Certified Finance and Accounting Professional Stage Examination

The Institute of
Chartered Accountants
of Pakistan

3 December 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 at Khalid & Company, Chartered Accountants and have recently been assigned to the statutory audit of Beyond Packages Limited (BPL) for the year ended 30 September 2024. Based in Karachi, BPL specializes in customized industrial packaging solutions for a diverse range of industries. In recent years, BPL has focused on growth through international expansion and technological innovation, integrating data analysis, automation, and AI-driven solutions into its packaging machines, despite challenges from rising inflation and interest rates.

The following are the extracts from the financial statements of BPL:

Extracts from statement of financial position

	2024	2023
	----------- Rs. in '000 -----------	
Property, plant & equipment	5,900,000	4,800,000
Intangible asset – Rebranding	500,000	-
Intangible asset – Software	1,000,000	1,160,000
Intangible asset – Others	300,000	340,000
Inventory	3,400,000	2,500,000
Trade receivables	4,500,000	3,000,000
Cash and cash equivalents	600,000	1,000,000
Lease liabilities	(700,000)	(900,000)

Extracts from statement of profit or loss

	2024	2023
	----------- Rs. in '000 -----------	
Revenue	12,500,000	9,800,000
Cost of sales	(8,700,000)	(7,300,000)
Operating expenses	(2,675,000)	(1,716,000)

Additional information:

(i) In 2024, BPL made significant investments in rebranding and enhancing market perception to strengthen its position in international markets. These initiatives were intended to increase brand visibility and align the company's image with recent technological advancements. As a result, BPL has expanded its presence into Southeast Asia, the Middle East, and Europe, offering a platform that integrates data analysis, automation and AI-driven solutions within its packaging machines. This platform also collects and analyzes customer data directly from packaging machines, enabling BPL to customize solutions to each client's needs. Given the variations in contract terms due to these tailored solutions, BPL has developed a standardized revenue recognition model to streamline bookkeeping and ensure consistency in revenue reporting across contracts.

(ii) During the year, BPL extended credit terms to its export customers, leading to an increase in export revenue and, consequently, trade receivables. Further, BPL has adopted more flexible payment options, allowing customers to use usance letter of credit (which allows deferred payment terms) instead of requiring letter of credit at sight (which requires immediate payment upon presentation of documents).

(iii) In January 2023, BPL entered into new leasing agreements to expand production capacity, acquiring state-of-the-art equipment and facilities to meet rising international demand and support efficient production targets.

(iv) During the year, BPL undertook a comprehensive overhaul of its machinery, incorporating significant upgrades and enhanced maintenance practices to improve operational efficiency and minimize downtime, thereby ensuring optimal machinery conditions over the long term.

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

Q.2

To: Jameel Ansari, Audit Partner

From: Ali Kirmani, CFO, Electric (Private) Limited

Date: 19 November 2024

Subject: Engagement for Financial System Transformation Project

Dear Jameel,

As you know, Electric (Pvt) Limited is experiencing significant growth, and it has become evident that our current financial and operational processes require modernization. For this reason, we are planning to upgrade our financial systems, and I would like your firm to assist us with this transformation as follows:

(i) We need your expertise in shortlisting top-tier accounting software solutions and evaluating which option aligns best with our specific requirements. Your guidance will be instrumental in helping us select the most suitable software for our needs.

(ii) Once a software is selected, we would like you to document our existing financial practices. This “as-is” analysis will serve as the foundation for the transformation, documenting our current state of affairs in accounting and reporting. With this understanding, you will develop business process blueprints that meet our operational needs and streamline our workflows.

(iii) Additionally, as part of this project, we would like you to oversee the setup of training sessions for our staff. A third-party vendor will be configuring and implementing the software along with conducting the trainings, but your assistance in coordinating these trainings will ensure our team adapts to the new software smoothly.

(iv) Data migration is also a critical component of this transition. We will need your expertise to facilitate the accurate transfer of our financial data from the old system to the new one, ensuring that all records remain intact and reliable.

