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## Audit and Assurance

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**Instructions to examinees:**

- (i) Answer all **NINE** questions.  
(ii) Answer in **black** pen only.
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Q.1 Khyber Foundation (KF) is a non-profit organization engaged in providing medicines and medical equipment free of cost or at substantially discounted rates to the underprivileged people of the society. KF has obtained the approval from the relevant regulatory authorities to operate as a non-profit organization. Therefore, KF is entitled to tax exemption subject to conditions that administrative expenses do not exceed 15% of total donations and all withholding taxes are duly deposited with the taxation authorities.

During the financial year 2020-21, KF has received cash donations from the following three sources:

- Corporate entities through banking channel;
- Donation boxes placed in various retail shops; and
- Collection kiosks placed in the major shopping malls as part of donation campaign in Ramadan.

KF has also received medical equipment from donors which are recorded at fair value.

Medicines and medical equipment are given only on a valid doctor's prescription. This facility is also available to KF's employees.

KF has employed two accountants who are pursuing their bachelor's degree. Both of them are responsible for recording receipts, making payments, managing inventory and reporting to the trustees.

**Required:**

Identify the risks which KF's auditor would need to consider.

(07)

Q.2 (a) Haris & Company, Chartered Accountants was appointed as the auditor of Cactus (Private) Limited (CPL) for the year ending 31 December 2021. Haris, the only audit partner of Haris & Company, passed away on 5 September 2021. No other auditor has yet been appointed by CPL.

**Required:**

State the requirements of the Companies Act, 2017 for the appointment of auditor in the above situation.

(03)

(b) Khursheed Jamal is a Chartered Accountant and has recently established his audit firm in the name of Khursheed & Company, Chartered Accountants. He is trying to expand his clientele and in this process his friend, who is his audit client and the owner of an advertising agency, has offered to provide significant discount for publicity of his new firm.

**Required:**

In the light of Code of Ethics for Chartered Accountants, discuss whether Khursheed should accept the offer of his friend.

(07)

- (c) Hussain Tarar is the audit partner responsible for the audit of Petra Travels (Private) Limited (PTL). The chief executive officer (CEO) of the company has informed Hussain that due to liquidity issues amid COVID-19, several employees including some staff members of finance department left the company. CEO has therefore requested Hussain to provide two staff of the audit firm for some time to run the finance department.

**Required:**

In the light of Code of Ethics for Chartered Accountants, discuss the threats in the above scenario and suggest appropriate safeguards. (07)

- Q.3 You are the audit manager in a firm of chartered accountants. Following independent matters are under your consideration:

- (i) In the draft financial statements of Elrond (Private) Limited (EPL) for the year ended 30 June 2021, capital work in progress of Rs. 100 million related to construction of a new production facility is included in property, plant and equipment. Your team has observed that the last cost incurred on the said facility was on 30 April 2021. However, it was put to use from 1 August 2021 and therefore no depreciation has been charged at the year-end.

The useful life of the said facility is assessed to be 10 years. The draft financial statements show that EPL's profit before tax is Rs. 150 million.

- (ii) Cafe Elixar (Private) Limited (CEL) operates a chain of cafes in Pakistan. Before the year-end, a large number of customers complained about food poisoning, possibly as a result of eating at the cafe. Some of the customers have taken legal action against CEL. An out of court settlement with these customers is under process. No information has been provided in this regard in the draft financial statements.

**Required:**

For each of the above independent matters:

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

- Q.4 Your firm is the auditor of Shahzad Limited (SL), a wholesaler of consumable products, for the year ended 30 June 2021. SL maintains up to date computerized inventory records. The following matters have been observed during the inventory count:

- (i) The inventory count took place on 1 July 2021 under the supervision of the warehouse manager and his staff, who are responsible for maintaining the inventory. No movement of inventory took place on that day.  
 (ii) Four counting teams were formed. Each team comprised of two persons. The floor area was allocated by the teams among themselves.  
 (iii) Each team was instructed by the warehouse manager to remember which inventory had been counted.  
 (iv) Pre-numbered count sheets were provided to the staff involved in the inventory count. To facilitate inventory count, inventory belonging to third parties and the inventory ledger balances were mentioned on the pre-numbered count sheets.  
 (v) All the cut-off documents were provided to the audit team on the very next day after the inventory count.

