The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

10 June 2024
4 hours and 15 minutes – 100 marks

Financial Reporting and Assurance Professional Competence

CRN:

Name: ______________________________

INSTRUCTIONS

Please carefully read the following instructions:

1. You are required to access your answer working area by using your Student ID and Password as mentioned on your Admit Card.
2. The overall duration of the exam is 4 hours and 15 minutes, which includes the reading time and an extra 30 minutes of time that has been allocated due to the introduction of computer-based examinations.
3. All questions are compulsory.
4. Questions can be attempted in any sequence.
5. There is no specific time allocated for individual questions.
6. An auto-save function runs every minute. Further, your answers are saved automatically when you navigate between questions or click on the > **(NEXT)** or < **(BACK)** symbols.
7. Each question provides an answer area with a Rich Text Format (RTF) editor for writing your answers. Additionally, below the RTF editor, a spreadsheet is provided to facilitate examinees in doing rough calculations or other workings. **However, please note that any work performed in the spreadsheet will not be considered for marking. To ensure your work is considered, you must copy and paste it from the spreadsheet to the RTF editor.**
8. Work done in the spreadsheet of one question can also be copied into the RTF editor of the same or another question.
9. You may use Microsoft Office applications such as MS Word or MS Excel for rough working. However, please remember that any work performed in these applications cannot be copied into the examination software, and vice versa. Furthermore, any such work will not be uploaded with your exam for marking.
10. You may use pen and paper for rough work, but please note that pen and paper work should only be done on the last two pages of the question paper that are specifically allocated for this purpose. Remember that any rough work done on these pages will not be uploaded with your exam for marking.
11. In accordance with the open book policy of this paper, you are allowed to have a maximum of **FIVE** original books duly bound. Please ensure that the books or notes you bring are permissible under the open book policy. Keeping a book or notes that are not permissible will be considered a violation under the policy on the use of unfair means.
12. An external calculator can be used, provided it is included in the list of permissible calculators issued by ICAP.
13. During the exam, access to any website other than Assessment Master is strictly prohibited. Engaging in such activities will be considered a violation under the policy on the use of unfair means, leading to disciplinary action.

QUESTION 1

You are Bahisa Dutt, an audit senior at Elahi and Co (EC) and are involved in planning the year-end audit of Health Kick Limited (HKL). HKL operates fitness clubs, sports facilities, health juice bars and other recreational facilities throughout Pakistan. HKL intends to list on the Pakistan Stock Exchange within two years. Management has ambitious plans to expand the business following the listing.

Your audit manager is Arham Mahmood and the audit partner is Zewad Ismail. Ahead of the audit of HKL for the year ended 31 March 2024, you have been presented with the following information:

Appendix 1 provides background information on HKL.

Appendix 2 is an email from the audit partner requesting information related to materiality at HKL.

Appendix 3 includes extracts from the draft financial statements of HKL for the year ended 31 March 2024.

Appendix 4 is an email from Muzhir Razzaq, the finance manager at HKL, providing information on certain events and transactions in the year.

Appendix 5 is an email from Arham Mahmood, with notes from a meeting with Muzhir Razzaq attached.

Appendix 6 is an email from Gulnar Ameen, the finance director of HKL, detailing a fraud discovered in the year.

Appendix 7 provides background information detailing two professional and ethical matters.

Requirements

(a) Identify and explain the key audit risks arising from your review of the background information (**Appendix 1**), HKL's draft financial statements for the year ended 31 March 2024 (**Appendix 3**) and the financial reporting issues from the events and transactions outlined in the email (**Appendix 4**). **(14 marks)**

(b) Prepare a response to the request from the audit partner in **Appendix 2**. **(03 marks)**

(c) Explain the correct financial reporting treatment for the events and transactions identified in **Appendix 4** and prepare any journal entries required to make the necessary adjustments. **(18 marks)**

