

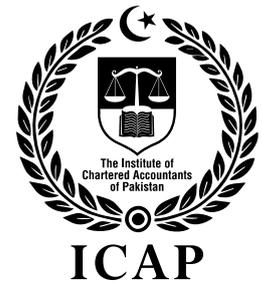
# Certificate in Accounting and Finance Stage Examination

## Audit and Assurance Essentials

3 March 2026

100 marks

3 hours and 15 minutes (including 15 minutes' reading time)



### **Instructions to examinees:**

- (i) Answer all **NINE** questions.
- (ii) Answer in **black** pen only.
- (iii) Use the first page of the answer script to answer the Multiple-Choice Questions.

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### SECTION A

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#### QUESTION 1

Select the most appropriate answer from the options provided for each of the following Multiple-Choice Questions.

- (i) According to International Standard on Sustainability Assurance (ISSA) 5000, when a practitioner evaluates the suitability of criteria for a sustainability assurance engagement, which of the following best describes the concept of “presumption of suitability”?
  - (a) Criteria are presumed suitable only if they are shown to possess all five qualitative characteristics: relevance, completeness, reliability, comparability, and understandability
  - (b) Criteria embodied in law or regulation, or issued by authorized or recognized bodies through a transparent due process, are presumed suitable in the absence of indications to the contrary
  - (c) Criteria commonly used by entities within the same industry or geographical region as the reporting entity are presumed suitable for the engagement
  - (d) Criteria developed for general-purpose financial reporting and accepted by the intended users are presumed suitable for sustainability assurance engagements **(01 mark)**
- (ii) Which of the following audit procedures is most relevant for obtaining sufficient appropriate audit evidence regarding the valuation assertion of capitalized development costs relating to a software project?
  - (a) Inspecting project development logs, technical documentation, and version control history
  - (b) Reviewing marketing plans and feasibility studies to assess whether a market exists and whether the entity has sufficient resources to complete the project
  - (c) Examining software licensing agreements and legal documentations
  - (d) Selecting a sample of research and development expense entries from the general ledger and tracing them to supporting documentation and the intangible asset register **(01 mark)**
- (iii) According to the IAASB pronouncements, which of the following engagements does **NOT** qualify as an assurance engagement?
  - (a) A practitioner evaluates enterprise risk management against a recognized framework and reports a conclusion to the Board of Directors
  - (b) A practitioner expresses a conclusion to a regulator on compliance with specified legal requirements
  - (c) A practitioner prepares financial statements in accordance with an applicable framework and issues a report describing in detail the procedures performed
  - (d) A practitioner evaluates non-financial performance information against established criteria and provides a written conclusion to external users **(01 mark)**

- (iv) According to ISA 210 Agreeing the Terms of Audit Engagements, which of the following is **NOT** a mandatory element that must be included in an audit engagement letter?
- (a) A clause stating the basis for determining the audit fees and the detailed billing arrangements for the engagement
  - (b) A clause identifying the applicable financial reporting framework used for the preparation of the financial statements
  - (c) An explicit acknowledgement of management's responsibility for internal control as they determine necessary for preparation of the financial statements that are free from material misstatement
  - (d) A reference to the expected form and content of any auditor's reports and a statement that the report may differ from its expected form and content **(01 mark)**

- (v) You are planning the audit of Zain Traders Limited (ZTL) for the year ended 31 December 2025. Overall materiality is Rs. 10 million. During planning, you note the following:
- ZTL is required to maintain a net profit margin of at least 5% under a bank covenant. Draft financial statements show a margin of 5.5%.
  - During the year, ZTL migrated to a new cloud-based ERP system.
  - Revenue is generated through 60 branches with frequent small posting errors.
  - In the prior year, management refused to adjust Rs. 4 million of judgmental misstatements.

What is the most appropriate conclusion regarding materiality at the planning stage?

- (a) Set performance materiality that is close to the overall materiality
  - (b) Revise overall materiality upward by selecting a more stable benchmark
  - (c) Set performance materiality significantly lower than the overall materiality
  - (d) Apply a separate lower materiality to branch transactions **(02 marks)**
- (vi) During the finalisation of the audit of Okra Limited, the auditor requests a written representation confirming that all related party transactions have been disclosed. The CEO responded that he personally oversaw transactions with group entities to ensure they were conducted at arm's length. However, he refuses to sign the written representation regarding related party disclosures, stating that it is an unnecessary formality that questions his integrity. No contradictory evidence has been identified.

Which of the following is the most appropriate auditor response?

- (a) Accept the CEO's verbal confirmation as sufficient appropriate audit evidence
  - (b) Reassess management integrity and treat the refusal as a scope limitation that may require a modification of opinion
  - (c) Include a Key Audit Matter Paragraph referring to the related party disclosures
  - (d) Perform extensive alternative audit procedures, and if no undisclosed transactions are identified, issue an unmodified opinion **(02 marks)**
- (vii) Your external audit client has an in-house internal audit department that has completed a review of high value production machinery across several factories. In assessing whether to rely on their work, you gathered the following information:
- Only the Chief Internal Auditor is a chartered accountant; some of the other team members are recent business graduates without any relevant certification.
  - Although the internal audit team reports quarterly to an independent Audit Committee, their work assignments and annual bonuses are determined by the Finance Director.

