



Malaysian Institute of Accountants
(Established under the Accountants Act 1967)
Institut Akauntan Malaysia
(Diperbadankan di bawah Akta Akauntan 1967)

QUALIFYING EXAMINATION

Auditing and Assurance Services

Date : 15 March 2018
Time : 9.30 am – 12.45 pm
Reading and Planning : 15 minutes
Writing : 3 hours

INSTRUCTIONS TO CANDIDATES:

This question paper contains 6 questions on 6 printed pages.

Answer ALL questions.

Answer Questions 1, 2 and 3 in separate booklet(s) from Questions 4, 5 and 6.

Do not open this paper until instructed by the invigilator.

During reading and planning time only the question paper may be annotated. You must **NOT** write in your answer booklet until instructed by the invigilator.



UNIVERSITI TEKNOLOGI MARA
Examination Body

Paper: Auditing and Assurance Services

QUESTION 1

A. Amin Afifah & Co is the auditor for Semarak Bhd, an automotive manufacturing company. The firm is also the auditor for Kimanis Sdn Bhd that had a contract with Semarak Bhd to supply automotive parts. The following are the ethical issues that arise during the annual audit:

- i. Afifah, who is the audit partner for Semarak Bhd is also acting as the audit partner for Kimanis Sdn Bhd. Semarak Bhd has just initiated a proposal to renew its procurement contract with Kimanis Sdn Bhd for the next five years. Kimanis Sdn Bhd has asked Afifah to provide advice on the matter.
- ii. Arman who is the son of Afifah had just graduated in Bachelor of Mechanical Engineering and is offered a position as an engineer at Semarak Bhd. Arman is considering the offer, as Semarak Bhd offered a starting salary which is higher than the industry average.
- iii. An audit manager who is responsible for the audit engagement for Semarak Bhd holds 1,000 units ordinary shares in the company which amounted to less than 1% of the total shares issued. Afifah just got to know about this matter after the engagement has started. However, she emphasised that she herself does not hold any shares in Semarak Bhd.
- iv. Due to financial difficulties, Kimanis Sdn Bhd had not paid their audit fees for the past three (3) years. In order to, overcome the unpaid audit fees, Kimanis Sdn Bhd offered to supply Amin Afifah & Co with new office furniture. The partner had accepted this offer in full consideration of the outstanding fees, even though the furniture was only worth 70% of the outstanding fees.

Required:

Comment on each of the ethical issues above in the context of independence requirement as stated in the MIA's By-Laws (On Professional Ethics, Conduct and Practice).

(8 marks)

B. PricewaterhouseCoopers (PwC), the global auditor was sued for USD\$5.5 billion over its failure to spot massive fraud in the failed Colonial Bank, whose accounts it had audited. Legal proceedings against PwC were brought by trustee of Taylor, Bean & Whitaker Mortgage, a subsidiary for Colonial Bank. PwC claims that sophisticated frauds are difficult to detect and audits are no guarantee of exposure.

(Forbes, August 2016)

Required:

- i. In the context of auditors' liability, explain the following terms:

- a. Privity of contract
- b. Ordinary negligence
- c. Professional indemnity insurance
- d. Duty of care

(6 marks)

ii. Differentiate the auditors' liability under Common Law and Statutory Law.
(6 marks)
(Total: 20 marks)

QUESTION 2

The principal activities of Evergo Sdn Bhd are manufacturing, assembling and sale of plastic moulded products, components and parts. Sales are made according to the orders placed by the customers. Over the years, Evergo Sdn Bhd has been servicing a number of loyal customers and has been their sole supplier of such products.

The customers would normally call in to place their orders to Encik Ali, who is the general clerk in the sales department. He then prepares a three-copy pre-numbered sales order form by filling in the pertinent information such as the customer's name, address, account number, quantity and items ordered. After the sales order form has been prepared, the customer's purchase order was attached together. For credit sales of less than RM5,000, approval is given by Encik Ali. For credit sales greater than RM5,000, a review of the credit worthiness of the customer is required before approval from the manager of the credit department.

At times, the customers would order custom-made products, which require Evergo Sdn Bhd to produce products according to the customer's specification. In such circumstances, the R&D department will set a special meeting with the customers to discuss their orders. The outcome of the meeting would be recorded in minutes of meeting and a copy of the minutes is forwarded to the production department. The production department would proceed with the order based on the information communicated in the minutes.

The finished custom-made products will usually be delivered to the customers once they are ready. The customers are putting full trust with Evergo Sdn Bhd to deliver the products as soon as they are ready with no specified deadline. Evergo Sdn Bhd engaged a reputable haulage company to deliver the products to the customers. The accounts clerk, Encik Abdin will prepare a two-copy sales invoice that states the quantity and selling price of the product delivered. The products will be delivered together with the original and duplicate copies of the sales invoice. If there is no query from the customers, the accounts department will assume the products are delivered safely and payments from the customers will be received according to the credit term stated in the invoice.

