THE INSTITUTTE OF CERTIFIED PUBLIC ACCOUNTANTS OF PAKSITAN (ICPAP)

Stage	**Essentials**	Course Code	**E-302**
Examination	**Summer-2011**	Course Name	**Audit and Assurance**
Time Allowed	**03 Hours**	Maximum Marks	**100**

NOTES:
1. All questions are to be attempted.
2. Answers are expected to the precise, to the point and well written.
3. Neatness and style will be taken into account in marking the papers.

Question No 1

Pak Dairy Co manufactures a range of dairy products (for example, milk, yoghurt and cheese) in one factory. Products are stored in a nearby warehouse (which is rented by Pak Dairy) before being sold to 350 supermarkets located within 200 kilometres of Pak Dairy's factory. The products are perishable with an average shelf life of eight days. Pak Dairy's financial statements year-end is 31 July.

It is four months since the year-end at your audit client of Pak Dairy and the annual audit of Pak Dairy is almost complete, but the auditor's report has not been signed.

The following events have just come to your attention. Both events occurred in late November.

(a) A fire in the warehouse rented by the company has destroyed 60% of the inventory held for resale.

(b) A batch of cheese produced by Pak Dairy was found to contain some chemical impurities. Over 300 consumers have complained about food poisoning after eating the cheese. 115 supermarkets have stopped purchasing Pak Dairy's products and another 85 are considering whether to stop purchasing from Pak Dairy. Lawyers acting on behalf of the consumers are now presenting a substantial claim for damages against Pak Dairy.

Required:

In respect of EACH of the events at Pak Dairy Co mentioned above:

(i) Describe the additional audit procedures you will carry out. 8

(ii) State, with reasons, whether or not the financial statements for the year-end require amendment. 8

(iii) Discuss whether or not the audit report should be modified. 4

Question No 2

Rehman & Co is a construction company (building houses, offices and hotels) employing a large number of workers on various construction sites. The internal audit department of Rehman & Co is currently reviewing cash wages systems within the company.

The following information is available concerning the wages systems:

i. Hours worked are recorded using a clocking in/out system. On arriving for work and at the end of each days work, each worker enters their unique employee number on a keypad.

ii. Workers on each site are controlled by a foreman. The foreman has a record of all employee numbers and can issue temporary numbers for new employees.

iii. Any overtime is calculated by the computerised wages system and added to the standard pay.

iv. The two staff in the wages department makes amendments to the computerised wages system in respect of employee holidays, illness, as well as setting up and maintaining all employee records.

v. The computerized wages system calculates deductions from gross pay, such as employee taxes, and net pay. Finally a list of net cash payments for each employee is produced.

vi. Cash is delivered to the wages office by secure courier.

vii. The two staff place cash into wages packets for each employee along with a handwritten note of gross pay, deductions and net pay. The packets are given to the foreman for distribution to the individual employees.

Required:

(a) (i) Identify and explain weaknesses in Rehman & Co's system of internal control over the wages system that could lead to mis-statements in the financial statements. 4

(ii) For each weakness, suggest an internal control to overcome that weakness. 4

(b) Compare the responsibilities of the external and internal auditors to detect fraud.
The computer system in the wages department needs to be replaced. The replacement will be carried out under the control of a specialist external consultant. 6

(c) Explain the factors that should be taken into consideration when appointing an external consultant. 6

Question No 3

You are the audit manager in the audit firm of KPMG. One of your audit clients is SERVICE Co, a company specializing in the manufacture and supply of sporting equipment. SERVICE has been an audit client for five years and you have been audit manager for the past three years while the audit partner has remained unchanged.

You are now planning the audit for the year ending 31 December 2007. Following an initial meeting with the directors of SERVICE, you have obtained the following information.

(i) SERVICE is attempting to obtain a listing on a recognized stock exchange. The directors have established an audit committee, as required by corporate governance regulations, although no further action has been taken in this respect. Information on the listing is not yet public knowledge.

(ii) You have been asked to continue to prepare the company's financial statements as in previous years.

(iii) As the company's auditors, SERVICE would like you and the audit partner to attend an evening reception in a hotel, where SERVICE will present their listing arrangements to banks and existing major shareholders.

