

TABANI'S SCHOOL OF ACCOUNTANCY

Mock Examination

AUDITING

Time Allowed: 03 Hours

Module D Refresher

11 August 2012

Maximum Marks: 100



Q.1 You are the quality control partner in Ramzan and Company, Chartered Accountants. The following matters are under your consideration:

- Your firm has been approached for appointment as external auditors of Muharram Limited (ML), a listed company. Your firm has been providing valuation services to ML.
- Safar 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.
- 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 Shawwal & Company, Chartered Accountants. It is expected that your firm would receive a commission of 15% of the assignment fee from Shawwal & 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. (09 marks)

Q.2 The draft accounts of Rajab Pharmaceutical Limited (RPL) for the year ended September 30, 2011 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:

- 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.
- On October 17, 2011 the Income Tax Department issued amended assessment orders for the tax years 2007 to 2010 in which an aggregate tax of Rs. 40 million has been demanded. RPL has filed appeals against the orders before the Income Tax Appellate Tribunal. RPL'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.
- 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 RPL'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:

- State with reasons what action you would take; and
- Discuss the implications on the audit report, if any. (09 marks)

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Q.3 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 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. (09 marks)

Q.4 Your firm has been appointed as the auditors of Shaban 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.

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Maximum Marks: 100



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:

- Is there any relevance of oral representations for the External Auditors?
- What are the situations in which written representation from the management is mandatory?
- What course of action would you like to take in the above circumstances? (08 marks)

Q.5 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 (2 each) and disadvantages (2 each) of judgmental and statistical sampling. (08 marks)

Q.6 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:

- Discuss the significance of the above donation, to the auditor and design appropriate audit procedures to address the issue. (04 marks)
- Discuss the possible impact of the above issue on the auditor's report. (02 marks)

Q.7 You are the audit senior with responsibility for directing, supervising and reviewing the work of the junior members of the engagement team during the external audit of Hilal Ltd.

Required:

Explain how you would discharge these responsibilities *before* and *during* the audit assignment. (10 marks)

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AUDITING

Time Allowed: 03 Hours

Module D Refresher

11 August 2012

Maximum Marks: 100



Q.8 (a) Describe the auditor's responsibility for subsequent events occurring between:

- (i) The year-end date and the date the auditor's report is signed; and
- (ii) The date the auditor's report is signed and the date the financial statements are issued. (4 marks)

(b) Shams Co operates a chain of food wholesalers across the country and its year end was 30 September 2011. The final audit is nearly complete and it is proposed that the financial statements and audit report will be signed on 13 December, 2011. Revenue for the year is Rs.78 million and profit before taxation is Rs.7.5 million. The following events have occurred subsequent to the year end.

Receivable

A customer of Shams Co has been experiencing cash flow problems and its year-end balance is Rs. 0.3 million. The company has just become aware that its customer is experiencing significant going concern difficulties. Shams believe that as the company has been trading for many years, they will receive some, if not full, payment from the customer; hence they have not adjusted the receivable balance.

Lawsuit

A key supplier of Shams Co is suing them for breach of contract. The lawsuit was filed prior to the year end, and the sum claimed by them is Rs.1 million. This has been disclosed as a contingent liability in the notes to the financial statements; however correspondence has just arrived from the supplier indicating that they are willing to settle the case for a payment by Shams Co of Rs.0.6 million. It is likely that the company will agree to this.

Warehouse

Shams Co has three warehouses; following extensive rain on 20 November, 2011 significant rain and river water flooded one of the warehouses. All of the inventory was damaged and has been disposed of. The insurance company has already been contacted. No amendments or disclosures have been made in the financial statements.

Required:

For each of the three events above:

- (i) discuss whether the financial statements require amendment;
- (ii) describe audit procedures that should be performed in order to form a conclusion on the amendment; and
- (iii) explain the impact on the audit report should the issue remain unresolved. (15 marks)

Q.9 You work as an assistant manager in one of the leading firm of chartered accountants. Your partner has asked you to prepare a presentation for some of the newly recruited staff on ISA 600 Audit of Group Financial Statements. Prepare the required presentation highlighting the following items:

- Understanding the Group and Its Components
- Significant Components and Work Effort on Components
- Component Auditors
- Communication with component auditors (08 marks)

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Mock Examination

AUDITING

Time Allowed: 03 Hours

Module D Refresher

11 August 2012

Maximum Marks: 100



Q.10 (a) International Standard on Auditing 300 *Planning an Audit of Financial Statements*, states that an auditor must plan the audit. Explain why it is important to plan the audit. (4 marks)

(b) Pluto Limited is a small engineering company with 14 employees and has recently appointed your firm as its auditors. You attended the company's yearend stock count on 31 December 2011 and ascertained that the company had a material amount of work-in-progress. Now, you are preparing to carry out the detailed audit work on the company's financial statements to 31 December 2011.

