The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

9 September 2024
3 hours – 100 marks
Additional reading time – 15 minutes

Audit and Assurance

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

Q.1 (a) You are the audit manager responsible for overseeing the audit of Candy Crafts Limited (CCL), a listed company, for the year ending 30 September 2024. The audit team, assigned in August 2024, gathered the following financial data, with the 2024 figures estimated based on quarterly financial statements prepared by CCL:

	2024	**2023**	**2022**
	------------- Rs. in million -------------		
Revenue	10,000	9,500	8,700
Profit before tax	2,235	1,980	1,905
Net assets	9,900	8,800	8,400
Debt to equity ratio	9:91	11:89	10:90

Required:
Calculate the materiality at the financial statement level. Also, discuss the reasons for the selection of the appropriate benchmark. **(03)**

(b) On 25 September 2024, a fire incident occurred at CCL, resulting in damage to some of the plant, machinery and inventory. This led to the impairment of the damaged plant and machinery and the write-down of the damaged inventory to its net realizable value. At year-end after incorporating these adjustments, the estimated figures have actualized, and they now stand at: revenue of Rs. 9,000 million, profit before tax of Rs. 50 million, and net assets of Rs. 7,700 million.

Required:
Discuss the impact of the additional information on the materiality calculated in (a) above. **(06)**

Q.2 You are part of the audit team for Metal (Private) Limited (MPL), a rapidly growing, family-owned manufacturing company specializing in industrial machinery, for the year ended 30 June 2024. During the year, MPL expanded its operations by opening a production facility in a new region with low operational costs. It was expected that MPL would continue to demonstrate fast-paced growth at the new facility as well. However, this new facility has faced significant challenges, including delays in production, higher-than-expected costs, and quality control issues. These issues have led to an accumulation of inventory at the new facility.

In response, MPL has decided to establish a separate internal audit function for this new facility and is conducting interviews for a Chief Internal Auditor and two support positions. Management is under significant pressure to demonstrate the success of the new facility to directors and other stakeholders.

Required:
Discuss the inherent and control risks present in the scenario. **(06)**

Q.3 You are the auditor of Glory Cosmetics Limited (GCL), a leading cosmetic company, for the year ended 30 June 2024. GCL is known for its various high-quality cosmetic products.

During the year, GCL discovered that some of its products had traces of banned substance; however, GCL has not been able to quantify the actual presence of such substances. No complaints have yet been received by GCL in this respect.

In a bid to remove banned substances from its products, in January 2024, GCL signed a contract with Organic Materials Limited (OML), a company specializing in the production of organic raw materials for the cosmetic industry. GCL started procuring new organic raw materials for all of its products from OML. The contract specifies that OML will deliver the raw material continuously over the next two years. According to the terms, OML bills GCL on the 15th of each month for the raw materials delivered during the preceding month. GCL is given a credit period of 60 days to settle each invoice.

Required:

(a) Evaluate the impact of the presence of the banned substance and the payment terms with the new supplier on the audit of GCL. **(03)**

(b) Suggest relevant audit procedures for your evaluation. **(10)**

Q.4 Yameen is an audit junior in a firm of chartered accountants. He was recently assigned to an audit client, Tech Innovations Limited (TIL), a company specializing in software development and technology solutions. TIL has significant intangible assets, primarily consisting of internally developed software and acquired patents. Yameen performed the following audit procedures at the assertion level:

Assertion verified	**Audit procedures performed**
Completeness	▪ Traced the amounts specified in the list of intangible assets to the figures included in the trial balance. ▪ Inspected software licenses and patents held by TIL.
Accuracy and valuation	▪ Checked the calculations in the amortization schedule provided by TIL. ▪ Verified that the amortization rates applied to internally developed software and acquired patents are in line with TIL's accounting policy.
Rights and obligations	▪ Verified the recorded amounts in the ledgers by cross-referencing them with the intangible asset register. ▪ Reviewed contractual agreements related to TIL's intangible assets.
Existence	▪ Obtained the intangible asset register and traced the recorded amounts to acquisition documents. ▪ Obtained management representation that all intangible assets are disclosed to the auditor and that TIL holds valid licenses for them.
Presentation and disclosure	▪ Confirmed that any revaluations or impairment losses are adequately disclosed in accordance with IAS 38 and IFRS. ▪ Reviewed acquisition agreements to identify terms and conditions such as amortization periods, and legal rights.

