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## Audit and Assurance

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- Q.1 (a) Explain the term 'Expectation Gap' in the context of an audit and give three examples of expectation gap. (04)
- (b) International Standards on Auditing require an auditor to evaluate the control environment and assess its effectiveness. State the factors that the auditor should consider in evaluating the control environment. (04)
- (c) A schedule of related party transactions provided by the client includes two significant transactions which are outside the normal course of business. State the substantive procedures that an auditor should undertake, in respect of these transactions. (04)
- (d) State key features of a review engagement which distinguish it from a statutory audit and identify two types of review engagements. (03)
- (e) Identify the factors that are considered in determining the independence of internal auditors. (02)
- (f) State four substantive procedures for verification of share premium account appearing in the statement of financial position. (02)
- (g) Briefly explain with examples, the different levels of assurance that can be provided to an assurance client. (03)
- (h) State the conditions under which an auditor may send negative confirmations. (04)
- Q.2 Your firm has been re-appointed as the auditor of Elegant Limited (EL) for the year ended 30 June 2015. The firm has been the auditor of EL for the last five years.
- Required:**
- (a) How would you assess whether it is necessary to send an audit engagement letter to EL for the year ended 30 June 2015? (05)
- (b) State how you would proceed if EL requests your firm to change certain terms of the engagement. (04)
- Q.3 You are the Audit Manager on the audit of Durable Cement Limited (DCL). The information contained in the planning document includes the following:
- (i) DCL is presently operating in poor general economic conditions and is also faced with tough competition, due to the availability of low priced imported cement.
- (ii) In addition to the wholesalers, DCL supplies cement directly to various government departments and real estate developers. The sale is authorized by the credit control department; however, payments from government departments are often delayed.
- (iii) During the year, DCL has made investment in securities of unlisted public companies.
- (iv) A long-term loan was obtained in 2007 to finance the existing plant. The amount is repayable in 10 annual instalments.
- (v) DCL operates a non-funded gratuity scheme for its employees.

**Required:**

Assess the inherent risks (high, low or moderate) along with appropriate justification, related to the following assertions:

- |   |                                       |
|---|---------------------------------------|
| ▪ Valuation of factory plant                  | ▪ Valuation of trade receivables      |
| ▪ Ownership right of finished goods inventory | ▪ Valuation of unlisted securities    |
| ▪ Accuracy of long-term finance               | ▪ Valuation of provision for gratuity |
- (09)

Q.4 Your firm is the auditor of Customized Machinery Limited (CML), a listed company, for the year ended 30 June 2015. CML has an asset base of Rs. 3.5 billion and profit before tax of Rs. 350 million. On 10 August 2015, after the issuance of audit report but prior to the issuance of financial statements, you have been informed as under:

- (i) CML had been awarded a contract of Rs. 500 million in April 2015 for supply of specialized machinery parts in August 2015 to a foreign customer. CML was expecting a profit of 20% on the contract. However, the government of the foreign country has placed certain restrictions on import because of which the customer has cancelled the purchase order under force majeure clause.
- (ii) The inventory against the above order is lying in the warehouse and requires an expense of Rs. 105 million in order to become usable for other customers.
- (iii) According to the management, the cancellation of this order will not affect the operations of the company in any significant manner.

**Required:**

Discuss how you would deal with the above situation.

(07)

Q.5 Following IT related controls are being employed at Vision Limited:

- (i) The general ledger system is automatically updated with sub-ledger transactions (e.g. Accounts Receivable) every night through batch processing.
- (ii) The system automatically maintains second copies of all programs and data files.
- (iii) Access to programs and data files is restricted using passwords.
- (iv) Invoices that are entered into the system are physically counted.
- (v) Firewalls (software and hardware) are installed to restrict unauthorized access.
- (vi) Screen warnings are displayed as regards incomplete processing.
- (vii) Vision Limited has service level agreements with reliable software companies, for technical support.
- (viii) Review of output against expected values.

**Required:**

- (a) In respect of each control, determine whether it is a preventive, detective or corrective control. (04)
- (b) Also classify each of the above between general IT controls and application controls. (04)

Q.6 As the engagement partner, you have reviewed the working papers of Nadeem Limited (NL) in which the audit team has highlighted the following matters:

- (a) NL provides six months warranty to its customers and has hired an expert to compute the warranty provision. The management is not willing to provide written representation for the warranty provision because the provision is in accordance with the expert's advice. (04)
- (b) Certain contingent assets have been disclosed in the draft financial statements in which inflow of economic benefits is possible but not probable. The management is of the view that International Financial Reporting Standards does not prohibit making additional disclosures which enhance the users understanding of the financial statements. (03)
- (c) According to the accounting policy for revenue recognition, revenue from sale of goods is recognized on dispatch of goods to customers. However, during the year, NL has entered into various agreements in which the goods are required to be delivered at the premises of the customers. (03)

**Required:**

Discuss the possible impact on the audit report.

- Q.7 (a) List any **four** ways in which the debtor balances may be stratified. **(02)**
- (b) You are the audit incharge on the audit of Opportunity Limited (OL). OL deals in fast moving consumer goods. For sending of confirmations, an audit team member has stratified the debtors as follows:

Category A	Balances exceeding Rs. 50 million	12 customers
Category B	Balances below Rs. 50 million	100 customers
Category C	Balances below Rs. 10 million	280 customers
Category D	Balances below Rs. 1 million	600 customers

During a meeting some of the team members have expressed divergent views, as follows:

- (i) Verification of balances of category A and B will provide sufficient coverage and evidence; therefore there is no need to cover other categories.
- (ii) Selection should be done on haphazard basis, as under this method all items of population have equal chance of selection.
- (iii) Selection of sample should be done systematically, whereby items constituting 10% of the amounts in each category should be selected in descending order.

**Required:**

Discuss the appropriateness of options discussed in the meeting and give your suggestion in this regard. **(05)**

- Q.8 (a) Differentiate between Symmetric key ciphers and Asymmetric key ciphers in relation to data encryption techniques. **(02)**
- (b) Identify any **four** types of information that can be extracted from system logs. **(02)**

Q.9 Discuss the categories of threats and related safeguards in each of the following situations:

- (a) Your firm is the auditor of Prime Super Markets Limited, a chain of super markets. During a promotional campaign, the management has distributed discount vouchers which have also been given to the audit team members. **(04)**
- (b) You are the manager on the audit of Abid Textile Mills Limited. The client has requested you to send two staff members on secondment for three months to assist the chief financial officer as its two senior accounting team members have resigned recently. **(05)**
- (c) Fine Petroleum Limited (FPL) is the audit client of your firm for five years. During the year, the engagement partner has been changed due to mandatory rotation as per Code of Corporate Governance. However, the firm has decided to retain Atif, the audit manager, who has been involved in the audit of FPL for the past five years. **(04)**

Q.10 You have been assigned to plan the test of controls in respect of salaries and wages. In this regard you are required to identify the following:

- (a) Possible control weaknesses in overtime payments **(03)**
- (b) Principal controls over payment of overtime **(04)**

**(THE END)**