(d) Prepare notes to explain how IFRS 8 *Operating Segments* will be applied to HKL. You should refer to the identification of operating segments and address the specific concerns of Arham Mahmood highlighted in **Appendix 5**. **(07 marks)**

(e) Prepare an email which explains the responsibilities of HKL and auditors with regards to the fraud described in **Appendix 6**. **(03 marks)**

(f) Discuss the professional and ethical matters outlined in **Appendix 7** and recommend the appropriate action EC should take. **(05 marks)**

Total: 50 marks

APPENDIX 1 – BACKGROUND INFORMATION

HKL operates gym and fitness clubs and sports facilities aimed at both adult and junior markets throughout Pakistan. It also operates health juice bars and other retail outlets on its sites.

Membership fees
Customers are required to become members prior to the use of HKL's facilities and can choose one of the following annual membership payment options:

- A one-off upfront joining fee followed by twelve monthly membership payments; or
- One annual membership fee paid at the start of the membership period.

The annual membership payment option was introduced on 1 April 2023 and is the cheaper of the two membership options overall. Approximately 50% of HKL customers choose the annual membership payment option.

Staffing
HKL facilities offer a range of fitness classes and personal trainer sessions which can be booked by members for an extra charge. The cost of each class or fitness session is set by HKL and paid on booking by the customer. HKL sets the timing of fitness classes and is responsible for making sure instructors are booked for all class times advertised to its members.

All fitness instructors and personal trainers are freelancers and invoice HKL in arrears for hours worked.

Customer app
During 2023-24, HKL recognised an intangible asset of Rs. 1,700 million relating to the development and launch of the HKL App. The HKL App is a new application which allows customers to scan a QR code for contactless facility access, book classes and track their progress against their own personalised fitness plans. HKL has produced the following breakdown of the costs recognised relating to the HKL App.

	Rs. in million
Development costs	1,000
Costs relating to testing the HKL App	200
Costs relating to advertising the HKL App to customers	200
Share of administrative costs for the HKL App	300
Total	**1,700**

Gym equipment
HKL needs to keep the gym and sports equipment on offer up to date and in a good state in order to attract and retain customers. On 1 April 2024, management identified gym equipment with a carrying amount of Rs. 950 million which did not meet HKL's strict requirements. Replacement equipment was ordered and will be delivered in July 2024. It is estimated that the old gym equipment can be sold for Rs. 500 million.

Internal audit
Work performed by HKL's internal audit department identified an issue with the segregation of duties over cash sales at HKL's juice bars. HKL's juice bars tend to be small stalls each run by one individual who is responsible for taking orders, receiving payments, closing the till and depositing any cash at the bank at the end of the day. Management estimate that approximately 75% of all takings at HKL's juice bars in 2023-24 were cash payments.

APPENDIX 2 – EMAIL FROM AUDIT PARTNER

To: bahisa.dutt@ec.com
From: zewad.ismail@ec.com
Date: 5 April 2024
Subject: HKL Materiality

Dear Bahisa,

I have reviewed the planning documentation for HKL and we are missing some information relating to materiality. Please can you produce the following for inclusion in the HKL file:

(i) A calculation of materiality for HKL's financial statements for the year ended 31 March 2024 as a whole, using a suitable benchmark
(ii) An explanation as to why the benchmark you have chosen is the most appropriate

Kind regards,

Zewad
Zewad Ismail
Audit Partner
Elahi and Co

APPENDIX 3 – DRAFT FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2024

Draft statements of profit or loss of Health Kick Limited for the years ended 31 March:

	2024	2023
	----- Rs. in million -----	
Revenue	11,789	10,112
Cost of goods and services	(6,729)	(6,468)
Gross profit	**5,060**	**3,644**
Administrative and support costs	(3,468)	(1,863)
Operating profit	**1,592**	**1,781**
Net finance costs	(415)	(463)
Profit before tax	**1,177**	**1,318**
Taxation	(145)	(156)
Profit for the year	**1,032**	**1,162**

There was no other comprehensive income in the years ended 31 March 2023 and 2024.

