paid	50
- Other expenses paid	20
	160
Bank balance as 31 December 2006	40

Notes to the Statement of Receipts and Payments:

1. During the year company issued further shares of Rs. 100 million.
2. Payments against purchases and other expenses are made through cheques and nothing was outstanding at the end of the year.
3. All goods purchased have been sold and all debts have been collected before the year end.

The audit firm has appointed you as job in-charge to audit the financial statements of the company. Following information has also been made available to you:

(i) There are only five shareholders in the company having close family relationship with each other and they are supervising the entire business activity themselves.
(ii) The company is engaged in sales and after sale services of a large number of products.
(iii) Payments against purchases and other expenses are made through cheques except the payments of some insignificant amounts.
(iv) The system of accounting and management information is reasonably sophisticated. However, the management does not apply some of the important internal controls due to its direct involvement in business operations.

The chief executive of the company has requested that since management lacks accounting knowledge, the receipt and payment statement may be treated as the financial statements or alternatively, a summary balance sheet and profit and loss account may be prepared by the auditor. He has justified his request on the ground that user group is extremely limited and is itself involved in the management of the company.

Required:
Discuss the following with appropriate explanations:

(a) What should be the response to the Chief Executive's request;
(b) Essential matters to be dealt at engagement stage; and
(c) Internal controls of the company. **(12)**

Q.3 During the audit of financial statements of Shine Limited, a member of audit team has developed the following differences of opinion with her job in-charge:

(i) She believes that an incorrect working of obsolete stock provided by the client, which was superseded by a revised working given subsequently, should be kept in the working paper file as there was material difference between the earlier and final workings. Job in-charge wishes to discard the working since it was revised by the client management themselves after discovering the error. An explanatory note describing the error and how it was corrected has already been included in the file.

(ii) She performed risk assessment procedures related to sales and concluded that the risk of material misstatement is high. While making such an assessment she tested the risk of material misstatement due to error but did not consider material misstatement due to fraud as she relied on the assessment and documentation made by the job in-charge at financial statement level. Job in-charge does not agree with her approach but he is not sure as to how she should have approached the issue.

(iii) She noted that a sales officer of the company had sold many products at exorbitant prices to a customer and earned handsome commission thereon. She suspects possibility of fraudulent collusion between sales officer of the company and employees of the customer. However, the difference between normal and abnormal prices is of below material amount. Job in-charge identifies it as a significant risk of fraud and wants to communicate the same to those charged with governance. She does not agree with the job in-charge.

Required:
(a) Resolve the above differences arising between the team member and job in-charge, giving proper explanation in each case. **(09)**
(b) Draft a policy statement and narrate the guidelines relating to difference of opinion within the engagement team. **(05)**

Q.4 While going through the newspaper, Mr. Akram came to know that the Ministry of Health had issued show-cause notices to those pharmaceutical companies which had not yet started their own manufacturing within a period of two years from the issuance of permission of toll manufacturing, as the said permission was subject to this condition.

Akram is involved in the audit of Dine Pharma Limited (DPL) as engagement partner. The audit is expected to be finalized within one month. DPL's products are manufactured under toll manufacturing arrangements and it has three to five years non-cancelable agreements with five manufacturing units. Akram has approached you as the firm's Technical Director for consultation on the above matter.

Required:
Briefly advise Akram about impact of the above matter on the financial statements disclosure as well as auditors' report. **(10)**

Q.5 Mr. Dar is the Chief Financial Officer (CFO) of a medium sized limited company engaged in sale of consumer goods through a number of distributors. These distributors collect and deposit the sale proceeds in collection accounts opened in more than 100 branches of a commercial bank situated in urban and rural areas all over Pakistan. These accounts are non-checking accounts (i.e. the company cannot issue cheque or transfer the amount to any account other than the designated sales collection control account). Under an agreement with the bank, the branches transfer the amounts collected on next working day to the designated sales collection control account.

The auditor of the company intends to obtain direct confirmations from all branches and intends to use positive as well as negative confirmations. Considering that such audit procedures would take considerable time and may delay the finalization of accounts, the Chief Executive Officer (CEO) is of the opinion that Mr. Dar should ask the auditor to omit this procedure. CEO believes that according to International Standards on Auditing management has a right to ask the auditor not to send direct confirmations.

Required:
Prepare an explanation for CEO on behalf of CFO explaining him the guidelines laid down in International Standards on Auditing in respect of external confirmation in the above case. **(09)**

Q.6 You are an Audit Manager in a large firm of chartered accountants which is also a member of a global firm. You have recently completed the audit of one of your clients. Your firm has already been appointed as auditors of the company for the following year. Soon after the appointment, you came to know that the chief executive of the company was involved in some illegal practices and he is about to face some investigation.

