Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

5 June 2024
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 You are the audit manager for Petro Synth Refinery Limited (PSRL) for the year ended 31 March 2024. PSRL, a key player in the petroleum refining industry, specializes in producing synthetic fuels and lubricants. PSRL has traditionally managed price risks by using crude oil futures contracts to hedge the cost of its main raw material, crude oil.

In the current fiscal year, PSRL has encountered a new financial challenge stemming from the devaluation of the local currency. This devaluation has compounded the cost pressures on oil imports, which are crucial for the company's operations. To mitigate the risk of rising costs due to unfavourable currency fluctuations, PSRL financial management team has decided to employ forward exchange contracts for its import bill payments.

PSRL engages in numerous hedging transactions throughout the year to manage its exposure to both volatile oil prices and the fluctuating exchange rate. The treasury department strategically uses a blend of oil futures and foreign exchange forward contracts to stabilize cost forecast and financial planning.

PSRL has recognized futures contracts at Rs. 297 million and forward contracts at Rs. 320 million on the statement of financial position as at 31 March 2024. For all of the hedging transactions entered during the year, PSRL has recognized a net profit of Rs. 93 million in the statement of profit or loss for the year ended 31 March 2024.

Required:
(a) Discuss the key matters regarding the hedging transactions that you would want the audit team to focus on. **(07)**
(b) State the audit procedures that should be performed for the above mentioned hedging transactions. **(10)**

Q.2 You have been appointed as the audit manager to lead the audit of Zenith Telecommunications Limited (ZTL), a leading telecommunication company with a large clientele. ZTL offers a wide selection of services, including, high-speed data plans, voice communication plans, and hybrid plans designed to address the unique requirements of its customer base.

During the initial risk assessment, revenue has been identified as an important and high-risk audit area. The following information has been gathered regarding ZTL's revenue:

(i) To deliver its services effectively, ZTL employs a state-of-the-art infrastructure that seamlessly manages customer subscriptions. This system automates the processes of customer sign-ups, subscription modifications, existing subscriptions, and plan migrations for those switching between various service options.

(ii) ZTL's revenue is mainly derived from monthly subscriptions, different packages, pay-as-you-go options, over usage data fees, special promotions, and additional services such as international calling and roaming. Revenue for these services is automatically recognized by the system at the point of sale, during usage, or upon change in service plan, depending on the terms and conditions.

Required:
In light of the above scenario:

(a) Suggest the strategy that you would recommend to the audit team for revenue. ***(Audit procedure are not required)*** **(05)**

(b) Describe any **seven** controls that should be in place at ZTL. **(07)**

Q.3 Your firm is the auditor for Horizon Construction Limited (HCL), a company listed on the Pakistan Stock Exchange, for the year ended 31 March 2024. HCL specializes in property development, construction, and the sale of residential and commercial units. During the planning meeting with management, you have been provided with the following financial information:

	Notes	2024	2023
		--- Rs in millions ---	
Project-wise revenue			
▪ Sea Breeze Towers – Karachi	1	30,708	-
▪ Smart Living – Multan	2	23,032	-
▪ Oasis Plaza – Lahore	3	12,045	-
▪ Other projects	4	43,914	50,772
Total revenue		109,699	50,722
Financial charges		350	200
Profit before tax		3,500	2,400
Property plant and equipment		17,261	16,908
Investments – Gold	5	620	-
Inventory		20,304	19,802

Notes to the financial information:

Note 1: Sea Breeze Towers (SBT) - Karachi
This project involves the construction of a high-rise residential building adjacent to the coastline in Karachi. Launched in April 2023, it initially attracted a strong market response. SBT offers both residential and commercial units on an instalment basis, committing to a five-year possession timeline. Under the payment plan, buyers must pay a 20% upfront deposit, with the remaining 80% spread across quarterly instalments.

Concrete filling work has been subcontracted to a renowned firm, which submits regular interim invoices based on progress milestones. Due to rising material costs, the subcontractor has submitted price escalation claims amounting to Rs. 300 million, which HCL is yet to accept. The finance department proposes passing these additional costs onto customers, but this suggestion is opposed by the marketing and legal departments.