(iv) SERVICE has indicated that the fee for taxation services rendered in the year to 31 December 2005 will be paid as soon as the taxation authorities have agreed the company's taxation liability. You have been advising SERVICE regarding the legality of certain items as 'allowable' for taxation purposes and the taxation authority is disputing these items.

Finally, you have just inherited about 5% of SERVICE's share capital as an inheritance on the death of a distant relative.

Required:

(a) Identify, and explain the relevance of, any factors which may threaten the independence of KPMG's audit of SERVICE Co's financial statements for the year ending 31 December 2007. Briefly explain how each threat should be managed. 8

(b) Explain the actions that the board of directors of SERVICE Co must take in order to meet corporate governance requirements for the listing of SERVICE Co. 8

(c) Explain why your audit firm will need to communicate with SERVICE Co's audit committee for this and future audits. 4

Question No 4

(a) ISA 210 *Terms of Audit Engagements* explains the content and use of engagement letters.

Required:
State SIX items that could be included in an engagement letter. 8

(b) ISA 500 *Audit Evidence* explains types of audit evidence that the auditor can obtain.

Required:
State, and briefly explain, four types of audit evidence that can be obtained by the auditor. 8

(c) ISA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* explains the form and content of audit reports.

Required:
State three ways in which an auditor's report may be modified and briefly explain the use of each modification. 4

Question No 5

PTA Co assembles mobile telephones in a large factory. Each telephone contains up to 100 different parts, with each part being obtained from one of 50 authorised suppliers.

Like many companies, PTA's accounting systems are partly manual and partly computerised. In overview the systems include:
(i) Design software
(ii) A computerised database of suppliers (bespoke system written in-house at PTA)
(iii) A manual system for recording goods inwards and transferring information to the accounts department
(iv) A computerised payables ledger maintained in the accounts department (purchased off-the-shelf and used with no program amendments)
(v) Online payment to suppliers, also in the accounts department
(vi) A computerised general ledger which is updated by the payables ledger

Mobile telephones are assembled in batches of 10,000 to 50,000 telephones. When a batch is scheduled for production, a list of parts is produced by the design software and sent, electronically, to the ordering department. Staff in the ordering department use this list to place orders with authorised suppliers. Orders can only be sent to suppliers on the suppliers' database. Orders are sent using electronic data interchange (EDI) and confirmed by each supplier using the same system. The list of parts and orders are retained on the computer in an 'orders placed' file, which is kept in date sequence.

Parts are delivered to the goods inwards department at PTA. All deliveries are checked against the orders placed file before being accepted. A hand-written pre-numbered goods received note (GRN) is raised in the goods inwards department showing details of the goods received with a cross-reference to the date of the order. The top copy of the GRN is sent to the accounts department and the second copy retained in the goods inwards department. The orders placed file is updated with the GRN number to show that the parts have been received.

Paper invoices are sent by all suppliers following dispatch of goods. Invoices are sent to the accounts department, where they are stamped with a unique ascending number. Invoice details are matched to the GRN, which is then attached to the invoice. Invoice details are then entered into the computerised payables ledger. The invoice is signed by the accounts clerk to confirm entry into the payables ledger. Invoices are then retained in a temporary file in number order while awaiting payment.

After 30 days, the payables ledger automatically generates a computerised list of payments to be made, which is sent electronically to the chief accountant. The chief accountant compares this list to the invoices, signs each invoice to indicate approval for payment, and then forwards the electronic payments list to the accounts assistant. The assistant uses online banking to pay the suppliers. The electronic payments list is filed in month order on the computer.

Required:

(a) List the substantive audit procedures you should perform to confirm the assertions of completeness, occurrence and cut-off for purchases in the financial statements of PTA Co. For each procedure, explain the purpose of that procedure. 5

(b) List the audit procedures you should perform on the trade payables balance in PTA Co's financial statements. For each procedure, explain the purpose of that procedure. 5

(c) Describe the control procedures that should be in place over the standing data on the trade payables master file in PTA Co's computer system. 5

(d) Discuss the extent to which computer-assisted audit techniques might be used in your audit of purchases and payables at PTA Co. 5

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