Required:
Discuss the various possibilities arising out of the above situation and what action would you take in each case. **(10)**

Q.7 You are the statutory auditor of Critical Limited. The company has asked you to submit a special purpose audit report for onward submission to a regulatory authority. The report has to be submitted on a format prescribed by the regulatory authority, the substance and wording of which does not conform to the requirements of International Standards on Auditing.

Required:
(a) Describe the essential contents of a special purpose audit report as required by the International Standards on Auditing.
(b) Explain how you would respond to the above situation. **(08)**

Q.8 Mr. Ali has recently joined as Audit Partner of ABC & Co., Chartered Accountants. On assuming the responsibility he discovered that the firm does not have comprehensive guidelines for "Engagement Quality Control Review". He wants to bring this issue to the notice of Managing Partner.

Required:
Prepare discussion points for Mr. Ali explaining the following:

(a) The basis of selecting engagements for review;
(b) Nature and timing of review; and
(c) Criteria for eligibility of engagement quality control reviewer. **(11)**

Q.9 SK is the engagement senior on the audit of PK Limited. One of his team members has been assigned the task of verifying the fair values of various assets in the financial statements. He is perplexed by the fact that out of various valuation methods available under the company's financial reporting framework, the management has used a particular method, except in one case where the management has changed the valuation method in the current year. The team member is confused and has approached SK for guidance.

Required:
Describe the procedures that should be performed in the above situation. **(05)**

Q.10 You are the job in-charge on the audit of Globe Industries Limited (GIL) which is the holding company of a large group of companies engaged in production and marketing of consumer items, food products and textiles. The net worth of the group is approximately Rs. 89 billion whereas profit for the year ended December 31, 2006 is Rs. 6.4 billion (2005 : Rs. 4.8 billion).

During the planning phase of the audit, you have gathered the following information:

(i) GIL holds 25% shares in Multan Industries Limited (MIL), at the beginning of the year. GIL purchased further 30% shareholding in MIL on April, 2006. MIL is audited by a large firm having international affiliation.

(ii) One of the group companies i.e. Karachi Industries Limited has incurred serious losses during the year. Company had to discontinue two of its main products after facing litigations on a copy right issue. The auditor of the company has expressed serious doubts about the status of the company as a going concern and has issued a disclaimer of opinion.

Required:
Describe the important aspects that you would consider at the planning stage. **(11)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2006

December 8, 2006

ADVANCED AUDITING **(MARKS 100)**

Module F **(3 hours)**

Q.1 ABC & Co. Chartered Accountants have been offered an appointment as the auditor of prospective financial statements of Alif Limited, which have been prepared in the form of a projection. These prospective financial statements are prepared to help the directors of the company to make certain strategic decisions for the expansion of the company. The volume of sale projected in the said financial statements had never been achieved by the company in the past.

ABC & Co., Chartered Accountants are also the external auditors of the company. You, as audit manger, of the firm, are required to prepare a memorandum for the partner in-charge containing the following:

(a) The matters that need to be considered before accepting this engagement. **(02)**

(b) The information to be contained in an unmodified audit report on the prospective financial statements. **(08)**

Q.2 While reviewing the directors' report of Bay Limited, at the conclusion stage of your audit, you noted that;

- Contingent liabilities reported in directors' report were Rs. 250 million, whereas the directors have previously agreed to report it in the financial statements as Rs. 525 million. On inquiry, the CFO informed that the directors had agreed with the view of the auditors to avoid qualification although they still believe that contingent liabilities should be reported at Rs. 250 million.
- A new plant was reported to be operative only for the half year while you have sufficient appropriate evidence that the said plant remained in operation for almost the whole year. However, financial statements do not contain any information about duration of plant's operation as it was not required under the law.

What course of action would you take to resolve the issues? **(06)**

Q.3 Jeem Limited has accumulated tax losses amounting to Rs. 250 million. The management has recognized a deferred tax asset amounting to Rs. 87.50 million assuming that there will be sufficient taxable profit in the future. Tax computation of the company is very complex and involves application of various rules and regulations which are subject to frequent changes by the government.

Briefly describe the steps that you would take as an auditor in the audit of deferred tax asset recognized by the management in the above case. **(06)**

Q.4 You are the member of an audit team formed to conduct audit of Safe General Insurance Limited, a listed company. The engagement partner of your firm has asked you to prepare a note containing the following;

(a) Threats that potentially affect independence. **(04)**

(b) Measures to be taken by the engagement partner to form a conclusion on compliance with independence requirements. **(04)**

Q.5 Ahmad & Co. Chartered Accountants have been appointed as auditors of Noon Limited for the first time. Prior years' financial statements have been audited by an affiliated firm.

