Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

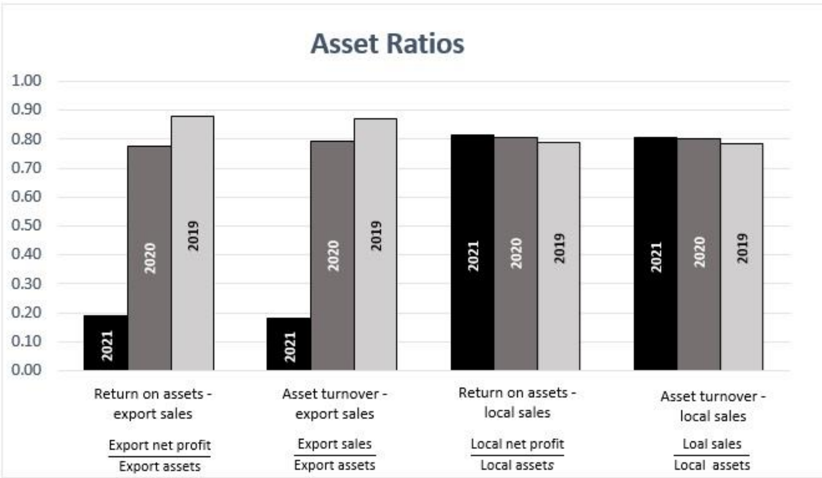
9 December 2021
3 hours – 100 marks
Additional reading time – 15 minutes

Audit, Assurance and Related Services

Instructions to examinees:
(i) Answer all **SIX** questions.
(ii) Answer in **black** pen only.

Q.1 Your firm has been appointed as the auditor of Harrier Limited (HL), a public unlisted company, for the year ending 31 December 2021. HL is in the business of textile and allied products. The previous year's audit was performed by another firm of chartered accountants who expressed an unmodified opinion.

HL has provided you its draft annual report which includes following graphical analysis regarding the profitability of its business. The audited financial statements are made part of this annual report which will be shared with all stakeholders.



Export sales represents sales of scuba diving suits mostly to various European countries. Total assets used for the calculation of ratios relating to export sales include a manufacturing plant acquired for producing scuba diving suits in October 2018 at a cost of Rs. 100 million and had an expected useful life of 20 years. As at 30 September 2021, this plant is appearing in HL's book at Rs. 85 million.

On inquiry with the management regarding the decline of export sales, they informed that in the third quarter of 2020, European Union withdrew the GSP + status of Pakistan. This resulted in cancellation of all future orders from European countries. They further informed that the plant remained idle several times in the current year due to lack of export orders as there is a minimal demand of such products in Pakistan and some other Asian countries.

The profit before tax as per draft financial statements is Rs. 200 million.

Required:
(a) Critically evaluate the issue discussed above and advise the course of action that your team should take. **(08)**
(b) Discuss all the possible reporting implications if:
  (i) the management agrees to account for as per the applicable financial reporting framework.
  (ii) the management does not agree to account for as per the applicable financial reporting framework. **(16)**

Q.2 Your firm has been appointed as the auditor of a recently launched innovative food business venture by the name of Macaw Foods (Private) Limited (MPL). Extracts from draft financial statements for the year ended 31 October 2021, provided by the management are as follows:

	Rupees
Statement of profit & loss:	
Joining fee – non refundable	12,500,000
Service charges	50,000,000
Profit on supply of ingredients	7,500,000
Statement of financial position:	
Current assets:	
Inventory	12,000,000
Cash and bank	10,000,000
Current liabilities:	
Payable to restaurants (net of service charges and profit on ingredients)	10,000,000
Equity:	
Share capital	300,000,000

Following additional information is available regarding MPL:

Background
Marium and Mujtaba are the co-founders of MPL and are also involved in the entity's operational activities. They had approached a venture capital fund (the fund) for financing the start up. The fund financed MPL in return of a 40% equity stake in the business. Being a high risk investment for the fund, they have a superior right on MPL's assets and payouts over other stakeholders. Remaining amount was raised through a Rs. 100 million bank loan.

Operations
MPL has established large shared kitchens in the key localities of the city where MPL offers restaurants to scale up and have immediate presence in that locality. If a restaurant brand joins MPL, all it needs to do is to share its recipe with MPL's team. On receiving the order, MPL will be responsible for sourcing of ingredients, cooking with care to packaging and delivering it to the customers. The restaurants thus save huge costs of setting up their own infrastructure through partnership with MPL.

To partner with MPL, restaurants have to enter into a three year contract under which they are required to pay a non-refundable joining fee of Rs. 100,000 and a 30% service charge for order delivered by MPL and 25% service charge for order delivered by any third party food delivery company. In addition, restaurants are also charged for the cost of commonly used ingredient on a standard rate communicated to all restaurants on the first day of the month. However, specialized ingredients are required to be supplied by the restaurants themselves. MPL purchases ingredients in bulk quantity and resultantly obtains huge discounts. MPL's management has presented profit on ingredients in its financial statements on a net basis as they believe that they are acting as an agent for restaurants.