Required:

Identify and explain the procedures that may lack relevance to the above-mentioned assertions. Also, recommend any **two** additional procedures to be performed for each assertion. **(13)**

Q.5 Titan Products Limited (TPL) operates in a highly decentralized manner, with each of its three plants having significant autonomy over procurement processes. TPL's procurement strategy emphasizes rapid sourcing to minimize production delays, especially for high-demand components critical to their manufacturing process. However, this autonomy has led to several challenges:

(i) Several plants have entered into binding purchase agreements with vendors without proper authorization or approval, often exceeding their delegated financial authority. In some cases, these unauthorized commitments were discovered only after the goods had been delivered and invoices received, leaving the company with significant unapproved financial obligations.

(ii) There have been increasing instances of collusion between plant procurement officers and certain vendors, leading to inflated prices and kickbacks. The decentralized nature of the procurement process has made it difficult to detect such fraudulent activities.

(iii) Due to the lack of standardized vendor evaluation criteria across plants, some vendors have been awarded contracts based on personal relationships rather than objective performance metrics. This has resulted in poor supplier performance, frequent delays, and inconsistent pricing, with some plants paying significantly more for the same goods and services than others.

Required:
Discuss **three** controls for each challenge faced by TPL. **(09)**

Q.6 Consider each of the following independent situations:

(a) You are a partner at a well-established audit firm. One of your audit clients, Grid Volt Limited (GVL), recently had its loan restructured by a bank. As part of the restructuring agreement, the bank waived a significant portion of the mark-up on the loan. Under the relevant tax laws, this waiver results in taxable income. GVL's CFO has approached your firm for advice on how to account for this mark-up waiver to avoid its taxability. **(07)**

(b) You are a partner at an audit firm, responsible for auditing the financial statements of Nova Mart Limited (NML), a well-known retail chain. NML has been with your firm for over a decade, and over time, you've developed a close working relationship with NML's senior management, particularly the CFO, who was once your colleague at another firm.

NML is currently under financial strain due to increased competition and changing market conditions. During the audit, your team discovered that NML has been aggressively recognizing revenue earlier than appropriate to boost its financial results. The CFO approaches you privately, acknowledging the issue but asks if you can overlook this in the audit report, citing NML's need to show strong financial health to secure additional financing. The CFO also hints that the board of directors have lately been contemplating a change of audit firm. **(08)**

Required:
In light of the Code of Ethics for Chartered Accountants, discuss the threats and the fundamental principles affected by these threats.

Q.7 You are the audit manager at a firm of Chartered Accountants. The following independent matters concerning the listed audit clients for the year ended 30 June 2024 are presently under your consideration:

(a) During the audit of Zero Synthetic Limited (ZSL), it was identified that ZSL has recognized revenue from a major contract before the delivery of the goods. The revenue recognized from this contract amounts to Rs. 175 million. Management justifies the early recognition by stating that it is a non-cancelable contract for which the customer has already made complete advance payment, as the goods were specifically manufactured for them. ZSL had incurred a cost of Rs. 150 million on these goods. The profit before tax of ZSL is Rs. 400 million. **(05)**

(b) Bio Health Limited (BHL) is engaged in extensive research and development activities. BHL has capitalized a large portion of its research costs, amounting to Rs. 300 million, arguing that initial surveys suggest that these projects will lead to significant future economic benefits. The profit before tax is Rs. 2,900 million. **(05)**

(c) Tech Geni Limited (TGL), a technology company, conducted an impairment exercise for its intangible assets and patents. TGL's management has estimated the impairment at Rs. 350 million, while your audit team determined it to be Rs. 375 million. The audit team engaged in extensive discussions with management and those charged with governance to understand why the impairment was not recognized at Rs. 375 million. However, management decided to record an impairment of Rs. 350 million in the financial statements, as they believe this to be their best estimate. The profit before tax is Rs. 1,500 million. **(05)**

Required:
Analyze each of the above independent situations and discuss the related audit reporting implications. ***(Audit procedures are not required)***

Q.8 (a) State any **five** problems that may arise when control systems rely excessively on the involvement of senior management. **(05)**

(b) The essential feature of analytical procedures in auditing is 'comparison'. Discuss any **four** types of comparisons, which could be made by the auditor. **(04)**

(c) State any **six** audit procedures for verifying work in progress in inventory. **(06)**

(d) Briefly describe any **five** inquiries that the auditor may make for identifying the risk of material misstatement due to fraud. **(05)**

(THE END)