

INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS OF PAKISTAN



Spring (Summer) 2010 Examinations

Tuesday, the 25th May 2010

RISK MANAGEMENT AND AUDIT (S-503)
STAGE - 5

Time Allowed – 2 Hours 45 Minutes

Maximum Marks – 80

- (i) Attempt all questions.
- (ii) Answers must be neat, relevant and brief.
- (iii) In marking the question paper, the examiners take into account clarity of exposition, logic of arguments, effective presentation, language and use of clear diagram/ chart, where appropriate.
- (iv) Read the instructions printed inside the top cover of answer script CAREFULLY before attempting the paper.
- (v) Use of non-programmable scientific calculators of any model is allowed.
- (vi) DO NOT write your Name, Reg. No. or Roll No. anywhere inside the answer script.
- (vii) Question No.1 – “Multiple Choice Question” printed separately, is an integral part of this question paper.

Marks

Q. 2 Prof. Dr. Raza, a very senior and renowned general physician established a clinic in 2005. The clinic is situated in a posh locality where patients generally can afford and are willing to pay high consultation fee provided they get the desired quality service. It is a full time clinic and Dr. Raza ensures his presence during the whole day. Dr. Raza’s wife is dentist by profession and has annexed a dental unit to the clinic which she attends in the evening. The clinic grew gradually and a team of almost six doctors is now working at the clinic during various timings mainly providing consultation while surgery cases are referred to nearby hospitals as per the case specifications. An emergency unit is also operating twenty-four hours a day. They have recently decided to add a surgical unit to the clinic for minor surgeries proposed to be constructed on the piece of land attached to the clinic recently purchased for this purpose. The plan also includes the addition of five rooms for providing short period admission to the patients. They are in the process of developing the feasibility for the proposed expansion.

Dr. Raza has contacted your firm for assistance to identify the risks to which they can have an exposure with the proposed expansion.

Required:

As a business risk specialist you have been assigned the task to prepare a short report for the client including the following:

- (a) The significant business risks to which there will be an exposure with the addition of the new surgery facilities. 10
- (b) The proposed approaches to manage these potential risks. 05

Q. 3 (a) During the course of the audit of Smart Services Limited for the year ended March 31, 2010, the auditor noted certain contradictions between the results of inquiries from company’s legal advisor and the representation provided by the management in respect of certain contingencies.

Considering the above scenario:

- (i) Define “Professional Skepticism”. 02
- (ii) Explain how the attitude of “Professional Skepticism” would help the auditor to deal with such matters? 03
- (b) Define and discuss the concept of “Reasonable Assurance” while conducting an audit in accordance with International Standards on Auditing. 10

PTO

Q. 4 Five Stars Foods International Limited is a producer/ manufacturer of wide range of food products including daily use items such as jams, marmalades, jellies, cereals and few specialized food products for diabetic and heart patients. The company has set up two manufacturing facilities, one in Karachi and the other in Lahore. Mostly, items are sold locally, however, the company also exports few high quality products mainly to Middle East and Afghanistan. Major raw material items are procured from local markets, however, few specialized items are imported directly by the company. The company's sales for the year ended June 30, 2009 amounted to Rs.500 million while the expected turnover for the year ending June 30, 2010 is Rs.750 million. The company is maintaining a steady profit margin at 10% which is expected to continue during the current year. The company's major financing has been made through equity and very small debt financing is arranged mainly for meeting working capital requirements. During the year the company has launched a new low calories products range –“Eat Light” in collaboration with a US based company. An aggressive advertisement and publicity campaign was undertaken for launching this new product range on which an amount of approximately Rs.10 million was incurred.

Your firm has been the auditor of Five Stars Foods International Limited for the last couple of years and you have gathered above information in the process of planning for the year ending June 30, 2010. During the year the Chief Executive Officer of the company was also changed and also there has been a major change in the Board of Directors. The new management has requested you to brief them on some key aspects of the audit.

Required:

In view of these developments you have to prepare a brief report for the management which should include the following:

- | | |
|---|----|
| (a) What is materiality? Why it is important for an audit under International Standards on Auditing? | 05 |
| (b) What is the relationship between materiality and audit risk and how does it impact on an audit? | 05 |
| (c) Do you consider the advertisement and publicity expense incurred on launching the new product range as material? Explain with reasons. | 05 |
| (d) The key audit risk areas for the year ending June 30, 2010 with brief reasons. | 05 |

Q. 5 Considering the understanding and knowledge of the assurance team, the clients often value the non-assurance services from them which is also expected to further enhance the understanding of the assurance team and to add value in assurance services. However, the provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level. The Code of Ethics for Professional Accountants prescribes certain activities which are expected to create so significant self-interest or self review threats that accountants are advised either to avoid such activities or refuse to perform the assurance engagement.

Required:

In view of the above statement:

- | | |
|---|----|
| (a) List down the non-assurance activities prohibited by the Code of Ethics. | 05 |
| (b) List down the prohibited services to be performed by an auditor of a listed company as included in the listing regulations of Karachi, Lahore and Islamabad Stock Exchanges. | 10 |

- | | |
|--|----|
| Q. 6 (a) While accepting the appointment, a cost auditor is advised to issue an acceptance letter to the client. Explain the importance of the acceptance letter and the contents of such letter. | 10 |
| (b) How would you verify the consumption of material while carrying out a cost audit? | 05 |

THE END