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## Audit and Assurance

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Q.1 A friend of yours has invested in the shares of Ascender Limited. On receiving the company's annual report, he made the following comments:

“The auditor has expressed an unqualified opinion. Since the auditor must have arrived at his opinion after testing majority of the transactions, therefore the financial statements are correct in all respects. Since no control deficiencies and fraudulent conduct had been reported by the auditor, I can safely invest further amount of money in the company because there is no risk that I will lose my money due to fraudulent conduct of management or misrepresentations in the financial statements.”

**Required:**

Write a letter to your friend to remove his misconceptions related to the audit of financial statements including brief explanation of your point of view. (08)

Q.2 (a) You are the audit senior at FSY Limited (FSY) for the year ended 30 June 2018. FSY manufactures and supplies toys to wholesalers, super stores and distributors. Different prices are charged from each customer depending upon their credit rating and amount of purchases.

Your team has made a plan for test of details for verification of sales. The sampling of invoices would be made as per the following plan:

- (i) Sales reported in the financial statements is Rs. 800 million net of sales returns. This would be used for determining the sample size.
- (ii) 50% of the net sales represents sales to distributors, 40% to super stores and 10% to wholesalers.
- (iii) FSY sells its toys to 10 super stores only, who are invoiced on a monthly basis. The audit team would test all the invoices of June and December because invoices prepared close to period end are more prone to overstatement. In addition, 2 invoices would be checked for each of the other 10 months.
- (iv) 100 sales invoices to distributors and wholesalers would be selected haphazardly from invoice files. The number of invoices to be checked has been determined considering that expected rate of deviation is low. The expectation regarding rate of deviation is based on the fact that overall audit risk has been assessed as low.

**Required:**

Identify the weakness in the sampling approach planned by the audit team and suggest appropriate changes. (10)

(b) Following matters arose during the performance of test of details on sales:

- (i) Three invoices of superstores could not be found in the record room. The staff explained that it would require a lot of time to find them and requested your team to select some other invoices. Scrutiny of the ledger revealed that total amount of these missing invoices was Rs. 6 million.
- (ii) Five of the invoices issued to distributors were booked at the rate of Rs. 1,725 per carton instead of Rs. 1,275 per carton. The quantity involved was 3500 cartons.

**Required:**

Explain how you would resolve the above issues.

*(Impact on the audit report is not required)*

(05)

Q.3 You are the audit manager responsible for the audit of Hub Mills Limited (HML). At the planning stage, materiality level was determined at Rs. 8 million.

Audit team has completed the audit field work for the year ended 30 June 2018 and has presented the following issues identified during the audit for your review:

- (i) Goods worth Rs. 3 million were returned by a customer on 5 July 2018 due to poor quality. Since the goods were returned subsequent to year end, no adjustment has been recorded by the management.
- (ii) HML is facing liquidity issues which has resulted in adverse key financial ratios. To address the issue, HML has sold one of its offices to a company managed by a director of HML. The office was sold for Rs. 40 million. Since the management had correctly recorded the disposal, no specific disclosures related to this sale have been made in the financial statements. Directors are confident that these sale proceeds would solve the cash flow problems of HML.
- (iii) A customer who owed Rs. 11 million at year-end, was declared bankrupt on 15 August 2018. The management had already provided 50% of the balance in the financial statements.

Revenue for the current year is Rs. 800 million (2017: Rs. 950 million) and loss before tax is Rs. 22 million (2017: Rs. 7.6 million).

**Required:**

- (a) In respect of each of the audit issues identified by your team, mention the impact (if any) which these might have on the audit report along with proper justification. (10)
- (b) What matters would you want to include in the management representation letter, with regard to the above issues. (05)

Q.4 You are the audit senior on the audit of Ormara (Pvt.) Limited (OPL). During the planning phase of the audit, you have identified that OPL has adopted the revaluation model for buildings for the first time. The valuation was carried out by an independent well established external valuer.

**Required:**

Identify and assess the risks of material misstatement at assertion level and briefly state the key audit procedures to mitigate these risks. (05)

*(Procedures for assessing the competence and objectivity of the expert are not required)*

Q.5 (a) You have recently been promoted as a partner in the assurance department of a firm of chartered accountants. Your portfolio of clients includes Shah Motors (Pvt.) Limited (SML), a leading car dealer. Qaiser, a senior manager assurance in your firm, has been auditing SML for the past 7 years. While updating you about SML, Qaiser informed about the following:

- (i) On the request of an audit team member, CFO of SML has helped the team member's brother in securing early delivery of a vehicle ordered by him on preferential basis.
- (ii) SML has hired a new Head of Marketing. His son Amjad is expected to be included as a junior team member in SML's audit team.

**Required:**

Discuss the possible threats which may arise, their significance and the safeguards required to mitigate those threats. (10)

- (b) State the circumstances where a chartered accountant may be required to disclose the information obtained during the audit. (03)

Q.6 Imran is the audit senior responsible for the audit of Pasni Garments Limited (PGL). During the audit he noticed that PGL made significant transactions with related parties.

**Required:**

- (a) State the audit procedures which should be performed to check whether all related parties have been disclosed. (05)
- (b) What steps should Imran perform if he identifies any related party transactions which were not identified and disclosed by the management? (06)  
*(Impact on the audit report is not required)*

- Q.7 (a) Briefly describe what is a system log file and give any **four** types of information that may be generated by a system log. (03)
- (b) Differentiate between General IT controls and Application controls. (04)
- (c) Advanced Limited (AL) uses an in-house developed integrated system for all its accounting and operational needs. AL has been facing following issues in transaction processing:
- (i) While processing a batch of 50 purchase invoices, it was noticed that 3 invoices of suppliers were posted twice in the accounts.
- (ii) Some instances have been identified in which AL's accountant had posted the amount received from the customers in some other customer's account due to a typing error of the customer code.
- (iii) While processing the payments, the accountant often fails to mention the cheque number, due to which it takes a lot of time to trace the payment in bank statement.
- (iv) While recording inventory movement, the accountant had used incorrect inventory codes. Since those codes did not exist, the system posted the transaction in suspense account.

**Required:**

Identify and briefly describe **one** specific application control in respect of each of the above type of errors, to reduce the risk of such errors. (08)

- Q.8 (a) The auditor should be cognisant of the fact that fraudulent financial reporting often involves management override of controls. State any **four** techniques which the management may use for fraudulent financial reporting. (04)
- (b) Under the Companies Act, 2017 identify the situations in which the Commission may appoint a person to fill the vacancy of an auditor. (03)
- (c) Briefly discuss the steps an auditor would need to take if management refuses to allow him to send confirmation request to a debtor. (05)
- (d) Mention any **six** tests of controls which an auditor may perform in respect of dispatch of goods and invoicing in an organisation where all related documents are prepared manually. (06)

**(THE END)**