



Audit and Assurance

Instructions to examinees:

- (i) Answer all **NINE** questions.
(ii) Answer in **black** pen only.
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- Q.1 (a) Discuss any **five** IT General Controls relating to program change management. (05)
- (b) State any **three** controls which would ensure that wages and salaries are not paid to the ghost (fake) employees. (03)

- Q.2 Your firm is the auditor of Adventure Travel (Private) Limited (APL) which offers a wide range of adventure sports services such as paragliding, parasailing and scuba diving. APL follows high safety standards to avoid any unfortunate events. However, during the year, one of its paragliding trips was affected due to bad weather which caused severe injuries to its clients. Immediately after this unfortunate incident, APL has invested heavily in further upgrading its equipment to prevent happening of such incident in future. The entire investment has been financed through a bank loan.

You have been informed that due to overwhelming response towards adventure trips, number of tour operators have launched the same services at significantly low prices as compared to APL; however, all these new tour operators are not following as high safety standards as are being followed by APL.

Considering the increased competition, APL has recently widened its scope of business and introduced:

- booking of air tickets and hotel rooms on behalf its clients at a discounted rate. APL is entitled to a commission, if bookings are made through APL. The commission on booking is recorded when the payment has been received.
- “Book now and Pay later” instalment scheme for all of its services.

Required:

- (a) Identify the matters that you will consider while obtaining an understanding of APL and its environment. (05)
- (b) Identify and discuss the business risks and the related audit risks from the above scenario. (09)
- Q.3 Comment on the validity of each of the following statements:
- (i) Inherent risk can be lowered by a strong control environment and oversight by the entity.
- (ii) The audit risk is derived from errors arising out of inherent risk which are not prevented/detected by entity’s internal controls.
- (iii) Detection risk can be lowered by carrying out more substantive tests in the audit.
- (iv) Higher inherent risk leads to higher detection risk. Consequently, it increases overall audit risk.
- (v) At an audit client, inherent risk has been assessed at 50% and control risk at 80%. To achieve an overall level of acceptable audit risk of 10%, the detection risk would be 25%. (06)

Q.4 Your firm has been approached by a recently formed IT Company, Data Technology Limited (DTL), for appointment as its statutory auditors. DTL is mainly owned by three foreign companies who are all registered abroad in tax heaven countries. Your firm does not have any experience of auditing an IT company.

Required:

In the light of the Code of Ethics for Chartered Accountants, identify the threats to the fundamental principles and discuss how your firm would evaluate these threats in the context of accepting the client and engagement. Also briefly discuss the safeguards available to your firm to address the threats. (13)

Q.5 You have received a copy of the year-end bank reconciliation statement, from your audit client Harison Limited (HL). Details of which are reproduced below:

	Rupees
Balance as per bank statement as at 31 December 2021	10,500,000
Add:	
(i) Incorrect interest charged by the bank (Note-I)	240,000
(ii) Charges reversed by bank on 10 January 2022 (Note-II)	100,000
Less:	
(iii) Cash directly deposited in bank by the customer to avail 5% discount	(220,000)
(iv) Cheques issued to customers not yet presented	(800,000)
(v) Cheques signed but not yet handed over to suppliers	(250,000)
Balance as per ledger	9,570,000

Notes to bank reconciliation statement:

- (I) Interest on bank overdraft amounting to Rs. 750,000 was recorded in the bank statement. However, review of the Accounts Officer indicated an error and HL recorded the correct amount of Rs. 510,000 in the bank ledger.
- (II) This represents Letter of Credit charges which were charged twice by the bank for import of raw material in December 2021.

Required:

- (a) State the audit procedures that should be performed on the above bank reconciliation statement. (06)
- (b) Briefly discuss whether the client’s year-end bank reconciliation provides evidence about receipts and payments cut-off. (02)

Q.6 Your audit client has provided you a draft representation letter. The extract from the representation letter is as follows:

No management employee is involved in any fraudulent activity.

All the related party transactions and the identities of those related parties have been disclosed to you. These have also been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards.

All the uncorrected misstatements identified are immaterial individually and therefore do not need any adjustments.

Required:

Critically analyze the above representations given by the audit client. (08)

Q.7 You are the audit partner in a firm of Chartered Accountants. Following independent matters for the year ended 31 December 2021 are presently under your consideration:

- (a) Pioneer Electronics Limited (PEL) had implemented a new accounting software in 2021. Due to high pressure from top management, the implementation of the new accounting software was hurried, which has resulted in numerous errors in the inventory, payable and receivable module of the software. PEL's staff is still in the process of identifying and rectifying the software deficiencies. The audit team has been unable to verify these balances through alternate means. Inventory, payable and receivable are appearing as Rs. 200 million, Rs. 150 million and Rs. 100 million respectively in the financial statements.

Profit before tax is Rs. 500 million, whereas the net assets are Rs. 1,850 million. (07)

- (b) Your firm has been appointed as auditor in place of retiring auditor for Smart Footwear Limited (SFL), a listed company. SFL owns number of retail outlets across Pakistan and many of them were acquired on rental basis. During the year, SFL has adopted IFRS 16 'Leases'. The audit team has made significant efforts to review the adjusting entries made in the financial statements to reconcile the change in accounting policy of operating leases. The matter was discussed in detail in the audit committee meeting. Your team has included the details about adjustments and impact on financial statements in the board letter. (07)

Required:

In each of the above independent situations, discuss the reporting implication(s) including the changes that needs to be made in the audit report as illustrated in ISA-700.

Q.8 (a) State the factors which may assist the auditor in assessing the reliability of audit evidence. (05)

(b) State **two** advantages and **two** disadvantages of statistical sampling. (04)

(c) State any **five** matters that need to be considered by engagement quality control partner while performing objective evaluation of audit of a listed company. (05)

Q.9 You are the audit manager in a firm of Chartered Accountants. Following independent matters for the year ended 31 December 2021 are presently under your consideration:

- (a) Quality Foods Limited has been facing liquidity issues and is heavily reliant on a bank overdraft, which was due for renewal on 15 February 2022. Management has informed you that negotiations with the bank are underway and it is expected that bank overdraft limit will be renewed in next few days. (07)

- (b) During the year, Delta Limited (DL) has recognised an intangible asset of Rs. 55 million in respect of development costs of a software which DL expects to market in future. The market research conducted by DL indicated a promising demand for such software.

In November 2021, one of DL's competitors successfully launched a similar software with the help of high foreign investment. It has helped them to capture a large market share in a short span of time.

DL's draft financial statements show profit before tax of Rs. 250 million. (08)

Required:

For each of the above independent situations:

- discuss, from an audit perspective, the impact on the financial statements.
- state the audit procedures which may be performed by the audit team.

(Reporting implications are not required)

(THE END)