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## Audit and Assurance

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- Q.1 (a) On 5 March 2018, HSB & Company, Chartered Accountants (HSB) has been offered appointment as external auditor of Tahir Limited (TL) for the year ending 31 December 2018. TL is the subsidiary of Crypto Bank Limited (CBL), which is audited by another firm of chartered accountants.

Hatim, a partner of HSB is using credit card of CBL and the balance outstanding against it on 28 February 2018 was Rs. 1.1 million. Hatim plans to clear the dues by 30 July 2018, which is well before the commencement of audit. It is expected that the audit planning activities will commence from 1 November 2018.

**Required:**

Comment on the above situation in the light of Companies Act, 2017.

(04)

- (b) State the matters which an auditor should consider to establish whether the pre-conditions for an audit are present.

(05)

- Q.2 You are the audit manager in a firm of chartered accountants. Following is the extract of the email received from the job-in-charge responsible for the audit of your client Concordia Limited (CL) for the year ending 31 March 2018:

“I am considering to circulate negative confirmations on 1 April 2018 for debtor balances outstanding as on 31 March 2018 as firstly, the reporting deadlines at CL are very stringent, secondly, the population comprises of a large number of small balances and thirdly, risk of material misstatement has been assessed as low.

I have also been offered by CL’s CFO that one of their staff would get all the confirmations signed from the debtors and deliver them to our firm’s office. This could help us in meeting the reporting deadline.”

**Required:**

Comment on the suggestions of the job-in-charge. Assuming that the suggestion by job in charge is not considered appropriate, suggest an alternative approach keeping in view the time limitations.

(06)

- Q.3 Faheem is the audit manager on audit of Blue Bell Limited (BBL) for the year ending 31 March 2018, which is in the planning stage. BBL has a well-established internal audit function which reports directly to the audit committee. The staff of the internal audit department have adequate level of competence and are members of professional accounting bodies.

Considering the above, Faheem intends to engage internal auditors to perform audit procedures for certain audit areas.

**Required:**

On behalf of the engagement partner, provide appropriate guidance to Faheem to assist him in selecting the areas where direct assistance of internal auditors can be utilized.

(06)

Q.4 (a) You are the audit partner at BLC & Company, Chartered Accountants. The following matters are under your consideration:

- (i) Artificial Technologies Limited (ATL) has recognised an intangible asset of Rs. 100 million in respect of development costs relating to a software which ATL expects to market in future.

The market research conducted by ATL indicates a promising demand for such software. However, the expected cost required to complete the software has increased significantly and ATL requires further Rs. 50 million to complete the project. Since ATL has already utilised its existing credit limit on other projects, it is facing difficulties in raising financing for the above software.

ATL's draft financial statements show profit before tax of Rs. 270 million. (05)

- (ii) RL is involved in the manufacturing and supply of beverages throughout Pakistan, through its plant situated in Lahore. During the year, a fire occurred at RL's plant due to which a significant portion of the plant has been destroyed. The management has written off the plant and recorded an insurance claim amounting to Rs. 400 million. The written down value of the plant at the time of fire was Rs. 390 million.

RL is negotiating the purchase of another plant and order is expected to be placed soon after receiving the insurance claim.

RL's draft financial statements show profit before tax of Rs. 300 million. (07)

**Required:**

Discuss how you would deal with each of the above situations and the possible implications of the above on the audit report. (*Drafting of audit opinion is not required*)

- (b) While reviewing the list of 'trade and other payables' at BAC Limited, you have noticed that one of the trade creditors is not in the list. State any **two** audit procedures to be performed in relation to the completeness assertions for trade payables. (02)

Q.5 (a) Discuss the threats and the related safeguards in each of the following situations:

- (i) Saleem is the audit senior at Mango Industries Limited (MIL). MIL's finance manager has requested him to provide the residential addresses of the engagement manager and the engagement partner. The finance manager wants to send them one of MIL's latest product. (03)

- (ii) Akram is the audit senior engaged on the audit of Dragon Limited (DL). He has informed the audit manager that he has been offered a job by DL and that he would be joining DL from 1 April 2018. The audit is expected to be completed on 15 March 2018. (03)

- (b) Amjad is the audit senior at Orange Limited (OL), a software house. OL has adopted IFRS 15 'Revenue from Contracts with Customers' for preparation of its financial statements for the year ending 31 March 2018. However, the manager finance of OL is indecisive as regards revenue recognition on certain contracts.