Draft statements of financial position of Health Kick Limited as at 31 March:

	2024	2023
	----- Rs. in million -----	
Non-current assets		
Property, plant and equipment	16,260	18,028
Right-of-use assets	15,276	16,080
Intangible assets	2,054	314
Financial asset	1,200	-
	34,790	**34,422**
Current assets		
Inventories	713	888
Trade receivables	1,252	924
Cash	2,983	4,822
	4,948	**6,634**
Total assets	**39,738**	**41,056**
Equity		
Ordinary share capital	2,000	2,000
Retained earnings	12,151	12,008
	14,151	**14,008**
Non-current liabilities		
Lease liabilities	17,550	18,620
Provisions	654	425
Deferred tax	417	498
	18,621	**19,543**
Current liabilities		
Trade payables	5,622	6,245
Other payables	1,212	1,164
Current taxes	132	96
	6,966	**7,505**
Total equity and liabilities	**39,738**	**41,056**

Draft statement of changes in equity of Health Kick Limited for the year ended 31 March 2024

	Ordinary share capital	Retained earnings	Total
	Rs. in million		
At 1 April 2023	2,000	12,008	14,008
Profit for the year		1,032	1,032
Dividends paid		(889)	(889)
At 31 March 2024	**2,000**	**12,151**	**14,151**

APPENDIX 4 – EMAIL FROM FINANCE MANAGER AT HKL

To: bahisa.dutt@ec.com
From: muzhir.razzaq@hkl.com
Date: 14 April 2024
Subject: Information on events and transactions in the year

Hi Bahisa,

I hope that you are well.

I spoke to Arham yesterday and he asked me to send you the details of certain events and transactions that have not yet been correctly reflected in the draft financial statements. My team is currently working on updating the draft financial statements for these.

Purchase of bond

On 1 October 2023, HKL acquired Rs. 1,200 million bond in one of the companies that supplies our gym equipment. The bond has been recognised in the draft statement of financial position at cost. We also paid Rs. 5 million in legal and other professional costs when we acquired the bond, and this amount has been recognised within administrative and support costs. The bond matures on 30 September 2029 and, at that date, it is redeemable at a premium. Until that date, it pays interest six-monthly in arrears at a six-month rate of 3%. The six-month effective interest rate has been calculated at 5%. Interest received in the year has been recorded in the draft financial statements. HKL intends to hold the bond to collect cash flows but may sell it before maturity, and we have determined the fair value of the bond at 31 March 2024 to be Rs. 1,245 million. At that date, we also identified that there is no significant increase in credit risk in relation to the bond, however if the issuer were to default on the loan before 31 March 2025, we would expect to receive cash flows with a present value of Rs. 1,205 million. If the issuer were to default between 1 April 2024 and 30 September 2029, we would expect to receive cash flows with a present value of Rs. 850 million.

Customer claim

In the first week of April 2024, we received a legal claim for damages of Rs. 75 million from one of our gym customers. The customer alleges that she was injured in February 2024 as a direct result of being given incorrect instructions by an HKL staff member on how to use a weight machine. I have spoken to our in-house legal team and external legal counsel and they have advised that, on the basis of the information presented, they expect that courts will decide in favour of the customer. They estimate that there is a 60% probability that HKL will have to pay the full amount of damages claimed, a 30% probability that we will have to pay Rs. 60 million and a 10% probability that we will have to pay Rs. 40 million. The cost of employing an external legal defence team is expected to be Rs. 3 million. HKL has full and comprehensive liability insurance; our insurers have informed me that in the event of damages becoming payable, we are liable for the first 10% and any additional amounts will be reimbursed to us.

