



**Pakistan Institute of
Public Finance Accountants**

Model Solutions

Audit, Assurance & Ethics

Summer Exam-2024

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Solutions – Audit, Assurance & Ethics

- Q.1.** Sampling risk—The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-sampling risk – The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

ISA530- AUDITSAMPLING- 5C & 5D

- Q.1.** Sampling unit – The individual items constituting a population. The sampling units might be physical items (for example, checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors' balances) or monetary units.

ISA530 – AUDIT SAMPLING - 5f & A2

Stratification—The process of dividing a population in to sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value)

ISA530 - AUDIT SAMPLING - 5h

- Q.1.** There are many methods of selecting samples. The principal methods are as follows:

- iii**
- (a) Random selection (applied through random number generators, for example, random number tables).
 - (b) Systematic selection, in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerized random number generator or random number tables. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.
 - (c) Monetary Unit Sampling is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.
 - (d) Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.



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- (e) Block selection involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

Q.2. Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted is that management and, where appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:

- (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;
- (ii) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (iii) To provide the auditor with:
 - a) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - b) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
 - c) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, (i) above may be restated as “for the preparation and fair presentation of the financial statements in accordance with the financial reporting framework,” or “for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework.”

The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”

ISA 200, OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING, 13(J)



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Q.3. Examples of actions that might eliminate threats created by offering or accepting such an inducement include:

- Declining or not offering the inducement.
- Transferring responsibility for any business-related decision involving the counterparty to another individual who the chartered accountant has no reason to believe would be, or would be perceived to be, improperly influenced in making the decision.

Examples of actions that might be safeguards to address such threats created by offering or accepting such an inducement include:

- Being transparent with senior management or those charged with governance of the employing organization of the chartered accountant or of the counterparty about offering or accepting an inducement.
- Registering the inducement in a log maintained by the employing organization of the accountant or the counterparty.
- Having an appropriate reviewer, who is not otherwise involved in undertaking the professional activity, review any work performed or decisions made by the accountant with respect to the individual or organization from which the accountant accepted the inducement.
- Donating the inducement to charity after receipt and appropriately disclosing the donation, for example, to those charged with governance or the individual who offered the inducement.
- Reimbursing the cost of the inducement, such as hospitality, received.
- As soon as possible, returning the inducement, such as a gift, after it was initially accepted.

Q.4. *Emphasis of Matter paragraph*—A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

Glossary of terms- ISA

When the Emphasis of Matter paragraph relates to the applicable financial reporting framework, including circumstances where the auditor determines that the financial reporting framework prescribed by law or regulation would otherwise be unacceptable,¹² the auditor may consider it necessary to place the paragraph immediately following the Basis for Opinion section to provide appropriate context to the auditor’s opinion.

When a Key Audit Matters section is presented in the auditor’s report, an Emphasis of Matter paragraph may be presented either directly before or after the Key Audit Matters section, based on the auditor’s judgment as to the relative significance of the information included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading “Emphasis of Matter”, such as “Emphasis of Matter – Subsequent Event”, to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.



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- Q.4.** We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.
- b**
- Q.4.** Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.
- c**
- Q.5.** The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control, and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people,
- a**
- Q.5.** Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:
- b**
- (a) Communication and enforcement of integrity and ethical values – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
 - (b) Commitment to competence –Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
 - (c) Participation by those charged with governance – Attributes of those charged with governance such as:
 - Their independence from management.
 - Their experience and stature.
 - The extent of their involvement and the information they receive, and the scrutiny of activities.
 - The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
 - (d) Management's philosophy and operating style – Characteristics such as management's:
 - Approach to taking and managing business risks.
 - Attitudes and actions toward financial reporting.
 - Attitudes toward information processing and accounting functions and personnel.
 - (e) Organizational structure – The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed
 - (f) Assignment of authority and responsibility–Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
 - (g) Human resource policies and practices – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.



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- Q.5.** Relevant audit evidence may be obtained through a combination of inquiries and other risk assessment procedures such as corroborating inquiries through observation or inspection of documents. For example, through inquiries of management and employees, the auditor may obtain an understanding of how management communicates to employees its views on business practices and ethical behavior. The auditor may then determine whether relevant controls have been implemented by considering, for example, whether management has a written code of conduct and whether it acts in a manner that supports the code.
- c**

The auditor may also consider how management has responded to the findings and recommendations of the internal audit function regarding identified deficiencies in internal control relevant to the audit, including whether and how such responses have been

implemented, and whether they have been subsequently evaluated by the internal audit function.

- Q.5.** Effect of the Control Environment on the Assessment of the Risks of Material Misstatement
- d**

Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity's control consciousness is influenced significantly by those charged with governance, because one of their roles is to counter balance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:

- Their independence from management and their ability to evaluate the actions of management.
- Whether they understand the entity's business transactions.
- The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures.

- Q.6.** Positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct.
- a**

A **blank external confirmation** request is a confirmation request that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.

A **Negative confirmation** request is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

- Q.6.** The auditor shall use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level if all of the following are present
- b**



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- (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions or conditions;
- (c) A very low exception rate is expected;

The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Q.7. Safe guards created by the profession, legislation or regulation include, but are not restricted to:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.