Required:

- a. Differentiate between the management's and auditor's responsibility on internal control.
(3 marks)
- b. State two (2) internal control activities that can be identified from the above case.
(2 marks)
- c. Identify five (5) weaknesses in internal control system of Evergo Sdn Bhd. For each of the weaknesses identified, briefly state the possible impact and suggest a recommendation to overcome the weaknesses.

Present your answers in the following format:

| Weaknesses | Possible impact | Recommendation |
|------------|-----------------|----------------|
| 1. | | |
| | | |

(15 marks)
(Total: 20 marks)

QUESTION 3

ISRE 2400: Engagements to Review Historical Financial Statements provides guidelines for the practitioners to perform review engagement. The practitioners' conclusion is based on the limited assurance obtained that an entity's financial statements are in accordance with an applicable financial reporting framework.

Required:

- a. Distinguish between a review of financial statements and an audit engagement. (4 marks)
- b. The practitioner should plan and conduct a review engagement with an attitude of professional scepticism. Give your comments. (2 marks)
- c. State any four (4) procedures that would normally be performed by the practitioner before any report on the review of client's financial statements can be issued. (4 marks)
(Total: 10 marks)

QUESTION 4

- A. The use of information technology (IT) for financial reporting and operational purposes are common in every sector of the business and industry. Auditor must be familiar with the effects of IT on the entity's internal control and on the auditor's risk assessment approach.

Required:

- i. Explain four (4) potential benefits of IT on internal control. (4 marks)
- ii. Discuss two (2) factors that affect the control environment with the implementation of IT in an entity. (4 marks)
- iii. Describe two (2) areas in which control procedures can be affected by the use of IT. (4 marks)

B. Encik Azim, the senior auditor of Dahlan & Associate is responsible for the audit of inventory for Maju Jaya Bhd. He will be attending the year-end inventory count on 30 June 2018. The manager of Dahlan & Associate wishes to utilise the computer-assisted audit techniques (CAATs) for the first time on test of controls and substantive testing in auditing Maju Jaya Bhd's inventory.

Required:

- i. Describe four (4) audit procedures that could be carried out using CAATs.
(4 marks)
- ii. Explain two (2) advantages and two (2) disadvantages of using CAATs.
(4 marks)
(Total: 20 marks)

QUESTION 5

You are the manager responsible for the audit of Sahara Stores Sdn Bhd, a company which operates a chain of supermarkets. The final audit for the year ended 31 January 2018 is nearing completion and you are reviewing the audit working papers. The draft financial statements recognised total assets of RM300 million, revenue of RM620 million and profit before tax of RM47 million. The issues that arise from the audit working papers are summarised below:

Distribution licence

The statement of financial position includes an intangible asset of RM15 million, which is the cost of a distribution licence acquired on 1 September 2017. The licence gives Sahara Stores Sdn Bhd the exclusive right to distribute a popular brand of soft drink in its stores for a period of five years.

Sale and leaseback arrangement

A sale and leaseback arrangement involving a large property complex was entered on 31 January 2018. The property complex was sold for RM37 million at its fair value on the date of disposal. The property complex had a carrying value of RM27 million as at the year end. The only accounting entry recognised in respect of this transaction was the record of cash received and the non-current liability classified as 'Obligations under Finance Lease'. The lease term is for 20 years, which is the remaining useful life of the property complex. Sahara Stores Sdn Bhd retains the risks and rewards associated with the leased asset.

Required:

Discuss five (5) audit evidences in respect of each of the issues described above.
(Total: 10 marks)

QUESTION 6

A. Feel Free Hotels Sdn Bhd operates a chain of 18 hotels located across the country. Each hotel has a local cuisine restaurant and leisure club facilities. Most visitors to the restaurant and leisure club are hotel guests. However, these facilities are open to the public. Hotel guests generally charged the cost of the meals and facilities to their room but other visitors must pay directly to the hotel staff. During the year, senior management noticed an increased level of cash discrepancies and inventory discrepancies, and they suspect that some employees have been stealing cash and goods from the hotels. They are keen to prevent this from recurring and are considering to establish an internal audit department to undertake fraud investigation.

Required:

a. Explain four (4) procedures of the internal audit department in preventing and detecting fraud and error.

(4 marks)

b. Describe four (4) limitations of Feel Free Hotels Sdn Bhd in establishing and maintaining an internal audit department.

(4 marks)

B. The directors would like the internal audit department to have broad roles, as this will make the decision to establish an internal audit department more cost effective.

Required:

Discuss six (6) additional functions of the internal audit department other than fraud investigations.

(12 marks)

(Total: 20 marks)

END OF QUESTION PAPER