Which of the following should the external auditor most critically evaluate before deciding whether to rely on the internal auditor work?

- (a) Does the internal audit team have sufficient staff and time to cover all factory locations?
- (b) Does the internal auditors possess adequate technical competence to audit complex assets?
- (c) Does the specific monthly salary brackets of the junior internal audit staff are consistent with the market rates?
- (d) Are the internal auditors truly free from the influence of the persons whose work they are auditing? **(02 marks)**

**QUESTION 2**

Your firm is the external auditor of Vertex Apparel Limited (VAL) for the year ended 31 December 2025. During the audit planning stage, the following matters were noted:

- (i) VAL's primary lender has imposed a financial covenant requiring VAL to maintain a minimum net profit margin of 8%. At the same time, VAL's top three international customers have entered into exclusive supply arrangements with a lower-cost manufacturer operating in a neighbouring jurisdiction.
- (ii) During discussion, the Chief Financial Officer (CFO) stated that he exclusively retains administrative access to the ERP's "Top-Level Adjustments" module. He explained that this arrangement is necessary because year-end accruals relating to potential contract incentives involve significant management judgment. Accordingly, such adjustments are processed personally by him on the final day of the reporting period to avoid unnecessary internal speculation.
- (iii) Despite the publication of a recent industry report indicating a 12% increase in defective fabric complaints across the apparel sector, VAL has continued to apply its historical sales return provision rates. Management has justified this approach by referring to the VAL's robust quality control procedures, asserting that no material sales return claims are expected.
- (iv) A review of the prior-year audit file revealed that three identified misstatements aggregating to Rs. 2 million (against overall materiality of Rs. 8 million), remained unadjusted. At that time, the CFO commented that "auditing is about the big picture, not clerical nuances", and that requesting adjustments for such differences would distract the finance team's focus from more strategic matters.

**Required:**

Identify and explain the fraud risk factors present in the above scenario.

**(09 marks)**

**QUESTION 3**

You are the engagement senior on the audit of Silver-Line Textiles Limited.

During the finalisation stage of the audit, management insists that certain key estimates relating to inventory obsolescence should remain unchanged from the prior year, on the basis that they were accepted by the auditors last year.

The engagement manager advises the audit team not to challenge the estimates aggressively, stating that revisiting this matter would imply that the firm's prior year judgement may have been incorrect.

**Required:**

In the light of ICAP's Code of Ethics, identify and discuss the fundamental principles affected and the threats arising from the above situation.

**(09 marks)**

**QUESTION 4**

- (a) Discuss how an audit engagement letter helps in managing the expectation gap between the auditor and users of the financial statements. **(04 marks)**
- (b) Explain the relationship between obtaining an understanding of the entity and identifying risk of material misstatement. Also, explain why risk identification is considered a dynamic and continuous process rather than a one-time exercise. **(05 marks)**

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**SECTION B**


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**QUESTION 5**

- (a) Your firm is the statutory auditor of North-Peak Manufacturing Limited (NPML) for the year ended 31 December 2025.

Inventory is material to the financial statements. During attendance at the physical inventory count, the following matters were noted:

**Central warehouse**

NPML conducted its physical inventory count on 31 December 2025 at its central warehouse. To facilitate the counting process, the Warehouse Manager printed pre-numbered inventory count sheets that included quantities as per the perpetual inventory records. He explained that this assists staff in identifying and correcting discrepancies more efficiently.

Each warehouse worker was assigned a separate storage area and was required to complete the count independently.

To ensure that final inventory figures were available by the end of the shift, warehouse clerks were granted access to the inventory system during the count. As differences were identified between physical quantities and system records, clerks updated the system quantities immediately.

**Regional warehouses**

NPML also holds inventory at several regional warehouses, which collectively represent approximately 10% of total inventory value. These locations conducted their own physical counts on the same date. Final count sheets were submitted through an online portal, based on which central inventory ledger was updated manually.

Due to staff constraints, the audit team did not attend the inventory counts at the regional warehouses.

**Required:**

- (i) Discuss the weaknesses in NPML's inventory count procedures and explain how these weaknesses could affect the reliability of the inventory count results. **(06 marks)**
- (ii) State any **three** documentary audit evidences that the auditor should obtain in relation to inventory held at regional warehouses. **(03 marks)**
- (b) NPML holds a small number of high-value robotic components and a large volume of low-value screws and bolts. The audit team tested all high-value items and selected a sample of low-value items.