I understand that this engagement includes a diverse set of tasks, and some areas may extend beyond the traditional external auditing roles. As you review the scope of work, I would appreciate your feedback on any areas that may fall outside your capacity as an external auditor. Please also suggest how we can modify the scope of work to maintain the independence of your role.

I look forward to your insights and expertise to move forward with this project.

Best regards

Ali Kirmani

Required:
In light of ICAP Code of Ethics for Chartered Accountants, advise Jameel Ansari on how to respond to this offer. **(15)**

Q.3 You are the audit manager at an audit firm and have been assigned to the audit of the financial statements of Zava Technologies Limited (ZTL), a manufacturer of electronic and medical equipment, for the year ended 30 September 2024.

During the audit, it was observed that the warranty provision at ZTL has been substantially revised due to an increase in warranty claims related to its medical equipment. Upon enquiry, it was revealed that ZTL has experienced a significant increase in warranty claims in recent months due to product defects identified in a major line of its medical equipment. These defects were severe enough to necessitate a partial recall in certain cities. Consequently, management has doubled its estimated warranty provision from the initial estimate recorded earlier in the year. To ensure the accuracy of the revised warranty provision in light of these defects and recalls, ZTL engaged a renowned expert for assistance.

The audit team also plans to engage an expert, Kausar Naz, to verify the warranty provision estimate provided by management. Kausar is a highly regarded specialists in this field, where such expertise is exceptionally rare. With extensive experience in estimating warranty liabilities for electronic and medical equipment, her expertise is invaluable in assessing the accuracy of ZTL's warranty provision. Moreover, Kausar's firm possesses an in-depth knowledge of ZTL, having recently been engaged to consult on product quality improvements and to provide recommendations for addressing quality issues in ZTL's electronic and medical equipment.

Required:

(a) Discuss the suitability of appointing Kausar as an expert and the matters to consider when making her appointment. **(09)**

(b) Outline the audit procedures, other than engaging an expert, that should be performed for the verification of the warranty provision. **(07)**

Q.4 Your firm is the auditor of Helium Limited (HL), a company listed on Pakistan Stock Exchange, for its standalone and consolidated financial statements for the year ending 31 December 2024. The following information was provided to you in the audit kick-off meeting.

(i) **Acquisition of Copper (Private) Limited (CPL):** HL initially acquired a 25% stake in CPL for Rs. 840 million on 1 January 2022. During the year, HL increased its stake to 55% by paying an additional Rs. 1,680 million to gain control. The acquisition terms also included a contingent consideration of Rs. 280 million, payable if CPL meets specific earnings targets over the next three years.

(ii) **Financial difficulties in Aluminium Limited (AL):** HL also owns another subsidiary AL, which is audited by another firm of Chartered Accountants. Currently AL has been facing severe financial difficulties. AL's revenues have been declining over the past two years, and is unable to meet certain debt covenants. Furthermore, AL relies significantly on the renewal of short-term borrowings to maintain liquidity. These financial difficulties have raised concerns regarding AL's ability to continue as a going concern. As on 30 November 2024, AL's net assets amount to Rs. 260 million.

The group's consolidated net assets as on 30 November 2024 are Rs. 2,500 million (31 December 2023: Rs. 2,250 million) and consolidated net profits for the period ended 30 November 2024 amount to Rs. 995 million (31 December 2023: Rs. 900 million).

Required:

(a) Suggest the audit procedures that should be performed in relation to the goodwill arising from the acquisition of CPL for inclusion in the consolidated financial statements. **(07)**

(b) Devise an audit strategy for AL, considering its potential going concern issue. ***(Audit procedures are not required)*** **(05)**

(c) If AL's auditor expresses an unmodified opinion with a paragraph on material uncertainty related to going concern, discuss the implications for the audit report on consolidated financial statements. **(05)**

Q.5 You are the audit manager at Alia Riaz & Company, Chartered Accountants, responsible for the audit of Sky Steels Limited, a listed company, for the year ended 30 September 2024. You have been provided with the following extracts from the draft unqualified audit report prepared by a team member:

Extracts from Draft Audit Report

Material Uncertainty Related to Going Concern
We draw attention to Note [x] in the financial statements, which indicates that the Company incurred a net loss of Rs. 300 million during the year ended 30 September 2024, and as of that date, the Company's current liabilities exceeded its current assets by Rs. 200 million. The Company is highly reliant on securing additional financing to meet its liabilities and continue its operations for the next twelve months. These circumstances, coupled with the challenges of maintaining cash flow, indicate the existence of a material uncertainty. In addressing this matter, we performed various audit procedures. These events or conditions, along with other matters outlined in Note [x], indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern.

