



Auditing

Intermediate Examination
Autumn 2012
Module D

5 September 2012
100 marks - 3 hours
Additional reading time – 15 minutes

Q.1 Shahrukh and Company, Chartered Accountants, have conducted the statutory audit of the financial statements of Karim Limited, a listed company, for the year ended 30 June 2012 under the Companies Ordinance, 1984. The job incharge has drafted the following audit report:

Auditors' Report to the Members

We have audited the annexed balance sheet of Karim Limited (the Company) as at 30 June 2012, and the related Income and Expenditure Account, Statement of Comprehensive Income, Cash Flow Statement and Statement of Changes in Equity together with the notes forming part thereof, for the year then ended and we state that we have obtained all the information and explanations which were necessary for the purposes of our audit.

It is the responsibility of the company's management to establish and maintain a system of internal control and prepare and present the above said statements in conformity with the approved auditing standards and the requirements of the fourth schedule to the Companies Ordinance, 1984. Our responsibility is to audit these statements.

We conducted our audit in accordance with the auditing standards as applicable in Pakistan. These standards require that we plan and perform the audit to obtain reasonable and limited assurance about whether the above statements are free of any misstatement. An audit includes examining evidence supporting the amounts and disclosures in the above said statements. An audit also includes assessing the accounting policies and significant estimates made by management, as well as, evaluating the overall presentation of the above said statements. We believe that our audit provides a reasonable basis for our opinion and, after due verification, we report that:

- (a) in our opinion, proper books of accounts have been kept by the company.
- (b) in our opinion:
 - (i) the balance sheet and profit and loss account together with the notes thereon have been drawn up in conformity with the Companies Ordinance 1984, and are in agreement with the books of account and are further in accordance with accounting policies consistently applied;
 - (ii) the expenditure incurred during the year was in accordance with the objects of the Company; and
 - (iii) the business conducted, investments made and the expenditure incurred during the year were for the purpose of the Company's business;
- (c) in our opinion and to the best of our information and according to the explanations given to us, the balance sheet, profit and loss account, statement of comprehensive income, cash flow statement and statement of changes in equity together with the notes forming part thereof, conform with the approved accounting standards as applicable in Pakistan and give the information required by the Companies Ordinance, 1984, in the manner so required and respectively give a true and fair view of the state of the Company's affairs as at 30 June 2012; and
- (d) in our opinion, no zakat was deductible at source under the Zakat and Ushr Ordinance, 1980.

Chartered Accountants
Date: 01 September 2012

Required:

Identify the errors in the above report vis-à-vis a standard statutory audit report.

(12 marks)

(Note: You are not required to redraft the report.)

- Q.2 As the engagement partner, you have reviewed the audit working papers of Samarkand Limited (SL). The audit team has highlighted the following matters in the working papers.
- Twenty percent of the company's recorded turnover (revenue) comprises of cash sales. Proper records of cash sales have not been maintained. Consequently, the audit team was unable to design audit procedures to verify the cash sales.
 - During the current year, the company changed the method of charging depreciation on its fixed assets from the straight line to the diminishing balance method. However, all the required disclosures have been included in the notes to the financial statements.
 - The previous year's financial statements were audited by another firm of chartered accountants which has issued an un-modified opinion on those financial statements.

Required:

Discuss the impact of each of the above matters on your audit report. (10 marks)

- Q.3 You are currently in the planning phase of the audit of Mineral Water Limited (MWL) for the year ended 30 June 2012. The following information is available to you:

Customer Segment	No. of Customers	Balance outstanding	10 days	10-20 days	21-30 days	31-90 days	> 90 days
	Rs. in thousand.....					
Super markets	12	20,014	8,125	5,053	6,396	311	129
Wholesalers	65	14,910	5,078	6,019	3,150	454	209
Retailers	553	4,743	1,756	1,798	724	278	187
Five star hotels	7	7,694	2,805	2,793	1,784	201	111
		47,361	17,764	15,663	12,054	1,244	636

50% provision for doubtful debts has been made by MWL against balances outstanding for more than 30 days whereas the balances outstanding for more than 90 days have been fully provided.

Required:

- Indicate what would be the basis for selecting debtors for circularising positive and negative requests for confirmations. (06 mark)
 - Briefly explain as to how would you deal with a situation where a debtor confirms a balance which is different from the amount appearing in the confirmation request. (08 mark)
- Q.4 (a) Classification of certain items reported in the financial statements is based on the management's intentions. In such a situation the auditor has to rely on management representations.

Required:

List the factors that the auditor should consider in evaluating the management's intentions with regard to their future course of action, as stated in their written representations. (04 mark)

- Briefly discuss how the auditor would deal with a situation where he is in doubt regarding the reliability of the written representations provided by the management of the company. (05 mark)

- Q.5 List the substantive procedures that may be performed by an auditor to verify the following:

- Bank reconciliation statements (06 marks)
- Payroll (08 marks)
- Raw material purchases (06 marks)

- Q.6 List the audit procedures that may be performed by the auditor in order to ensure that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are identified and appropriately reflected in the financial statements. **(10 marks)**
- Q.7 Discuss the categories of threats that may be involved in each of the following independent situations and advise the partners of the concerned firm with regard to the possible course of action that may be followed, in each case.
- (a) Burewala Bank Limited (BBL) is a listed audit client of Umer and Company, Chartered Accountants (UCC). BBL has granted a house loan of Rs. 5 million to a partner in UCC. **(04 marks)**
- (b) Kamal was the audit manager during the last year's annual audit of Faisalabad Textile Mills Limited (FTML). He has joined FTML as their Manager Finance, prior to the commencement of the current year's audit. **(08 marks)**
- Q.8 Comment on each of the following independent situations with reference to the applicable rules and regulations.
- (a) Zaman is a partner in a firm of Chartered Accountants and holds 5,000 shares in Mardan Limited (ML). His firm has received an offer for appointment as auditors of Khanewal Limited (KL). ML and KL are subsidiaries of Dera Khan Limited (DKL). **(03 marks)**
- (b) Bilal and Company has received an offer for appointment as auditors of IJK Limited. The total paid up capital of the company is Rs. 990 million whereas its ordinary share capital is Rs. 130 million.
- Faryal, the wife of a partner in Bilal and Company, is a director in LMN Limited which holds 50 million non-voting preference shares and 2 million ordinary shares in IJK Limited. Faryal also holds 10,000 shares in LMN Limited. The par value of both types of shares is Rs. 10 each. **(04 marks)**
- Q.9 List the important matters that are required to be included in an audit engagement letter. **(06 marks)**

(THE END)