Juice bar gift cards

During November 2023, as part of a drive to expand our customer base, HKL started selling Rs. 5,000 gift cards that can be redeemed in our health juice bars. These are valid for one year from the date of purchase and any unused amount cannot be exchanged for a cash reimbursement. Between their launch and the reporting date, we sold 50,000 gift cards for their face value and have recognised Rs. 250 million as revenue in the draft statement of profit or loss. The internal team that was involved in launching the gift cards continues to monitor them and has advised that sales worth Rs. 105 million were paid for using gift cards between November 2023 and the end of March 2024. The team has also said that, based on research of similar gift card schemes, and past experience of a gift card scheme at HKL café outlets, it confidently expects that on average 12% of each gift card's value will expire unused.

As soon as we have updated the draft financial statements for these issues, I shall forward them to you.

I look forward to seeing you during the audit,

Kind regards

Muzhir

APPENDIX 5 – EMAIL FROM AUDIT MANAGER

To: bahisa.dutt@ec.com
From: arham.mahmood@ec.com
Date: 15 April 2024
Subject: Meeting notes

Hi Bahisa,

As you know, HKL intends to list on the Pakistan Stock Exchange within the next two years, with the overall strategic aim of developing its service lines whilst maintaining its current geographical spread. As a result of the upcoming listing, the company will be required to prepare operating segment disclosures in line with IFRS 8.

Muzhir Razzaq has asked me to meet with him to explain what will be required so that he can start putting in place the necessary internal reporting framework. He has sent me the attached information and has asked me to be specific about HKL's position in my explanation.

I am on annual leave next week and it's been a long time since I was involved in segment reporting, so I'd like you to make notes that I can use in my meeting. At this stage, I'd like you to focus on how to identify reportable segments. As well as that, please can you address the following?

- Can the HKL's head office be classified as an operating segment?
- Should operating segments be determined by geographical area or business line?
- Can operating segments be aggregated so that HKL can reduce the amount of information disclosed to competitors?

Many thanks – please email the notes to me so that they are ready on my return.

Arham

ATTACHMENT

HKL operates a matrix structure whereby a director is appointed to oversee operations in each of Pakistan's geographical regions, and separate directors are appointed to oversee different business lines.

Financial information relating to regions and business lines is prepared regularly and used by the senior management team as the basis for decision making, resource allocation and performance evaluation. The senior management team includes both geographical and business line directors, as well as board directors.

In addition to five business lines, the company operates a head office function. This is effectively a cost centre that provides centralised accounting, IT, HR and marketing functions. However, it also generates income in the form of interest income and occasional foreign exchange gains.

An example of the type of financial information provided to the senior management team is the following analysis of total (external) revenue:

	Business lines					
	Gym & fitness	**Sports**	**Junior sports and fitness**	**Food & beverage**	**Non-food retail**	**Total**
Region	**---------------------------- Rs. in million ----------------------------**					
Balochistan	1,545	888	475	107	75	3,090
Sindh	1,005	840	376	172	107	2,500
Punjab	2,360	1,369	748	386	39	4,902
Khyber Pakhtunkhwa	652	271	170	193	11	1,297
Total	**5,562**	**3,368**	**1,769**	**858**	**232**	**11,789**

Other segment financial information provided to the senior management team includes operating profits, total assets and total liabilities. Internal sales and purchases are negligible.

APPENDIX 6 – EMAIL FROM FINANCE DIRECTOR OF HKL

To: zewad.ismail@ec.com
From: gulnar.ameen@hkl.com
Date: 18 April 2024
Subject: Misappropriation of cash

Dear Zewad,

HKL recently discovered that a member of staff in our juice bar in Karachi has been stealing cash from the business. When questioned, the staff member admitted that he had been misappropriating cash for the entire three years he had been employed by HKL. We estimate the total amount stolen over this time to be Rs. 500,000.

Your firm has been our auditor for the past three years but has never identified that this cash was missing from our accounts. We are extremely concerned that past audits have not discovered this fraud. Please can you explain why EC did not find and report this fraud to us in any of its previous audits?

