

**INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS  
OF PAKISTAN**

PROFESSIONAL—III (NEW/EXISTING) EXAMINATION—SUMMER, 2003

Tuesday, the 27th May, 2003

**AUDITING**

1305

*Time Allowed—3 Hours*

*Maximum Marks—100*

- (i) Attempt SIX questions including compulsory question No. 3 which carries 20 marks. All other questions carry 15 marks each.
- (ii) Answer must be neat, relevant and brief.
- (iii) In marking paper, the examiners take into account clarity of exposition, logic of arguments, presentation and language.
- (iv) Read the instructions printed on the top cover of answer script CAREFULLY before attempting the paper.
- (v) DO NOT write your Name, Reg. No. or Roll No. anywhere inside the answer script.

Marks

**Special Instructions for Q. 1 :**

- An overwritten answer will carry no mark.
- Present your answer in the format given below :

S. No.	Your choice	Rationale (brief reason for your answer)
(i)		
(ii)		
& so on		

Q. 1 (i) Select the best answer from the following :

12

- (a) Which of the following is not included in the scope of external audit ?
- (1) Review of internal controls.
  - (2) Review of operating data.
  - (3) Assessment of management estimates.
  - (4) Assessment of compliance with laws and regulations.
- (b) Which of the following is not an example of control environment :
- (1) Segregation of duties.
  - (2) Budgetary controls.
  - (3) Internal auditing.
  - (4) Reconciling bank accounts.

P.T.O.

- (c) Control procedures include all of the following, except :
- (1) Checking arithmetical accuracy.
  - (2) Management philosophy and operating style.
  - (3) Comparison of internal data with external data.
  - (4) Control accounts and trial balance.
- (d) Non-adjusting events include all of the following, except :
- (1) Mergers and acquisitions.
  - (2) Issue of shares.
  - (3) Strikes and labour disputes.
  - (4) Insolvency of a customer.
- (e) Principal purpose of management letter is to :
- (1) Serve as an introduction to company personnel.
  - (2) Point out the weaknesses in the system of internal control.
  - (3) Remind management of its primary responsibility for financial statements.
  - (4) State the liabilities not recorded.
- (f) Substantive tests imply all of the following, except :
- (1) To examine documents and records.
  - (2) To ascertain that the transactions have taken place in accordance with the internal control system.
  - (3) To ascertain that all accruals and prepayments have been recorded as cut off procedure.
  - (4) To prepare books of accounts.
- (ii) Match the term(s) with related description. Each term may be used once/more than once/not at all : 4

<u>Description</u>	<u>Terms</u>
(1) The methods which have been developed to apply fundamental accounting concepts to financial transactions.	(a) Representation by management. (b) Objectives of audit committee. (c) Accounting bases. (d) On line real time System.
(2) Evidence obtained from management for material business transactions/ procedures.	(e) Scope paragraph.

---

Description

- (3) In Computerised environment, where users have direct access to computers and instant updating of all relevant files.
- (4) To ensure maintenance of adequate documents, records & evidence.

Q. 2 (a) Is it appropriate to include in the audit engagement letter that : "There is an unavoidable risk that even some material misstatements may remain undiscovered" ? 8

(b) Auditor's report under the Companies Ordinance, 1984 states : "We plan and perform the audit to obtain reasonable assurance about, whether, the financial statements are free of any material misstatements." 8  
Explain how would you determine whether an item is material ?

Q. 3 (a) You are the auditor of Stylus Builders for the year ended Dec. 31, 2001 :

Stylus builders acquired materials worth Rs. 12 million for construction of a building in December 2001. The contract provided that the quality of materials used will be approved by the Quantity Surveyor of the customer. Stylus did not obtain prior approval of the material from the customer. The Quantity Surveyor visited the site on January 24, 2002 and rejected the material on the grounds that the specifications did not meet the contract terms. Net realizable value of this material on December 31, 2001 was Rs. 12.5 million and on January 24, 2002 the net realizable value was Rs. 10 million. The directors of the company refused to record the loss of Rs. 2 million in 2001. They are of the view that the loss may be written off in 2002.

**Required :**

How would this situation affect your report ? 10

Draft extracts for the suggested audit report. You need not reproduce full audit report. Only set out opinion paragraph (paragraph regarding true and fair view) of the standard report.

(b) Set out briefly, legal, ethical and commercial requirements in acceptance of a client. 10

P.T.O.

- Q. 4 (a) Discuss matters to be considered in designing audit programmes for (a) tests of controls and (b) substantive procedures, to verify loans and advances obtained by clients. 8
- (b) Discuss matters to be considered in group audit, as regards, planning, performance of audit, review and reporting. 8
- Q. 5 (a) A new client has approached your firm to carry out the audit. Enumerate some significant client screening procedures. 8
- (b) Prepare an internal control evaluation questionnaire relating to purchases and payable for a medium sized manufacturing company. Your answer should set out four key controls to be considered. 8
- Q. 6 (a) What are the rights of an auditor under the Companies Ordinance, 1984 ? 6
- (b) What are the advantages of an Audit Programme ? 5
- (c) What is the importance of audit working papers ? 5
- Q. 7 "Audit in a Computerised environment is a complex activity with the peculiarities associated with Computer based accounting system" :
- (a) State the audit process in a computer/IT based accounting systems. 8
- (b) What internal controls do you expect to exist in a computer/IT based accounting system. 8
- Q. 8 (a) Explain the concept of "Proprietary Audit". Who should conduct this Audit ? 8
- (b) Differentiate between Audit & Investigation. Tabulate your answer. 8

THE END

---