As audit in-charge of the company, you noticed that last year's audit report had been qualified by the previous auditors on the following matters:

- Disagreement on capitalization of borrowing costs amounting to Rs. 15 million.
- Inadequacy of records maintained for recording sales, causing non-identification of related party transactions.

You are planning to carry out certain specific procedures in respect of opening balances. Your team members consider these procedures unnecessary as previous years' audits were done by your affiliated firm. They feel that, this audit should not be considered as an initial audit engagement.

You are required to brief your audit team on the following:

(a) Reasons for considering this audit an initial audit engagement and the evidence you will obtain from applying procedures on opening balances. **(04)**

(b) Audit approach in respect of matters that caused modification of last year's audit report. **(06)**

Q.6 At the planning phase of the audit of Prudent Limited, a listed company, senior auditor of your team submitted the following information;

- The Board of Directors of the company has recently appointed Mr. Smart as new chief executive whose remuneration is mostly based on efficiency bonus and stock options.
- Mr. Smart is reputed as a seasoned business executive and has been a very good friend of the Chairman of the audit committee.
- Since his joining he has proved to be the main decision maker and the Board appears to be relying considerably on Mr. Smart and less interested in day to day operations of the company.
- Board's main concern is now the growth in net earnings estimated for the next year, which Mr. Smart strongly believes, will be 30% at the minimum.
- There are a number of instances of lack of segregation of duties and Mr. Smart being cost conscious, has allowed the situation to continue.
- 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.
- Mr. Smart has introduced an employees' skill development scheme only for top management personnels.

(a) Describe the fraud risk factors, if any, that are indicated in the above information. **(07)**

(b) "Management is in a unique position to perpetrate fraud because of management's ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. While the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities and is a significant risk of material misstatement due to fraud".

What are the procedures that an auditor should design and perform to address the risk of management's override of controls? **(06)**

Q.7 Mr. Kay, the audit partner of JKL & Co. Chartered Accountants, came across the following matters relating to the trainee students of the firm;

- They freely discuss information of one client with other clients unless client specifically requests for confidentiality.
- One trainee disclosed some key information of an ex-client to his friends outside the firm, which probably were used by them for their personal benefit. However, the trainee himself had not used such information in any way.
- Another trainee supplied certain information to one of the lawyers of the client. However, he had obtained prior written permission from the said client.

To address the issues relating to confidentiality Mr. Kay decided to hold a training session for trainee students. As the audit manager, you are required to make a presentation covering the following points;

(a) Principles of confidentiality. **(04)**
(b) Any breach of such principles with relation to given instances. **(03)**
(c) Examples of circumstances when disclosure of information of a client is considered to be in order. **(03)**

Q.8 After the completion of field work of the audit of Ray Limited you, as audit in-charge, have noted the following:

- The provision of a material amount against a pending legal suit remained unresolved between the auditor and Chief Financial Officer (CFO) until a second opinion from a lawyer was received. Thereafter, liability was booked appropriately.
- This year, auditors performed extensive audit procedures on revenue account.
- There were a number of minor errors which were corrected on the auditor's intimation. However, there were many other similar errors, which remained uncorrected by the management, being considered immaterial, in aggregate.
- There exists a disagreement between the auditors and the CFO relating to provision for bad debts of material amount.
- Internal audit department was found efficient and effective.
- Chief Executive by-passes the credit committee frequently and approves credit sales to some customers.

Which of the above matters may be included in your communication with the management and audit committee of the company? Explain. **(09)**

Q.9 While conducting initial meeting with members of your audit team, you have noticed that they are confused about use of tests of controls in the presence of risk assessment procedures related to internal controls. They are of the opinion that auditor is not required to perform tests of operating effectiveness of internal controls in each audit period. They also believe that auditor can save much time and energy by omitting substantive tests when tests of controls give sufficient and appropriate evidence that efficient and reliable controls were in effect through out the period under audit.

(a) Briefly discuss why tests of controls are required to be performed when risk assessment procedures have already been performed. **(04)**

(b) How does an auditor rely on operating effectiveness of internal controls tested during previous audits? **(04)**

(c) Give your comments on the team's understanding about omitting substantive procedures? **(02)**

Q.10 Zay (Pvt.) Limited engaged in construction of industrial buildings has been asked by a prospective customer to attach summarized financial statements of the company duly certified by a practicing chartered accountant, with the tender documents.