Kind regards,

Gulnar
Gulnar Ameen
Finance Director
Health Kick Limited

APPENDIX 7 – BACKGROUND INFORMATION DETAILING TWO PROFESSIONAL AND ETHICAL MATTERS

Zewad Ismail receives a phone call from Gulnar Ameen, finance director at HKL. Gulnar explains that HKL's financial controller resigned several months ago and the company has struggled to find a suitable replacement. She would like EC to assist with recruitment and would particularly appreciate assistance with searching for the best candidate.

Gulnar also explains that the members of the finance team have been working long hours on account of the financial controller position being unfilled. In order to reduce the pressure on the finance team, Gulnar would like EC to perform a compilation engagement, preparing information required for the upcoming listing. Gulnar explains that it is important that the practitioner performing the compilation engagement is supportive of HKL's business aspirations. Therefore, EC will only be offered this engagement if a clean auditor's report is issued on HKL's 2023-24 financial statements.

QUESTION 2

You are Rashid Sultan, an accountant working in the finance team of Aziz Garment Manufacturing (AGM), a company that manufactures and sells clothing. The company has the following interests in other companies:

- 75% interest in another company in the same industry, CC Garments (CCG)
- 80% interest in a company that manufactures outerwear, Raincloud Clothing (RC). AGM had held a 30% interest previously and acquired an additional 50% holding in the year ended 31 March 2024.
- 25% interest in Sports Wear (SW)

You have been presented with the following information:

Appendix 1: Consolidated statement of profit or loss and other comprehensive income and consolidated statement of financial position

Appendix 2: Email from Namrah Sarwar, finance manager at AGM, providing details relating to the acquisition of RC

Appendix 3: Email from Namrah Sarwar providing additional information

Appendix 4: Email from Kamran Qasim, finance director at AGM, asking you to research a potential new auditor

Requirements

(a) Prepare notes for the trainee accountant which explain, with calculations, how the acquisition of the additional shares in RC (**Appendix 2**) has been accounted for in the consolidated financial statements for the year ended 31 March 2024. **(07 marks)**

(b) Correct the draft cash flows from operating activities calculation (**Appendix 3**) and complete the consolidated statement of cash flows for the AGM group for the year ended 31 March 2024. **(11 marks)**

(c) Explain deficiencies in the requirements of IAS 7 due to which the statement of cash flows prepared by different entities may not be consistent and are less understandable and comparable for users. **(03 marks)**

(d) Explain the guidance relating to advertisements provided in ICAP's *Code of Ethics for Chartered Accountants* and discuss whether the advertisements attached to the finance director's email (**Appendix 4**) are consistent with the guidance. **(04 marks)**

Total: 25 marks

APPENDIX 1 – DRAFT CONSOLIDATED FINANCIAL STATEMENTS

Draft consolidated statement of financial position as at 31 March

	2024	2023
	----- Rs. in million -----	
Non-current assets		
Property, plant and equipment	70,940	43,960
Investment in associates	5,340	12,795
Financial assets	7,120	4,620
Goodwill	3,650	2,750
Other intangible assets	7,535	4,100
	94,585	**68,225**
Current assets		
Inventories	7,520	4,560
Trade and other receivables	10,440	6,900
Cash and cash equivalents	4,200	13,125
	22,160	**24,585**
Total assets	**116,745**	**92,810**
Equity and liabilities		
Share capital	5,000	5,000
Retained earnings	60,930	56,360
Financial assets at FVTOCI reserve	1,460	1,250
	67,390	**62,610**
Non-controlling interest	11,295	4,650
	78,685	**67,260**
Non-current liabilities		
Loan notes	12,500	12,500
Deferred tax	3,910	2,100
	16,410	**14,600**
Current liabilities		
Trade and other payables	12,300	8,810
Current tax	2,780	2,140
Overdraft	6,570	-
	21,650	**10,950**
Total equity and liabilities	**116,745**	**92,810**

Draft consolidated statement of profit or loss and other comprehensive income for the year ended 31 March