**Required:**

Identify any **four** weaknesses in the inventory count procedures and state their implications on the physical count. (06)

- Q.5 You are the audit manager in a firm of chartered accountants. Your audit client Dairy (Private) Limited (DPL) has emailed you its draft financial statements for the year ended 30 June 2021 along with related notes. The information provided by DPL is summarized below:

**Draft statement of financial position as at 30 June 2021**

	2021	2020
	----- Rs. in '000 -----	
Equity and reserves	35,922	26,000
Long-term loan	6,000	12,000
Trade and other payables	7,800	6,500
<b>Equity and Liabilities</b>	<b>49,722</b>	<b>44,500</b>
Property, plant and equipment	22,630	26,818
Prepayments	1,500	-
Trade debtors	12,000	8,000
Inventory	13,000	7,000
Cash and bank balances	592	2,682
<b>Assets</b>	<b>49,722</b>	<b>44,500</b>

**Draft income statement for the year ended 30 June 2021**

	2021	2020
	----- Rs. in '000 -----	
Sales	110,000	73,000
Cost of sales	(83,050)	(54,750)
<b>Gross profit</b>	<b>26,950</b>	<b>18,250</b>
Admin and marketing expenses	(12,100)	(10,950)
Finance cost	(675)	(1,530)
<b>Net profit before taxation</b>	<b>14,175</b>	<b>5,770</b>
Taxation @ 30%	(4,253)	(1,731)
<b>Net profit</b>	<b>9,922</b>	<b>4,039</b>

**Notes:**

- (i) During the year, sales price of DPL products were increased by 20%, to offset the corresponding increase in cost of production.
- (ii) On 30 June 2019, DPL had obtained a loan of Rs. 20 million, which is payable in 10 equal quarterly instalments at the end of every quarter. The loan carries fixed mark-up rate of 9%.
- (iii) Decrease in property, plant and equipment represents disposals made during the year, net of depreciation.
- (iv) Prepayment represents advance rental payment of warehouse, obtained for 6 months on 16 June 2021 at a monthly rent of Rs. 250,000.

**Required:**

Using analytical procedures, identify any **four** unexplained fluctuations and inconsistencies in the above situation. State the key audit procedures which you would perform to address the issues identified by you.

Q.6 You are the audit manager in a firm of chartered accountants. Following independent situations are under your consideration:

- (i) Mega Motors Limited (MML) offers 3-year warranty for its products. MML assessed its warranty obligation to be Rs. 20 million for the year ended 30 June 2021. The board of directors has approved the financial statements on 6 September 2021. Just before signing the audit report, your audit team came to know about a latent defect in MML's products. This defect was neither earlier discovered nor known to MML.
- (ii) Dawn Hotel Limited was severely damaged by flash flood on 31 August 2021. Initial assessment of the incident shows that significant repairs are required and the hotel would not be operational for at least a month. Audit report for the year ended 30 June 2021 has not yet been issued.

**Required:**

For each of the above situations, evaluate the need for amendment in the financial statements and suggest the auditor's course of action.

(10)

Q.7 You are the audit senior responsible for the audit of Tetra Milk Limited (TML). Your audit team member has drafted a balance confirmation request to be sent to a major customer:

<b>Tetra Milk Limited</b>
<b>Customer's name and address:</b> DB Limited, 46-Safoora Palace, Mall Road, Quetta.
<b>Date:</b> 7 September 2021
Dear Mr. Salman Shahid
In accordance with the request of our auditor, Abid Ali & Co, Chartered Accountants, we ask that you kindly confirm your indebtedness to us which, according to our records, amounted to Rs. 45.6 million as shown by the enclosed statement.
If the above amount is in agreement with your records, please sign in the space provided below.
If the amount is not in agreement with your records, please notify us of the amount shown by your records.
Yours faithfully,
<b>-Signature-</b>
<b>Tetra Milk Limited</b>
<b>Confirmation No. A-172</b>
<b>The amount shown above is/is not in agreement with our records.</b>
Account No. ....
Signature .....
Date .....
Title or position .....

**Required:**

Identify the shortcomings in the above draft of balance confirmation request and suggest the necessary changes.

(06)

Q.8 The management of Rose (Private) Limited (RPL) seeks your guidance for the following matters:

- (a) RPL is developing a sales invoicing system both for its cash and credit customers. The system would record customer's name, email address, cell number, NTN number etc. at the time of sale.

**Required:**

Briefly discuss any **four** application controls, with the help of examples, which should be incorporated in the system to ensure completeness and accuracy of data. (06)

- (b) RPL's office has recently been damaged by fire causing a system downtime for five days.

**Required:**

Advise any **three** general controls to RL which may ensure continuity of its operations in future. (03)

Q.9 (a) How would an auditor assess the competency and capabilities of an auditor's expert? (03)

- (b) Discuss the auditor's course of action when a client requests to change the existing terms of the audit engagement. (03)

- (c) State the auditor's responsibility for identifying, detecting and responding to fraudulent activities. (04)

- (d) State any **four** factors which the external auditor may need to consider while assessing the competence of the internal audit function. (04)

- (e) List any **six** examples of system logs. (03)

**(THE END)**