Invoicing
An electronic data interchange system has been set up which directly connects MPL with the restaurants ordering system. Weekly invoices are also automatically shared with restaurants. Restaurants which do not operate an online ordering system are catered manually. A separate ledger is maintained for each restaurant in which all receipts and payments are recorded. Each restaurant is invoiced weekly on the basis of their ledger balance. Being a recent start up, MPL is a bit understaffed as there are only two accountants who are responsible for managing, processing and recording all cash inflows, outflows and preparation of management reports.

Required:
Discuss the audit risks that exist in the above scenario and suggest the key audit procedures to be performed in respect of identified risks. **(23)**

Q.3 Tortoise Publishing (Pvt.) Limited (TPL) is a publisher of children books which is part of curriculum for major schools in Pakistan. TPL is planning to expand its business and diversify into Educational Technology Business. For this purpose, TPL is considering to acquire a business namely Swan Technology Enterprise (STE). TPL has requested your firm to carry out a due diligence for acquisition of STE.

After initial discussion for the due diligence exercise, your team has brought the following matters to your attention:

(i) In 2018, STE was formed as a partnership concern by two software graduates, Saleem and Sabir. Initially, they had designed and developed the application for schools which included Student Management System and Learning Management System. This application manages all the data related to curriculum learning material, billing to students, student educational records and tracking of assignments given to students. Due to shortage of funds, they were not able to market its application properly and were able to sell the application to few schools only.

In early 2019, Saleem and Sabir had secured significant funds from an investor to finance the growth and expansion. Thereafter, a marketing team was recruited at attractive packages to market the application and an administrative team was also set up to look after the accounts and other administrative tasks. However, the marketing team has not been able to penetrate into the market as expected.

(ii) TPL believes that since it has good connection with many schools due to its publishing business, they can not only market the application in a more aggressive way but can also exploit synergies by using TPL's marketing, finance and administrative teams. TPL also has a plan to market this application to schools situated in under developed countries.

Required:
Identify and explain any **six** matters which you may consider in your due diligence review. Also recommend any **three** additional information that you may need in respect of each matter identified by you. **(15)**

Q.4 Your firm is the external auditor of Antilope Limited (AL) for the year ended 30 September 2021. AL is in the fishing business and it operates various fishing trawlers.

On 1 November 2020, a new fishing license worth Rs. 10 million was given to AL by the government at a nominal amount of Rs. 100,000 for a period of four years in consideration of the following conditions:

(i) AL should help Fisheries Department in protecting the endangered marine species.
(ii) AL should not hunt and catch any of the endangered marine species.
(iii) AL should educate other fishermen in adopting the practices which would help in preservation of the endangered marine species.

On receipt of license, AL recorded it at its fair value of Rs. 10 million.

Your audit team has performed various audit procedures and obtained management representation to ascertain that the conditions for grant of the license have been met. After completing audit field work, you have provided an initialled draft audit report.

After issuance of initialled audit report, a media report has surfaced which indicates that some employees of AL are involved in selling the endangered marine species, caught by AL's trawlers, in the fish market.

Required:
Evaluate the above matters and discuss your firm's course of action. Also briefly mention the related reporting implications. **(17)**

Q.5 You are the quality assurance manager in Asghar & Company, Chartered Accountants. Following matter has been brought to your attention:

Your firm has deputed two staff members to perform the following tasks in Badger (Private) Limited (BPL):

- Raising purchase orders.
- Raising customer orders.
- Calculating depreciation on fixed assets.
- Posting transactions coded by the client to the general ledger.

On 15 November 2021, BPL has appointed your firm as external auditor for the year ending 30 June 2022. Your firm informed BPL that they will not be able to continue the above mentioned services from the date of appointment as it would affect firm's independence and objectivity. BPL accepted your firm's point of view. However, BPL's management has requested your firm to assist them in shortlisting the candidates for the roles which your firm's personnel were performing.

Required:
Discuss the categories of threats involved in the above situation and advise the possible course of action that may be followed. **(14)**

Q.6 You are planning the audit of Jackal Power Limited (JPL) for the year ending 31 December 2021. JPL owns and operates an electricity generation power plant of 1500 MW. JPL sells all the electricity produced to a government entity National Power Distribution Limited (NPDL). There have been continuous delays in clearing the invoices raised to NPDL. This has resulted in significant increase in trade receivables.

JPL's management has informed you that on 21 August 2021, all the electricity producers have signed a Memorandum of Understanding (MoU) with the Government of Pakistan (GoP) under which:

(i) the GoP has provided its guarantee for all invoices pertaining to year 2013 and onwards; and
(ii) a payment of 30% will be made on 31 December 2021 and the remaining 70% payment would be made over a period of 3 years;
(iii) late payment surcharge will be charged on KIBOR basis which was earlier charged at an annual rate of 15%.

Required:
Discuss the audit procedures which need to be performed by the audit firm in order to obtain sufficient and appropriate audit evidence for receivables from NPDL. **(07)**

(THE END)