	2024	2023
	----- Rs. in million -----	
Revenue	35,890	33,120
Cost of sales	(18,570)	(17,330)
Gross profit	**17,320**	**15,790**
Operating expenses	(11,313)	(9,530)
Share of profit of associates	945	790
Other income	820	310
Operating profit	**7,772**	**7,360**
Finance costs	(1,160)	(1,530)
Profit before tax	**6,612**	**5,830**
Tax on profits	(2,250)	(1,640)
Profit for the year	**4,362**	**4,190**
Other comprehensive income		
Changes in fair value of financial assets	1,000	(290)
Reclassification adjustments	(680)	-
Related tax effect	(66)	40
Share of associate's change in fair value of financial assets (net of tax)	56	20
	310	**(230)**
Total comprehensive income	**4,672**	**3,960**
Profit attributable to:		
Owners of the parent	3,825	3,700
Non-controlling interest	537	490
	4,362	**4,190**
Total comprehensive income attributable to:		
Owners of the parent	4,035	3,540
Non-controlling interest	637	420
	4,672	**3,960**

APPENDIX 2 – EMAIL FROM FINANCE MANAGER

To: Rashid Sultan
From: Namrah Sarwar
Date: 22 April 2024
Subject: Acquisition of RC

Rashid,

As you know, AGM completed the acquisition of RC on 31 March 2024 and we have already incorporated the new subsidiary into the draft consolidated financial statements, as required by IFRS. Prior to this, we classified RC as an associate.

I think that this acquisition presents an excellent learning opportunity for Yousef, our new trainee accountant and, with that in mind, I would like you to explain to him how it has been accounted for in the consolidated financial statements.

I have provided additional notes on the acquisition below.

Many thanks

Namrah

Notes:

- The original 30% investment in RC was acquired five years ago at a cost of Rs. 4,820 million and, on that date, RC had net assets with a fair value equal to their carrying amount of Rs. 15,000 million. This amount was represented by share capital of Rs. 3,000 million, retained earnings of Rs. 10,200 million and financial assets at FVTOCI reserve of Rs. 1,800 million.
- The additional 50% investment was acquired at a cost of Rs. 14,100 million, which was paid in cash on 31 March 2024. On that date, the fair value of 30% shareholding in RC was Rs. 8,200 million and the fair value of 20% shareholding was Rs. 5,400 million. The non-controlling interest was measured at fair value.
- RC does not pay dividends.
- At 31 March 2024, the summarised statement of financial position of RC is given below. This does not include RC's brand 'Raindaze' which was determined to have a fair value of Rs. 2,200 million. RC holds only debt instruments as financial assets.

	Rs. in million
Property, plant and equipment	18,560
Financial assets	2,800
Inventory	1,900
Trade and other receivables	4,300
Cash and cash equivalents	3,200
Total assets	**30,760**
Share capital	3,000
Retained earnings	18,100
Financial assets at FVTOCI reserve	2,900
Deferred tax	1,950
Trade and other payables	3,910
Current tax payable	900
Total equity and liabilities	**30,760**

APPENDIX 3 – EMAIL FROM FINANCE MANAGER

To: Rashid Sultan
From: Namrah Sarwar
Date: 25 April 2024
Subject: AGM statement of cash flows

Rashid,

As you know, I have had to take a few days of sick leave and I am worried that we will fall behind with the finalisation of the draft AGM consolidated financial statements. To help us stay on track, please could you finish preparing the consolidated statement of cash flows for the group. I have made a start and my draft workings for cash generated from operations are attached. I have checked all the amounts in the working and am confident that they are correct, however I haven't had time to think about whether any other adjustments are required to the profit figure. I know that you already have a lot of the information to complete the statement, but I have listed below additional points that I think you will need.

Thank you.

Namrah

Additional information:

- ***CCG***
  CCG was acquired when its net assets had a carrying amount (equal to fair value) of Rs. 10,500 million. The NCI was measured at fair value and the acquisition gave rise to goodwill of Rs. 2,750 million. This goodwill was not impaired until August 2023, when it was written down by Rs. 600 million. Between acquisition and 31 March 2024, CCG made total comprehensive income of Rs. 8,100 million and paid dividends totalling Rs. 3,200 million, some of which were paid in the current financial year. On 31 March 2024, AGM sold 10% shareholding in CCG to an unrelated company for Rs. 2,500 million. This disposal has been accounted for correctly with the resulting adjustment calculated as a proportion of CCG's total carrying amount including goodwill.