Our opinion is not modified in respect of this matter.

Key Audit Matters
Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming opinion thereon, and we do not provide a separate opinion on these matters. Following is the key audit matter:

Key audit matter	How the matter was addressed in our audit
Revenue from contracts with customers	Our audit procedures amongst others included the following:
(Refer Note [y] to the financial statements) The Company recognizes revenue from sales of cold rolled and color coated steel coils and sheets upon satisfying performance obligations by transferring control of goods to customers. Over the year, net sales to domestic customers decreased by 40%, while export sales increased significantly by 25%, largely driven by increased export volumes. Due to the materiality and significance of the above matter, we have considered revenue recognition as a key audit matter.	▪ Evaluated the design, implementation and effectiveness of key internal controls involved in revenue recognition; ▪ Assessed the appropriateness of the accounting policy for revenue recognition; ▪ Tested revenue transactions on a sample basis, reviewing supporting documents such as dispatch records and sales invoices; ▪ Performed cut-off procedures on a sample basis to verify that sales was recorded in the correct accounting period; ▪ Confirmed that sales prices are negotiated and authorized by relevant authority; ▪ Verified the commission calculations and associated distribution expenses as per company policy; and ▪ Verified the adequacy of revenue presentation and disclosures in the financial statements.

Other Information
Management is responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditor's report thereon, which we obtained prior to the date of this auditor's report, and some of the reports are expected to be made available to us after that date.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have not yet received the complete annual report and therefore are unable to conclude whether there is a material misstatement in the other information.

Required:
Critically analyze the sections of the audit report drafted by your team member. **(16)**

Q.6 Green Earth Organic Products Limited (GEOP) produces organic farming products, including organic fertilizers, seeds, and pesticides. These products are sold to distributors, farmers, and through an e-commerce platform.

GEOP has approached your firm to seek an independent assurance opinion on its cash flow forecast, prepared as part of a Rs. 2 billion loan application. The loan is intended to support GEOP's expansion into international markets with its existing product portfolio, as well as the launch of a new line of organic cosmetic products. This move aligns with the increasing global demand for sustainable products, with the international market for such items experiencing an annual growth rate of 6%. The loan is structured for repayment over a period of eight years and carries an interest rate of 10% per annum.

The cash flow forecast prepared by GEOP is as follows:

	Actual	Forecast			
	30-Sep-24	30-Sep-25	30-Sep-26	30-Sep-27	30-Sep-28
	Rs. in million				
Receipts					
Sales to distributors	1,850	1,943	2,040	2,142	2,249
Sales to farmers	500	525	551	579	608
Export sales	-	840	916	998	1,088
E-commerce sales	100	350	380	441	463
Loan proceeds	-	2,000	-	-	-
Payments					
Operational expenses	(2,175)	(2,284)	(2,398)	(2,518)	(2,644)
Fixed assets	-	(2,300)	(110)	(95)	(87)
R&D for new product line	(149)	(300)	(315)	(331)	(347)
Marketing expenses	(150)	(400)	(446)	(500)	(622)
Interest payments	-	(200)	(175)	(150)	(125)
Loan repayments	-	(250)	(250)	(250)	(250)
Taxation	(5)	(90)	(95)	(99)	(104)
Cash flow for the year	(29)	(166)	98	217	229
Opening cash	50	21	(145)	(47)	170
Closing cash	21	(145)	(47)	170	399

Required:
Suggest the key examination procedures that your firm would perform in respect of the above information. **(16)**

(THE END)