



Audit and Assurance

Instructions to examinees:

- (i) Answer all **EIGHT** questions.
 - (ii) Answer in **black** pen only.
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Q.1 You are the quality control partner in an audit firm. Following independent matters are presently under your consideration:

- (a) The firm has received an offer for appointment as the auditor of Hyper Limited for the year ending 30 June 2023 in place of the outgoing auditor.

Required:

Discuss the actions that the firm should take regarding communication with the outgoing auditor. (03)

- (b) Freshco (Private) Limited (FPL) has asked your firm to help them in implementation of an ERP software. Your firm has refused to accept the engagement as the firm believes that it does not have the required competencies. However, the firm has referred FPL to an IT firm which has relevant competencies. As part of arrangement, the IT firm will pay 15% of fee charged to FPL to your firm.

Required:

Identify and explain the threats to the fundamental principles of ICAP code of ethics. (03)

- (c) Ahmed has recently joined your firm as an audit manager. The firm intends to depute him on the audit of Monsoon (Private) Limited (MPL). Prior to joining the firm, Ahmed had been providing accounting and taxation consultancy services to MPL for last many years. Ahmed was also assisting MPL in preparation of annual budgets, management accounts and calculation of tax provision based on audited financial statements.

Required:

Identify and explain the threats to the fundamental principles of ICAP code of ethics. Also evaluate the significance of the identified threats. (07)

Q.2 (a) The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides development of the audit.

Required:

For establishing an overall audit strategy:

- (i) identify any **eight** characteristics of the engagement that define its scope. (06)
- (ii) identify any **four** considerations to ascertain the reporting objectives, timing of the audit and nature of communication. (04)

- (b) Suggest any **five** controls to prevent misappropriation of petty cash. (05)

- (c) The auditor will normally select a sample of debtors who will be asked to provide confirmation of their balances. State any **six** audit procedures for sending the confirmation. (06)

Q.3 You are the audit manager in a firm of chartered accountants. Following independent situations of three listed audit clients are under your consideration:

- (a) The client's management has refused to provide written representation about management responsibilities. (05)
- (b) Power Generation Limited has used the fuel price as at 30 June 2022 to value its closing fuel inventories. Consequently, the value of fuel inventories has been increased from Rs. 500 million to Rs. 750 million. Profit before tax for the year ended 30 June 2022 is Rs. 2,000 million. (05)
- (c) Based on detailed assessment, the management of Walmart Limited (WL) believes that WL may not be a going concern. Consequently, they have prepared WL's financial statements on liquidation basis. (05)

Required:

Briefly evaluate each of the above independent situations and discuss the impact of each matter on the audit report including impact on the key audit matter section, if any.

Q.4 Your firm is the auditor of Ninja Foods Limited (NFL) for the year ended 30 June 2022. NFL is a food chain having restaurants located in all major cities of Pakistan. NFL specializes in Pan-Asian cuisine and has Japanese, Thai and Chinese food on its menu.

Following information has been gathered by the audit team:

- (i) Some of the ingredients used in the food products offered to customers are imported. On 31 August 2022, the government has banned import of luxury food items which includes most of the imported items used in the NFL's most selling items. NFL currently has stock of these imported items which fulfil its requirement of next one month only.
- (ii) 70% of the customers pay in cash while the remaining 30% pay through credit/debit cards. Furthermore, 55% of the customers' visits are on weekend. All cash collection on weekend is deposited in the bank on the very next working day.
- (iii) NFL follows a policy in which all the expired stock is to be placed in separate store room, which can then be adequately destroyed. In the internal audit report, it has been highlighted that two of the restaurants were not following this policy.
- (iv) During the year ended 30 June 2022, NFL's profits have been reduced by 30% mainly due to rising electricity prices, increase in interest rates on long term loan, decrease in demand of the product due to recession in the economy and increase in raw material prices due to rupee devaluation.

Required:

- (a) Identify the key audit risks in the above scenario. (*Ignore the risk related to going concern*) (10)
- (b) Assess NFL's ability to continue as a going concern. Also suggest the audit procedures which your team need to perform in order to validate your assessment. (10)

Q.5 Your audit team performed verification of the payroll cost for the year ended 30 June 2022, by projecting the June 2021 payroll cost in line with increase in revenue from last year to current year.

Required:

Comment on the suitability of analytical procedure as substantive procedure performed by your audit team. Also suggest any changes to be made in the analytical procedure. (05)

Q.6 Your firm is the auditor of Chemicals Limited (CL). Following matters have been observed while planning the inventory count for the year ending 30 September 2022:

- (i) One of the chemicals having radioactive properties has been procured for a government agency. Considering its hazardous nature, it is stored in a special container which can only be opened in the presence of agency's officials. The container was last opened in the presence of agency's official on 30 June 2022.
- (ii) CL's plant has been running on maximum capacity. Therefore, in order to timely deliver an export order to Colombia, CL has decided to procure the chemicals from Malaysia and directly ship the chemicals from Malaysia to Colombia. The chemicals are currently lying at a warehouse in Malaysia and will be shipped to Colombia in the first week of October 2022.
- (iii) The production process cannot be stopped during the inventory count. Your team may not observe the inventory count which will be in process on 30 September 2022.

Required:

State the audit procedures to verify the inventory quantities in each of the above situations. (08)

Q.7 You are the audit manager in a firm of chartered accountants. Following independent situations are under your consideration for the year ended 30 June 2022:

- (i) The board of directors of Hacksaw Limited (HL), producer of confectionery products, approved the financial statements on 7 September 2022. Before signing the audit report, it was revealed that retailers are returning one of HL's products to the distributors. On enquiry, it was found out that certain batches of that product were not processed correctly and have caused a very bad taste. HL's closing inventory also contains finished goods from those batches.
- (ii) Your audit client, Cola Limited was in negotiation for the acquisition of Orange Limited (OL) since April 2022. On 15 June 2022, it was principally agreed to acquire OL at a price of Rs. 4 billion. However, the agreement was formally signed on 10 July 2022.

Required:

For each of the above situations, evaluate the need for amendment in the financial statements and suggest the auditor's course of action. (12)

Q.8 The board of directors of Green Limited (GL) intends to re-appoint the existing auditor for the next year. However, Haider, a shareholder of the company, wants to appoint a different auditor.

Required:

Briefly explain the procedure that Haider should follow. Also state the responsibilities of GL in this regard. (06)

(THE END)