Note 2: Smart Living (SL) - Multan
HCL launched this project in Multan earlier this year, offering residential and commercial plots on instalments with a three-year possession timeline. Customers who paid in full received a 10% cash discount for early payment.

While HCL has acquired most of the land necessary for the project, some land portions are yet to be acquired. Token payments have been made to landowners under Agreements to Sell; however, HCL is encountering issues with some landowners who are hesitant to complete their transactions due to a recent hike in property prices in the area.

Note 3: Oasis Plaza (OP) - Lahore
In 2022, HCL ventured into the shopping mall sector, diverging from its usual focus on selling land or constructed units. This new initiative involves the construction of a shopping mall in Lahore's Gulberg district. The construction of OP was completed in October 2023, and it opened for business in the same month. Due to HCL's inexperience in mall management, HCL formed a partnership with Canopy Limited (CL), a well-known mall management company. Both HCL and CL share the management responsibilities, along with the rental revenues and expenses of the project.

Note 4: Other projects
In addition to above three projects, HCL has two more projects under construction. One is scheduled for completion next year, while the other has been currently halted. The current finances, totaling Rs. 3,000 million obtained at an average rate of 15%, have been fully utilized. HCL is seeking additional financing for the halted project, but efforts to secure funds have not yet been successful. Additionally, HCL maintains a separate running finance facility to support HCL's working capital requirements.

Note 5: Investments – Gold
Given the cash intensive nature of the construction industry, HCL receives a significant portion of its payments in cash. To protect against the depreciation of value, HCL has started converting a significant portion of its cash receipts into gold bars, which are securely stored in bank lockers.

Required:
Discuss the audit risks that exist in the above scenario. **(20)**

Q.4 You are the Senior Manager in the Assurance Department at Nazir Ayub and Company, Chartered Accountants. Your firm has been appointed by Retz Hotel Limited (RHL), a leading hotel chain, to perform a due diligence review of a potential acquisition target, Island Hotel Limited (IHL), a seafront hotel.

As part of the due diligence review and to determine an appropriate offer price, RHL has requested you to identify the value of the assets and liabilities of IHL that may not currently be reported in the statement of financial position. During the preliminary engagement procedures, your team evaluated the situation and performed certain inquiries and provided you the following information:

Engagement Team's Observations
To assess the customer perception of IHL, we investigated feedback on platforms such as TripAdvisor and Google. The reviews were mixed. While some guests praised the hotel's location and restaurant, recent negative reviews highlighted significant issues. These included problems with the room reservation system, which was purchased a few years ago. This system has caused booking errors, leading to lost reservations and disputes with arriving guests. Additionally, there were complaints about the hotel's waste disposal practices, specifically discharging waste into the sea.

IHL Management's Comments:
- The hotel's accommodation facilities are somewhat outdated and in need of renovation. However, they emphasized their focus on large corporate events, maintaining long-term contracts with corporate clients for conferences and trainings.
- The hotel enjoys a high rate of repeat customers due to its excellent customer loyalty program and special incentives for returning guests. Additionally, the hotel's restaurant is highly regarded, as evidenced by numerous positive reviews highlighting the chef's unique recipes and the use of high-quality ingredients. To ensure this quality, IHL has established long-term agreements with suppliers that offer favourable credit terms.
- Management claimed that no alternatives are available for waste disposal due to the lack of a proper sewage system in the area, necessitating the current disposal method.