- ***Non-current assets***
  The depreciation charge for the year ended 31 March 2024 amounted to Rs. 2,300 million and the amortisation charge was Rs. 375 million.

  Property, plant and equipment with a carrying amount of Rs. 5,920 million was disposed of, resulting in a loss on disposal of Rs. 1,250 million.

  No intangible assets were sold during the year.

  Debt instruments held as financial assets measured at FVTOCI were also sold in the year but, as required by IFRS 9, these were re-measured to fair value prior to de-recognition and no profit or loss arose. Between acquisition and sale, the fair value of these financial assets had increased by Rs. 350 million.

- ***Presentation***
  We present interest and dividends paid as cash flows from financing activities, and interest and dividends received as cash flows from investing activities.

- ***Dividends***
  AGM did not pay any dividends during the year.

Attachment: Draft consolidated statement of cash flows for the year ended 31 March 2024 - workings

Cash flows from operating activities	**Rs. in million**
Profit before tax	6,612
Finance costs	1,160
Depreciation and amortisation	2,675
Loss on disposal of PPE	1,250
Goodwill impairment	600
Share of profit of associates	(945)
Increase in inventories	(1,060)
Decrease in trade and other receivables	760
Decrease in trade and other payables	(420)
Cash generated from operations	**10,632**

APPENDIX 4 – EMAIL FROM FINANCE DIRECTOR

To: rashid.sultan@agm.com
From: kamran.qasim@agm.com
Date: 10 May 2024
Subject: Auditors

Dear Rashid,

It has become clear that AGM has outgrown its current small firm of auditors and will need a larger firm for next year's audit. I have attached a couple of advertisements for larger audit firms.

The board place importance on hiring auditors with high ethical standards so please review the advertisements with this in mind.

Let's arrange a meeting next week to discuss.

Kind regards,

Kamran

Iqbal and Co

- Audit, tax and accounts preparation
- We have over 30 years of experience
- Free quotations
- We can work faster than the Big Four with superior results
- Call us now for a second opinion

Javed and Co

- Audit, bookkeeping, tax and payroll services
- Limited companies, charities and partnerships
- We offer a friendly, quality and reliable service whether you are a small or large company.
- We guarantee to complete all audits within six weeks of year-end
- Guaranteed lowest fee

QUESTION 3

You are Sadaf Tariq, an audit senior at Ilyas and Co and are working on the year-end audit of Karakoram Property Limited (KPL) for the year ended 31 March 2024. As per draft financial statements, amounts of revenue and total assets are Rs. 9,028 million and Rs. 18,710 million respectively.

KPL is a listed company which constructs and sells, or holds and rents, properties through its different divisions. KPL measures owner-occupied properties using the cost model and investment properties using the fair value model.

You have been presented with the following information:

Appendix 1: Email from the audit manager, Zoya Nabi, with an attachment including information on two KPL's transactions in the year ended 31 March 2024

Appendix 2: Background information detailing the use of an auditor's expert

Appendix 3: Notes from an audit finalisation meeting

Requirements

(a) Explain the accounting treatment that should be applied to the two transactions in **Appendix 1** and calculate the amounts to be presented in the KPL's financial statements for the year ended 31 March 2024. **(14 marks)**

(b) Explain the matters to consider prior to engaging Murad Valuations and Co as detailed in **Appendix 2**. **(05 marks)**

(c) Explain the impact of the items detailed in **Appendix 3** on the auditor's report of KPL for the year ended 31 March 2024. **(06 marks)**

Total: 25 marks

APPENDIX 1 – EMAIL FROM AUDIT MANAGER

To: Sadaf Tariq
From: Zoya Nabi
Date: 30 April 2024
Subject: KPL's transactions

Hi Sadaf,

Ahead of the KPL's audit, the client's finance manager, Isha Zaman has forwarded details of two transactions that KPL has entered into during the year. Since these are new types of transactions for KPL, I consider them of higher risk, and it would be useful for the audit team to have an idea of what accounting treatment should be applied and what amounts they should expect to see in the financial statements.