He has asked Amjad to suggest accounting treatment of such contracts in accordance with IFRS 15. Amjad does not have in-depth knowledge of this IFRS and therefore, he has consulted his friend who has recently attended a workshop on IFRS 15.

**Required:**

- (i) Discuss the threats in the above situation. (03)
- (ii) What actions the firm should take to ensure that such situation is avoided in future? (03)

- Q.6 (a) Briefly discuss the key benefits which may arise due to splitting of work between interim and final audit. (02)
- (b) Briefly describe any **three** risks of material misstatement in case of significant related party transactions. (03)
- (c) What course of action should the auditor take, if he doubts the reliability of the management representation due to its inconsistency with other audit evidence? (04)
- (d) Discuss the circumstances in which an auditor may include other matter paragraph in the audit report. (04)
- (e) State any **four** controls that an auditor expects over data transmission. (03)
- (f) Auditor should actively look for subsequent events up to the date of auditor's report. State the procedures which an auditor should perform specifically for identification of subsequent events. (04)

Q.7 You have been assigned the audit of Pacific Shipping Limited (PSL) for the year ended 31 December 2017. During the audit, you have noted that the invoicing system was not operational for four days in January 2017. Upon inquiry, you were informed that some changes were made by one of the three programmers working in the IT department, merely on the request of a sales officer. The change caused the whole invoicing system to malfunction and it had to be closed down. During these four days, all invoices were generated manually.

**Required:**

Identify any **three** control weaknesses in the above situation and suggest any **two** mitigating controls against each weakness. (09)

Q.8 Green Limited (GL) is a listed company engaged in the manufacturing of garments and apparels. During the audit planning meeting for the year ending 31 March 2018, the Chief Financial Officer of GL has provided the following information:

- (i) GL was previously exporting all its production under the brand name of 'Wearables'. However, it has been facing the issue of decline in export orders and therefore has decided to start focusing on the local market. Accordingly, it has made an agreement with BL, according to which GL's products would be sold to BL who would market them through BL's retail outlets spread throughout Pakistan. A director of GL holds major shareholding in BL.
- (ii) Two of the directors of GL holding 16% and 13% shares in GL have informed the Board that they intend to sell their entire shareholding in GL in order to concentrate on some of their other businesses.
- (iii) While discussing some of the internal control deficiencies in the payroll processing department, which were raised in the previous year's management letter, the CFO has informed that the matter has been referred to the internal audit department but is pending because of the illness of the Chief Internal Auditor.

**Required:**

- (a) Identify fraud risk factors in the above scenario. (04)
- (b) Describe what actions an auditor should take on identifying a fraud risk factor. (05)

Q.9 You are audit senior at Advanced Limited (AL) which is engaged in the business of assembling and marketing of consumer electronics. The process followed by AL for procurement is as follows:

- (i) Store Department generates a numerically sequenced purchase requisition (PR), when the quantity falls below re-order level. PR shows the name of goods and quantity required and is signed by the store officer. The approved PR is forwarded to the Purchase Department for procurement.
- (ii) Purchase Department has a list of suppliers which was prepared in 2015 by including all the suppliers who had supplied goods to AL during the previous five years. Later, some suppliers were added to the list on the recommendation of the store manager.
- (iii) When a PR is received, the five most experienced suppliers are contacted and purchase order (PO) is issued to the most experienced supplier provided he agrees to supply the goods on the same price which was paid by AL on the latest purchase. The PO is issued in the form of an email by the purchase manager. A copy of the email is also sent to the store manager and the finance manager. In case of large or unusual purchases, PR and PO are also authorised by the store manager prior to sending the email.
- (iv) On receiving the goods, the store officer agrees the goods dispatch note (GDN) of the supplier with the PO to ensure that description of goods is the same as were ordered by AL. An acknowledged copy of GDN is given to the supplier and another copy is sent to the accounts department.
- (v) Store Department prepares sequentially numbered Goods Received Note (GRN), which is signed by the store officer after counting the goods received. Entry in the stores ledger is made on the basis of GRN.
- (vi) On receiving the invoice, purchase is recorded by the accounts department after comparing the quantity received as per the GDN with PO and the invoice.

**Required:**

Identify the weaknesses in the internal control system of AL and their possible effects and give your recommendations to AL.

(15)

(THE END)