Audit and Assurance

Q.1 You are the manager of Saba and Company, Chartered Accountants, responsible for the audit of Tiger Limited (TL). While reviewing the draft financial statements and the working paper file, following matters have come to your attention:

(i) No subsequent events were identified.
(ii) During the stock count, certain items were physically present but were not appearing in stock sheets provided by TL. The management informed you that these items were sold but were not dispatched upon customer request.
(iii) TL has a policy for making full provision against receivables when they become overdue for 360 days or more. However, three customers were not fully provided for in accordance with the TL’s policy. The management contended that they are rigorously following up with these parties and are confident to recover the outstanding balances very soon.
(iv) There was only one litigation pending against the company which has appropriately been disclosed in the financial statements.

Required:
Discuss whether it would be necessary to obtain management representation in respect of above matters.

Q.2 (a) Aslam is a junior member of your audit team. During an informal discussion with your team members, Aslam has inquired you about the reasons of emphasizing on professional scepticism when honesty and integrity of the management is not questionable based on prior experience. Briefly respond to the inquiry of Aslam.

(b) Mention any four general controls over development of new computer information systems and applications.

(c) Briefly describe any five inquiries that the auditor may make for identifying the risk of material misstatement due to fraud.

(d) State any five audit procedures that could be performed to obtain sufficient appropriate audit evidence for determining whether or not a material uncertainty exists when events are identified that may cast doubt on the entity’s ability to continue as a going concern.

Q.3 Amjad is the chief executive and major shareholder of a newly incorporated private limited company. He has offered your firm to be the first external auditor of the company. During a meeting, he was of the viewpoint that statutory audit exists because it has been legally mandated and it does not add value to business. However, he believes that audit helps in finding all major frauds within the company.

Required:
Discuss how you will respond to the viewpoints of Amjad regarding the audit of financial statements.
Q.4 You are the job-in-charge on the audit of Ostrich Limited (OL), a food processing company, for the year ended 30 June 2019. For sending debtor balance confirmations, OL has provided you the following schedule for the year ended 30 June 2019:

<table>
<thead>
<tr>
<th>Debitors</th>
<th>No. of customers</th>
<th>Balance as at 30 June 2019 Rs. in ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chain Stores</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Store – A</td>
<td>1</td>
<td>5,150</td>
</tr>
<tr>
<td>Store – B</td>
<td>1</td>
<td>3,398</td>
</tr>
<tr>
<td>Store – C</td>
<td>1</td>
<td>4,236</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>30</td>
<td>7,104</td>
</tr>
<tr>
<td>Restaurants</td>
<td>500</td>
<td>6,364</td>
</tr>
<tr>
<td>Credit balances</td>
<td>3</td>
<td>(1,000)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>25,252</strong></td>
<td></td>
</tr>
</tbody>
</table>

There are no overdue and nil balances as on 30 June 2019. The risk of material misstatement has been assessed as low and controls have been tested.

**Required:**
Discuss the audit strategy that you would follow for selecting the debtors for balance confirmation.

(07)

Q.5 You are the manager responsible for the audit of Zebra Limited (ZL). ZL normally has significant sale and purchase transactions with its related parties.

Guide your audit team regarding the audit procedures and related activities that should be performed for obtaining information relevant to identifying the risks of material misstatements associated with related party relationships and transactions.

(08)

Q.6 You are the job-in-charge on the audit of Sambar (Private) Limited (SPL), engaged in production and marketing of textile products.

Your team has performed a walkthrough of the sales and receivable process which is summarized as follows:

(i) SPL has employed a Sales Representative (SR), who is responsible for finding new customers and taking orders from all customers.

(ii) Orders are recorded on a pre-numbered order form duly signed by the customers. After taking the customer order, SR mentions the maximum credit limit and credit time after verbally confirming them with the Director Operations, on the order form. SR then forwards one copy of the order form to the warehouse and another copy to the Factory Accountant (FA).

(iii) Warehouse supervisor dispatches the completed order from the warehouse, accompanied by a manually prepared pre-numbered delivery note. He keeps a copy of delivery note and sends another to FA.

(iv) FA manually prepares a pre-numbered invoice using the details mentioned on the order form. FA also ensures that the customer should not exceed the maximum credit limit after the new order. FA normally sends one copy of invoice to the customer along with the delivery note and keeps the second copy along with the order form in the record of accounts department. However, due to delay in receiving the order information, invoice is sometime sent after the delivery.

(v) Each Friday, FA inputs the week’s invoices into the computerized accounting software. At each month end, FA prepares age analysis and follows-up with customers who have not paid within their credit time.
Required:
Identify the control weaknesses in sales and receivable process of SPL along with their possible effects and give your recommendations to SPL. (15)

Q.7 You are the audit manager on Beluga Limited (BL) for the year ended 31 August 2019. The following issues have been brought to your notice by your audit team:

(i) BL has pending tax litigation in which tax department has raised demand of Rs. 75 million. The matter has been challenged by BL and the decision in this respect is currently pending with the Appellate Tribunal. BL’s tax advisor is confident of positive outcome of this litigation. No provision has been made in this regard; however, it has been disclosed as a contingency in the financial statements.

(ii) On 20 September 2019 one of the warehouses of BL caught fire destroying entire inventory, furniture, fixtures and equipment. The book values of the destroyed assets at the time of fire were Rs. 100 million. BL has lodged a claim with the insurance company.

The draft financial statements for the year ended 31 August 2019 show a profit before taxation of Rs. 500 million and net assets of Rs. 1,400 million.

Required:
(a) State the audit procedures which may be performed in respect of each of the above audit issues identified by your team. Also briefly discuss the implications of these issues on the audit report. (10)

(b) Draft an opinion paragraph to be included in the audit report of BL in accordance with the requirement of International Standards on Auditing, assuming that the matter in (i) above is not dealt with in accordance with the requirements of IFRS. (Basis of opinion paragraph is not required) (05)

Q.8 (a) Shayan has recently been hired as the audit manager in a firm of chartered accountants which is the auditor of Python Limited (PL). Shayan previously served as manager finance in PL for three years.

The firm is considering to depute Shayan as the engagement manager for the audit of PL for the year ended 31 August 2019.

Required:
Identify the possible threats which may arise and discuss their significance. Also, discuss the safeguards required to mitigate the threats under each of the following assumptions:

(i) Shayan resigned from PL with effect from 30 June 2019
(ii) Shayan resigned from PL with effect from 30 June 2018 (07)

(b) Your firm has been asked to submit a tender for appointment of an engagement currently held by another firm of chartered accountant.

Required:
Briefly discuss the safeguards that shall be applied to eliminate any threat(s) or reduce them to an acceptable level before accepting the engagement. (04)

(c) You are the manager on the audit of Dolphin (Private) Limited for the year ending 31 December 2019. The client has requested you to send an audit trainee on secondment for October and November 2019 to assist the chief financial officer, as one of the key staff members of the accounting team has resigned.

Required:
Identify the threat(s) in the above scenario and suggest appropriate safeguards. (04)
Q.9  Plover Limited has recently developed an integrated system for maintaining its financial records. During testing, following input and processing errors were identified in the system:

**Input errors**
(i) A non-existent product number was mentioned on the online order form.
(ii) Inward movement of inventory was recorded in some other inventory account.

**Processing errors**
(i) In the payroll system, all employees of a department were processed at the rate of Rs. 100 per hour instead of approved rate of Rs. 80 per hour.
(ii) Salaries of few employees were processed twice.

**Required:**
Identify and briefly describe one application control in respect of each of the above type of errors, that would have been effective in either preventing or detecting the error. (08)

(THE END)