Required:
In light of the above discussion with management, identify and discuss the probable off-balance sheet assets and liabilities. Also, suggest key investigation procedures that need to be performed for each of these assets and liabilities. **(16)**

Q.5 (a) Your firm is the auditor of Pharma Glycon Limited (PGL), a company listed on the Pakistan Stock Exchange, for the year ended 31 March 2024. PGL issued its financial statements on 1 June 2024, with a profit before tax of Rs. 1,500 million. Audit report was also signed on 1 June 2024. PGL's management has informed you that they intend to amend the financial statements after incorporating the effects of the following developments:

(i) On 31 May 2024, the court ruled in favour of PGL, upholding the validity of its patent and awarded the company Rs. 150 million in damages to cover legal costs and compensation for the harm caused by the litigation. However, the official signed judgement was received by management on 3 June 2024. This litigation was filed against PGL by one of its competitors in 2022. PGL had been disclosing the details of this litigation as a contingency in its financial statement since then. PGL's management is now considering recording this as other income in its financial statements.

(ii) In April 2023, the government gave an interest free loan of Rs. 600 million for drug development to various companies, repayable after four years. In addition to this, the government had set a two-year target for drug development, which, if met, would result in this loan being converted into a forgivable loan. As at 31 March 2024, PGL had assessed that they could only develop this drug in three years and therefore did not record grant income related to the forgivable loan. However, on 31 May 2024, the government notified about relaxing the condition to three and a half years. PGL came to know about this government notification on 3 June 2024. PGL is now confident that they will meet this timeline and therefore they intend to record the grant income in their financial statements.

PGL has informed your firm that they have taken the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation.

Required:
Evaluate the need for amendment in the financial statements and advise the course of action. Also, discuss the implications on the audit report. **(11)**
(Audit procedures are not required)

(b) Your firm is the auditor of E-Tech Solution Limited (ESL), a company listed on Pakistan Stock Exchange, for the year ended 31 March 2024.

While finalizing the audit, your team has presented the following matters to you:

(i) ESL has implemented an information system that has rendered its entire operation paperless. In January 2024, ESL suffered a cyber-attack, resulting in the data loss of revenue transactions for three weeks of December 2023. This missing data constitutes approximately 7% of the total annual revenue. Despite efforts to recover the data, ESL has been unable to do so.

(ii) ESL management has provided the audit team a draft annual report. In this report, the CEO presents an optimistic outlook for the company's future growth and anticipated market share gains. The CEO's statement includes a comparison of these projections with industry data, highlighting significant growth in the market. However, during the initial assessment of ESL and its environment, the audit team concluded that this market is currently experiencing a slowdown.

Required:
Evaluate the above matters and advise the course of action. Also, discuss the implications on the audit report. **(12)**
(Audit procedures are not required)

Q.6 Mikaeel Aleezay and Company, Chartered Accountants, a growing firm specializing in audits and assurance engagements, is in the process of updating its system of quality management. The firm has provided the following information:

(i) The firm's leadership structure consists of a CEO, a managing partner, and several departmental heads.
(ii) The CEO, Mikaeel Sabri, holds ultimate responsibility and accountability for the system of quality management.
(iii) The managing partner, Aleezay Khan, with extensive experience and authority within the firm, is assigned operational responsibility for the overall system of quality management.
(iv) Both Mikaeel and Aleezay, the founding members of the firm, have experience of managing nearly all functions of the firm.
(v) The firm has designated Laeeq Soomro, one of the audit partners, to oversee compliance with independence requirements.
(vi) To ensure effective monitoring and remediation, the firm has appointed Dawood Yousuf, a senior manager in the audit department, with operational responsibility for this process.
(vii) Both Dawood and Laeeq are known for their meticulous attention to audit details. Dawood has been reporting to Laeeq for the last two years, and they make up a competent team with extensive experience in auditing the manufacturing and service industries. Considering their current workload, the CEO has given Laeeq and Dawood this additional responsibility, believing they are capable of managing it due to the relatively fewer clients they have.
(viii) The firm has implemented a formal communication structure where Laeeq and Dawood report directly to Aleezay, who then reports to Mikaeel.
(ix) The firm encourages an open-door policy to facilitate communication at all levels and urges staff to follow the command line for any form of communication. All observations and decisions are centralized, with Mikaeel making the final decisions.

Required:
Critically analyze the above roles and responsibilities for the system of quality management. **(12)**

(THE END)