Please could you use the information below to prepare briefing notes for the team.

Many thanks

Zoya

Construction contract
In October 2023, KPL tendered for a contract to construct a hotel property for a multinational leisure group on land owned by that group. KPL incurred various costs in relation to the tender, including Rs. 35 million for due diligence work, Rs. 20 million of external consulting costs to assist in the preparation of the tender and Rs. 12 million in internal administrative costs incurred in preparing the tender. KPL won the competitive tender and, as a result, paid Rs. 40 million as commission to its sales team. The contract price was set at Rs. 4,600 million and the construction project commenced on 1 November 2023, with an expected completion date of 31 August 2024. Stage payments of Rs. 1,800 million will be made on 31 March 2024 and 30 June 2024 and the balance is payable on completion. The contract is expected to be profitable.

On 18 February 2024, when the construction of the hotel was determined to be 40% complete based on work certified, KPL agreed to modify the contract at the client's request. The scope of the contract was extended and KPL agreed to build a standalone fitness centre in the hotel grounds, in addition to the hotel itself. The normal contract price for building the fitness centre would have been Rs. 1,200 million, however KPL agreed to a discounted price of Rs. 1,000 million. The original stage payment plan remained in place and the additional price for the fitness centre would be payable to KPL on completion. By 31 March 2024, construction of the hotel was 55% complete based on work certified, however construction of the fitness centre was yet to begin. KPL still expected the contract to be profitable.

Leased property
On 1 April 2023, KPL acquired a large office property by way of a ten-year lease, requiring it to pay Rs. 240 million per annum in arrears. KPL's incremental borrowing rate at 1 April 2023 was determined to be 6% per annum and the present value of future lease payments at that date was Rs. 1,766 million. KPL paid Rs. 20 million in legal fees to arrange the lease. The property is newly constructed and is estimated to have an economic life of 50 years. The property has two floors, which are of equal size. KPL immediately occupied the ground floor for its administrative functions and leased the first floor to an unrelated party under a four-year lease. After this time, KPL will reassess whether it requires use of the first floor for its own operations. The tenant is required to make payments of Rs. 144 million per annum in arrears. At 31 March 2024, the office property was determined to have a fair value of Rs. 11,400 million and the fair value of KPL's right to use the property was determined to be Rs. 2,100 million.

APPENDIX 2 – BACKGROUND INFORMATION

Ilyas and Co has identified that an auditor's expert is required so that sufficient appropriate evidence can be obtained with regards to the valuation of KPL's properties.

Zoya Nabi has contacted Murad Valuations and Co (MVC), a firm that has provided Ilyas and Co with expert valuation services for another audit client in the petrochemicals industry. MVC's most senior valuer is not available for four weeks, but it is able to send a trainee next week if required. MVC management has explained to Zoya Nabi that the trainee has a good understanding of KPL's business because he carried out an internship there recently and they believe this will help them in calculating an accurate valuation.

APPENDIX 3 – MEETING NOTES

Karakoram Property Limited
Minutes from audit team finalisation meeting
1 June 2024

(i) We identified valuation of property as the most significant risk of material misstatement as this was an area involving significant judgement and subjectivity.

(ii) The earthquake which struck in April 2024 destroyed several of KPL’s properties, including those still under construction. The carrying value of properties destroyed is estimated at Rs. 6,500 million. KPL has included relevant disclosures in the financial statements.

(iii) We have received the director's report and corporate governance statement which will be included in KPL's annual report. The team has reviewed these reports and there are no inconsistencies with the audited financial statements.

(THE END)