The Chief Financial Officer (CFO) contacted Abdul Qadir & Company, Chartered Accountants, who had recently been appointed by the company in place of another firm of chartered accountants and requested them to issue the required certificate. For the said purpose, CFO also sent a set of summarized financial statements extracted from audited financial statements on which previous auditor had issued his audit report.

(a) Explain whether the firm can accept the engagement. **(03)**

(b) Briefly describe the main elements of auditor's report on summarized financial statements? **(07)**

Q.11 Briefly explain the following components of Internal Control System:

(a) Entity's risk assessment process. **(04)**

(b) Information and Communication. **(04)**

(THE END)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2006

June 09, 2006

ADVANCED AUDITING

(MARKS 100)
(3 hours)

Q.1 You are manager incharge on the audit of the financial statements of XYZ Pakistan Limited, a large multinational FMCG company, which has appointed your firm as auditors for the first time. During the course of finalization of audit you had various meetings with the senior management of the Company. The management of the company is really proud of their systems, business ethics and transparency in the financial reporting systems. Nevertheless, during discussion you came across a situation whereby the management has refused the request of signing the general representation letter. The chief executive and chief financial officer of the company are of the view that all their procedures and financial reporting systems are transparent and you are given full liberty to check and verify any information and there is no bar on providing you any information that you may require for the purpose of your audit. Accordingly, they feel that through a representation letter, you wish to transfer your responsibility to them. Therefore, they are not willing to sign any sort of representations by whatever name called.

In this respect you are required to submit a memorandum to the management highlighting the requirements of the International Standard on Auditing on management's representations. Accordingly, you are required to:

(a) List down the documents through which the auditor can ensure that the management and those charged with governance acknowledge their responsibility for the preparation of the financial statements; **(03)**
(b) Identify who should sign the representation letter. **(02)**
(c) Explain as to what should be the date of representation letter; and **(02)**
(d) Describe what would be your action, if the management continues to refuse providing a written representation letter. **(03)**

Q.2 At planning stage of the audit of a new client, you, as an audit manager had a meeting with the CEO and CFO of the company. Various matters such as company's performance, profitability, turnover of staff, import of plant and machinery during the year, inventory turnover, collection from debtors, payment of creditors, investment in marketable securities etc were discussed.

As a result of the discussion you were able to assess that a significant portion of the company's business is conducted with parties which are closely linked with the company.

As the audit manager you are now required to explain the following to the members of the audit team:
(a) Procedure as to how completeness of related party transaction could be verified. **(04)**
(b) Examples of transactions, which indicate the existence of related parties. **(03)**
(c) Examination of identified related party transactions **(04)**

Q.3 State Street Limited (SSL) is a public limited company. Their external auditors are Mohammad Din & Co., Chartered Accountants. They are also providing taxation services to SSL. You are working as Manager Audit on the above engagement. You came to know that your firm's tax services department has agreed with the management of SSL to represent the Company before the taxation authorities in respect of an appeal filed by them involving substantial amount of tax demand. In consideration thereof, the tax department will charge ten percent of the amount of tax relief that may be allowed.

As an audit engagement manager you are not comfortable with the above arrangement as it may impair independence of the Firm. You are required to put forward a note before the audit engagement partner highlighting the guidance provided in the Code of Ethics as issued by the Institute of Chartered Accountants of Pakistan in respect of contingent fees charged to clients for assurance and non-assurance services. **(06)**

Q.4 You are a manager on the audit engagement of Afghan Automobiles Limited. Yasin, the incharge of audit engagement, while reviewing the draft financial statements noticed that the current assets include an asset described as Derivative Financial Instruments. Upon his inquiry, the Chief Financial Officer explained that there are certain open foreign exchange forward contracts that are recognized at their fair value in accordance with the International Accounting Standards. He further explained that these contracts were entered into in order to manage the company's risk exposure relating to fluctuations in the foreign currency exchange rates.

Yasin has no prior experience of auditing the derivatives and the audit plan approved by the manager did not cover the procedures for auditing derivatives. Therefore, she consulted you being the engagement manager for seeking guidance on planning and performing auditing procedures for financial statement assertions related to derivative financial instruments. You are required to answer the following questions raised by him:

(a) Describe briefly what are 'Derivative Financial Instruments' **(04)**

(b) What are the key substantive procedures related to valuation and measurement assertions about derivatives? **(05)**

Q.5 Discuss 'Audit Matters of Governance Interest' that arise from the audit of financial statements and are required to be communicated to those charged with governance? **(05)**

Q.6 You are currently working as Audit Senior in a medium sized audit firm. Your firm does not have any international affiliation and all the working standards and practices of the firm have been developed locally in the light of the International Standards on Auditing and the pronouncements of the Institute of Chartered Accountants of Pakistan.