The following quantity differences were identified during inventory count:

Item category	Quantity per records	Physical quantity
Robotic component A – units	120	114
Screws – units	48,000	50,500

During testing of the sampled low-value items, a pricing error was also identified. Management explained that this error arose due to a mistake made by a temporary clerk who has since left NPML and asserted that the error is isolated and does not affect the valuation of the remaining inventory.

**Required:**

- (i) Describe any **four** audit procedures that should be performed to investigate the differences identified during inventory count. **(04 marks)**
- (ii) Discuss whether the auditor should project the pricing error identified in the sample of low-value inventory items. **(04 marks)**

**QUESTION 6**

Your firm is the external auditor of Nova Manufacturing Limited (NML) for the year ended 31 December 2025. NML manufactures engineered plastic components through a continuous production process comprising multiple stages, including moulding, finishing, and final assembly.

During the final quarter of the year, NML experienced frequent machinery breakdowns and shortages of skilled technical staff. These operational disruptions resulted in reduced production volumes, increased reprocessing of work-in-process, and higher material wastage resulting in an increased production cost.

**Required:**

- (a) Identify the key audit issues relating to cost of goods sold arising from the above scenario. **(02 marks)**
- (b) Discuss the audit procedures that the auditor should perform to address the issues identified in part (a). **(08 marks)**

**QUESTION 7**

Your firm is the external auditor of Spectra Packaging Limited (SPL) for the year ended 31 December 2025. SPL is engaged in the manufacture and sale of industrial packaging materials and historically operates solely as a manufacturing entity. SPL routinely undertakes internal research and development (R&D) activities to support its manufacturing operations.

During the audit, management disclosed that one of SPL's directors holds a significant interest in Orion Trading (Pvt.) Ltd (OTL). Management further informed the audit team that, during the year, SPL transferred an ongoing R&D project relating to a new biodegradable packaging material to OTL as part of a strategic realignment of group activities.

The transfer was carried out at market value, based on an independent valuation. The consideration for the transfer was recorded as income during the year.

**Required:**

- (a) Evaluate the transaction with OTL and discuss the audit issues arising from it. **(02 marks)**
- (b) Discuss the substantive audit procedures that the auditor should perform to address the issues identified in part (a). **(08 marks)**

**QUESTION 8**

- (a) Your firm is the statutory auditor of Orax Limited (OL) for the year ended 31 December 2025. OL provides engineering and maintenance services for large infrastructure projects.

During the year, OL changed its measurement basis for a class of specialised equipment from the cost model to the revaluation model. The assets previously had a carrying value of Rs. 500 million and now reported at a revalued amount of Rs. 1,900 million, based on a valuation performed by an independent valuer. The profit before tax for the year amounts to Rs. 900 million.

Management has disclosed the reason for the change in measurement basis, the fact that the revaluation model will be applied consistently going forward, and the financial impact of the change on the current year's financial statements.

**Required:**

Evaluate the above situation and discuss the implications for the auditor's report.

*Audit procedures are not required.*

**(05 marks)**

- (b) Your firm is the external auditor of Vertex Technologies Limited (VTL) for the year ended 31 December 2025. VTL develops and licenses specialised enterprise software solutions to corporate clients.

During the audit, the audit team identified that a cyber-attack at one of VTL's overseas data centres resulted in the loss of records relating to internally generated software development costs incurred during the first half of the year. These records supported capitalisation of development expenditure amounting to Rs. 420 million. The profit before tax and the non-current assets are Rs. 1,500 million and Rs. 5,250 million respectively.

Management has confirmed that due to the confidentiality of the documents no backup documentation existed. Management has refused to adjust the financial statements, stating that the cyber-attack was beyond its control and that the development costs are commercially justified.

**Required:**

Evaluate the above situation and discuss the implications for the auditor's report.

*Audit procedures are not required.*

**(05 marks)**

### QUESTION 9

Your firm is the external auditor of Rave Appliances Limited (RAL) for the year ended 31 December 2025. RAL manufactures small household electrical appliances. The industry remains highly competitive and has recently experienced significant pricing pressure.

Extracts from RAL's draft financial statements are as follows:

	2025	2024
	----- Rs. in million -----	
Cash and bank	90	130
Trade receivables	360	240
Inventory	450	325
Current assets	900	695
Trade payables	520	350
Short-term borrowings	360	180
Current liabilities	880	530
Long-term borrowings	620	420
Equity	520	560
Profit before tax	100	210

**Additional information:**

- During the year, RAL renegotiated payment terms with its major suppliers, extending credit periods from 90 days to 240 days. These suppliers account for approximately 75% of total purchases. There are no legally binding agreements supporting these extended terms.
- Customer credit terms remain unchanged at 30–45 days. The increase in trade receivables and inventory is primarily attributable to slower customer collections and inventory accumulation.

**Required:**

- (a) Perform a going concern analysis of RAL, with reference to profitability, liquidity and gearing indicators. **(08 marks)**
- (b) Discuss at least **eight** key audit procedures that the auditor should perform for evaluating RAL's ability to continue as a going concern. **(08 marks)**

**(THE END)**