



Audit and Assurance

Instructions to examinees:

- (i) Answer all **NINE** questions.
- (ii) Answer in black pen only.

Q.1 You are manager responsible for the audit of Oak (Private) Limited (OPL) for the year ending 30 September 2020. The following issues have been brought to your notice by your audit team:

- (i) During planning the year-end inventory count, audit team decided to visit third party premises for inventory valued at Rs. 10 million. Third party has informed that because of restrictions imposed by the government in the wake of COVID-19, it has limited number of staff and consequently may not allow the audit team to visit its premises for inventory count at year-end. However, the audit team may visit its premises on or after 31 October 2020 for inventory count.
- (ii) A competitor has alleged that OPL has infringed its patent rights and has taken legal action for damages of Rs. 500 million. OPL's independent legal advisor is of the view that no estimate can be made about the outcome of the case at this point of time. No provision has been made for the possible loss, however OPL intends to fully disclose it in the notes to the financial statements.

The projected profit before tax is Rs. 75 million.

Required:

For each of the above issues:

- (a) state the audit procedures which may be performed by your audit team. **(10)**
- (b) discuss with reasons, the implication(s) on the audit report. **(08)**

Q.2 (a) You are manager responsible for the audit of Pine Limited (PL) for the year ended 31 August 2020. PL has large contracts with many government entities. During the year, the government has significantly reduced its spending which has also affected its contract volumes with PL. Devaluation of the local currency has also resulted in increased costs of the materials purchased from overseas suppliers.

During the planning work review, your team has provided you the following ratios:

	2020	2019
Gross profit margin	32%	28%
Accounts payable to cost of sales ratio	0.20	0.28
Trade days receivable	90	75

Required:

- (i) Explain the fluctuations and inconsistencies in the given ratios.
- (ii) State any **four** key audit procedures which you would perform to address each issue identified in (i) above. **(09)**

- (b) Your firm is the statutory auditor of Teak Pakistan Limited (TPL) for the year ended 30 June 2020.

During the final review of audit work, your audit team informed you that TPL uses a third party software for its payroll. While checking the tax calculation, they identified an error in the calculation of monthly tax deduction from salary. The audit junior who performed the test, extrapolated the error over the entire population. This resulted in an overall short deduction of Rs. 920,985. She concluded that the error was not material because this amount was less than the audit materiality set at the financial statement level i.e. Rs. 1,000,000.

Further, she discussed this matter with the TPL's management who has agreed to deduct the differential amount from the salary of the next month and will deposit it into government exchequer. Therefore, she concluded that no accounting adjustment is required for the year ended 30 June 2020.

Required:

- (i) Briefly discuss the conclusion made by the audit junior regarding materiality of the transaction and recording of the error.
- (ii) State the additional steps that you would suggest to your audit team. *(Implications on audit report are not required)*

(07)

- Q.3 During the audit of Cedar Limited (CL), your audit team observed that CL has sold one of its freehold lands to Maple (Private) Limited (MPL) at a loss of Rs. 10 million. Your team's further investigation of the matter and reading of the minutes of the board of directors' meeting revealed that:

- (i) a director of CL holds 20% shareholdings in MPL which makes this entity as CL's related party; and
- (ii) MPL would pay 30% of the consideration in cash and the remaining amount over a period of five years.

Required:

Evaluate the above related party transaction and suggest any **eight** key audit procedures that your team should perform in this respect.

(10)

- Q.4 Consider each of the following independent situations:

- (i) Spruce Limited issued its financial statements on 15 September 2020 for the year ended 30 June 2020. On 22 September 2020, your audit team came to know that a major debtor has filed bankruptcy due to destruction of its production facility in a terrorist attack on 20 August 2020.
- (ii) During the audit of Larch Limited (LL) for the year ended 30 June 2020, the audit team noticed that the management of LL had worked out the net realisable value (NRV) on the basis of the sales price at year-end. Since NRV was greater than cost, LL recorded the inventory in the draft financial statements at cost. However, after reporting period, LL is facing difficulties in selling the inventory at current price level and therefore considering to revise its prices.

Required:

In each of the above situations, evaluate the need for amendment in the financial statements and suggest the audit procedures, if any, which the auditor would need to perform.

(09)

- Q.5 You are manager responsible for the audit of Bamboo Limited. Your team has asked for your guidance whether to involve an auditor's expert for:
- (i) valuation of provision for doubtful debts. The provision has significantly reduced by Rs. 100 million as compared to previous year.
 - (ii) fixed asset revaluation. The management has recently revalued its fixed assets. The revaluation surplus has increased by Rs. 80 million.

The draft financial statements show a profit before tax of Rs. 500 million.

Required:

Guide your audit team about involvement of an auditor's expert. (06)

- Q.6 (a) Differentiate between general IT controls and application controls. (04)
- (b) The internal auditor of Cyprus (Private) Limited has identified some discrepancies in the sales revenue. After investigation, it was identified that some unknown changes were made to the master price-list which resulted in such discrepancies.

Required:

Suggest any **three** general IT controls and **three** application controls to prevent occurrence of such error. (06)

- Q.7 You are the audit manager responsible for the audit of Beachwood Textile Limited (BTL). At the planning stage, your audit team has assessed that there is no significant risk of material misstatement due to fraud and management override of controls. The audit team's assessment is based on the fact that BTL has been an audit client of the firm for the last 10 years and no material misstatement had been reported in the previous years.

Required:

Guide your audit team with regard to their assessment of risk. (08)

- Q.8 Haris Awan has recently been appointed as a partner in HBC Chartered Accountants. Haris has been assigned the audit of Hemlock Limited (HL). HL has been the firm's client for the past 15 years. Haris has asked Babar Raza, manager responsible for the audit of HL for the last seven years, to assist him in the planning phase. Babar has informed him that:

- (i) attitude of HL's Chief Financial Officer (CFO) has been very aggressive towards audit team members, particularly at times when questioned on any of his judgements in relation to accounting matters.
- (ii) CFO normally gives us a short deadline for completion of the audit.
- (iii) one of the previous audit team members has recently joined HL as Manager Finance and has ensured us his full cooperation towards the timely completion of the audit.

Required:

Discuss the possible threat(s) which may arise in the above situation, their significance and the safeguards required to mitigate those threats. (12)

- Q.9 (a) In the light of ICAP's Code of Ethics, state the circumstances where a Chartered Accountant is required to disclose confidential information. (03)
- (b) In the light of Companies Act 2017, describe the requirements for the cost audit and the person authorized to conduct it. (04)
- (c) Briefly explain any **four** elements of an assurance engagement. (04)

(THE END)