Two junior members of the audit team have asked you to explain the process for obtaining audit evidence. They are aware of ISA 500 *Audit Evidence*, and want to know the factors that will influence your firm's judgment in deciding what will be sufficient appropriate evidence when auditing the financial statements of Pluto Limited. They are also unsure about the specific procedures your firm will use to obtain audit evidence.

Required

- i. State four factors that generally influence an auditor's judgment in assessing the reliability of audit evidence. (4 marks)
- ii. Describe each of the procedures listed below, used to obtain audit evidence, and for each procedure give TWO examples of when it may be used during the audit of the financial statements of Pluto Limited. (6 marks)

(a) Observation;

(b) Inquiry;

(c) Confirmation.

(THE END)

TABANI'S SCHOOL OF ACCOUNTANCY

Send-up Examination (21st MFC)

AUDITING

Time Allowed: 03 Hours

Module-D

Saturday: 04 August, 2012

Maximum Marks: 100



Q. No.

Marks

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 - Safar 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.
 - 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 Shawwal & Company, Chartered Accountants. It is expected that your firm would receive a commission of 15% of the assignment fee from Shawwal & 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.

2. The draft accounts of Rajab Pharmaceutical Limited (RPL) for the year ended September 30, 2011 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: (09)
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 - On October 17, 2011 the Income Tax Department issued amended assessment orders for the tax years 2007 to 2010 in which an aggregate tax of Rs.40 million has been demanded. RPL has filed appeals against the orders before the Income Tax Appellate Tribunal. RPL'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.
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Required:

In respect of each of the above matters:

- State with reasons what action you would take; and
 - Discuss the implications on the audit report, if any.
3. 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: (09)
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 - 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.
 - 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.

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SEND-UP EXAMINATION



- (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 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.

4. Your firm has been appointed as the auditors of Shaban 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. (08)

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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?

5. 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. (08)

Required:

Briefly narrate the advantages (2 each) and disadvantages (2 each) of judgmental and statistical sampling.

6. 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. (04)
 (b) Discuss the possible impact of the above issue on the auditor's report. (02)

7. You are the audit senior with responsibility for directing, supervising and reviewing the work of the junior members of the engagement team during the external audit of Hilal Ltd. (10)

Required:

Explain how you would discharge these responsibilities *before* and *during* the audit assignment.

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SEND-UP EXAMINATION



8. ABC & Co. is the auditor of Galaxy Limited which operates in Pakistan and which has five subsidiaries namely Sun, Star, Moon, Planet & Earth. In accordance with ISA 600 "Audit of Group Financial Statements" ABC has accepted the engagement as the Group Auditor of Galaxy Limited. Following is the information regarding the components and their respective auditors:

Component	Component Auditor	Relation of Component Auditor with ABC	Significance of Component	Professional oversight over component	Jurisdiction of Component
Sun	ABC	Same Auditor	Due to Size	Yes	Pakistan
Star	AB	Same network	Due to Size	No	Afghanistan
Moon	XYZ	No relation	Due to Size	Yes	Pakistan
Planet	PQR	No relation	Due to Nature	Yes	Pakistan
Earth	AB	Same network	Insignificant	Yes	Nepal

Required:

- (a) Which of the above auditors can act as component auditors for the audit of Group Financial Statements of Galaxy Limited? (05)
- (b) Specify the work effort of the auditor in case of each of the component mentioned above. (05)
- (c) Compare and comment on the nature, timing and extent of understanding of component auditors highlighted in (a). (04)
9. (a) Describe the auditor's responsibility for subsequent events occurring between:
- (i) The year-end date and the date the auditor's report is signed; and
- (ii) The date the auditor's report is signed and the date the financial statements are issued. (04)
- (b) Shams Co operates a chain of food wholesalers across the country and its year end was 30 September 2011. The final audit is nearly complete and it is proposed that the financial statements and audit report will be signed on 13 December, 2011. Revenue for the year is Rs.78 million and profit before taxation is Rs.7.5 million. The following events have occurred subsequent to the year end.

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Lawsuit

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Warehouse

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Required:

For each of the three events above:

- (i) discuss whether the financial statements require amendment;
- (ii) describe audit procedures that should be performed in order to form a conclusion on the amendment; and
- (iii) explain the impact on the audit report should the issue remain unresolved. (15)
10. Your firm is newly appointed external auditor to a large company that sells maintains and leases office equipment and furniture to its customers. You have been asked to co-operate with internal audit to keep audit costs down. The company wants you to rely on some of the work already performed by internal audit department.
- Required:**
- a. Describe the circumstances in which it would not be possible to rely on the work of Internal Auditors. (05)
- b. Explain why it will be necessary for your firm to perform its own work in certain audit areas in addition to relying on the work performed by internal audit. (03)