The firm has commenced an exercise to further strengthen the working procedures of the firm in general and to improve the quality control process in particular, in line with the revised ISA on Quality Control for Audits of Historical Financial Statements. In this respect, the managing partner of the firm advised you to prepare memorandum describing the following:

(a) The term "Engagement Partner"; and **(03)**
(b) Responsibilities of an engagement partner. **(06)**

Q.7 (a) The financial position of Sonia Limited as at 31 December 2005, is as follows:

- Current liabilities over current assets are Rs. 200 million.
- Carrying value of property, plant and equipment is Rs. 600 million.
- Long term borrowing is Rs. 750 million.

You are the senior incharge of the audit engagement for this client and have expressed your concern on the company's ability to continue as a going concern. The management shared with you its five-year plan. You are satisfied that the assumptions used in preparation of the plan are appropriate and reasonable but the ability to obtain further borrowing is uncertain. However, management is confident that the company would be able to obtain borrowing. Management is willing to give disclosures of its five-year plan in the financial statements.

Explain and discuss the above situation to your partner along with your suggestions with regard to type of audit report that should be issued? **(05)**

(b) Discuss those factors, which should be considered by the management in assessment of going concern assumption? **(04)**

Q.8 A company was incorporated on 1 January 2005 and started its commercial operations accordingly. While reviewing the financial position of the company as at 30 June 2005, it comes to the knowledge of the management that there are certain cases of non-compliance of laws and regulations such as Companies Ordinance 1984, Sales Tax Act, 1990 and Income tax Ordinance, 2001. The management has serious concerns on this situation and seeks your advice in this respect.

Advise the management regarding policies and procedures that may assist the management in the prevention and detection of non-compliance with laws and regulations. **(05)**

Q.9 A private limited company with paid up capital of Rs. 25 million has outsourced its internal audit department for a period of 3 years to a professional firm of chartered accountants, Shams Qamer & Co., during the year ended 31 December 2005. According to the 'Outsourcing Agreement', if the management changes the internal auditor before expiry of 3 years, the management would pay a compensation of Rs. 1.00 million to Shams Qamer & Co.

Before holding an annual general meeting for the year, the company received a notice from a member of the company for change of external auditors and also proposed the name of Shams Qamer & Co. for the same.

The management is confused whether internal auditor can also be appointed as external auditor of the company. Therefore, management contacted you for seeking your opinion in this respect.

Advise the management with reference to ISA on the subject and the Code of Ethics issued by Institute of Chartered Accountants of Pakistan as to whether Shams Qamer & Co. engaged as internal auditors can also be appointed as external auditors of the company simultaneously. **(07)**

Q.10 During the audit of financial statements of an investment advisory company, for the year ended 31 December 2005, you noted the following:

(a) The company has accumulated losses at the close of financial year amounting to Rs. 50 million which have eroded the company's capital of Rs. 30 million.
(b) During the financial year, the company provided loan of Rs. 250 million to its directors for their personal business. The receivable from directors at year-end is NIL.

Explain how would you deal with the above matters while finalizing the audit of the company. Suggest a suitable modification in audit report if the same is considered necessary. **(08)**

Q.11 A listed company situated in Pakistan has two independent branches in other countries. At the planning stage of audit for the year ended June 30, 2005 you sent appropriate instructions to the auditors of both branches and requested them to perform the work in accordance with the International Standards on Auditing and send audit opinion on the financial statements accordingly.

One of the reports you received from the auditors states that audit work has been carried out in accordance with the local auditing standards. The other auditor has completed his work according to your satisfaction.

How would you handle the above situation? **(06)**

Q.12 You are the engagement manager of National Commercial Bank Limited. As part of the audit planning you are evaluating the risk factors that may indicate the possibility of fraudulent financial reporting or misappropriation of assets. Considering the significance of this aspect of audit, the Audit Committee of the Bank has requested you to give them a presentation as to how the audit team has planned to address the risk of fraud in the upcoming audit of the Bank.

Prepare the key points that you will include in your presentation for the Audit Committee of the Bank on the following:

(a) "Fraud is more likely to be perpetrated at banks that have serious deficiencies in corporate governance and internal control". **(05)**
(b) Fraud risk factors in respect of the following banking operations:
    (i) Deposit taking **(03)**
    (ii) Lending **(03)**

Q.13 While reviewing the published financial statements of a listed company audited by you, it was found that a note to the financial statements as contained in the signed copy available in your working paper is missing. The amount involved in the note was not material.

Discuss auditor's responsibility in such case? **(04)**

(THE END)