ICAP

Certified Finance and Accounting Professional Stage Examination

13 June 2025
3 hours and 30 minutes – 100 marks

Audit, Assurance and Related Services

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 3 hours and 30 minutes, which includes the 15-minute reading time and an extra 15 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, where necessary, 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 page of the question paper that is specifically allocated for this purpose. Remember that any rough work done on the last page will not be uploaded with your exam for marking.
11. In accordance with the open book policy of this paper, you are allowed to use only digital copies of the permissible books. Keeping a hard copy of any book or notes is not permissible and 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 exam software website and the digital copies of permissible books is strictly prohibited. Engaging in such activities will be considered a violation under the policy on the use of unfair means.

Q.1 Your firm is the auditor of Pulse Health Limited (PHL) for the year ended 31 March 2025. PHL is a rapidly growing provider of licensed and cloud-based healthcare software solutions. Its platform is used by hospitals and clinics to manage electronic health records, facilitate telehealth consultations, and perform data analytics on patient outcomes.

Below are the extracts from the financial statements of PHL:

	2025 (Draft)	2024 (Audited)
	----- Rs. in million -----	
Extracts from the income statement		
Revenue	18,200	14,000
Research expense	2,240	1,310
Profit/(loss) after tax	900	(840)
Extracts from the statement of financial position		
Intangible assets	16,800	5,600
Cash and cash equivalents	120	560
Borrowings	6,800	2,500
Deferred revenue	3,520	3,240
Total equity	3,000	2,100

Additional information:

(i) In August 2024, PHL acquired 100% shares in Medi Analytics (Pvt.) Limited (MAL) for Rs. 2.24 billion. The objective was to integrate MAL's advanced predictive health algorithms into PHL's AI-driven healthcare platform, which was launched in January 2025 (See point (ii)). However, the departure of key developers shortly after the acquisition has hindered the effective integration of MAL's technology with PHL's systems.

(ii) In January 2025, PHL launched its AI-powered diagnostic module following a two-year development period. PHL had a competitive advantage due to its access to a large volume of data from hospitals and clinics hosted on its platform. Development costs amounting to Rs. 8.36 billion were capitalized after technical feasibility and market potential were established. Although the module was successfully tested and completed by 31 December 2024, regulatory approval is still pending due to the product's innovative nature.

(iii) On 25 March 2025, PHL signed a contract with Lifecare Hospital and Dawood Hospital, each involving an upfront license fee of Rs. 1.2 billion for PHL's comprehensive hospital software solution. The full amount has been recognized as revenue. The contracts were offered at a 20% discount to help PHL improve liquidity. All future software updates will be sold separately. Smaller clinics that cannot afford the upfront cost are offered scalable cloud-based solutions with monthly or annual billing options.

(iv) During the year, PHL made substantial investments in research and development to strengthen its position in the healthcare technology industry. These investments align with a broader strategy to generate future revenue, particularly through AI-based solutions, which PHL believes have significant commercial potential.

(v) To support its expansion and improve liquidity, PHL issued Rs. 2.8 billion bonds, which include an option to convert into equity by July 2028. Furthermore, PHL plans to launch a rights issue next year. As the first company in Pakistan to offer AI-driven healthcare technology, PHL anticipates strong investor interest and expects to secure a favourable valuation by capitalizing on the current market enthusiasm for AI technology.

Required:
Identify and explain the audit risks arising from the above scenario that the engagement team should consider when auditing the unconsolidated financial statements. **(20)**

Q.2 Your firm is the auditor of Luxury Fashion Limited (LFL) for the year ended 31 March 2025. LFL operates its own brand, Bella-Wear, a high-end fashion label renowned for its luxury handbags and apparel. Until recently, Bella-Wear products were sold exclusively through company-owned retail stores located throughout Pakistan.

Due to persistently high operating costs and a strategic focus on rapid global expansion, LFL began transitioning from a wholly owned retail model to a franchise model starting in January 2025. Under the new franchise arrangement, the key terms are as follows:

(i) A 10-year franchise agreement will be entered into with individual franchisees;
(ii) Each franchisee will pay an upfront, non-refundable franchise fee for the right to operate Bella-Wear branded stores and transfer of ownership of the store;
(iii) Franchisees will operate under the Bella-Wear brand, and in return for ongoing operating support and brand rights, will make royalty payments equal to 5% of the franchisee's sales;
(iv) The transfer of existing stores to franchise ownership, including all equipment, fixtures, and staff, subject to a premises refurbishment or refresh.

Out of LFL's 50 owned retail stores, the following status applies as at 31 March 2025:

- 16 stores have already transitioned to the franchise model;
- LFL is actively seeking franchisees for a further 24 stores;
- The remaining 10 stores will continue to be owned and operated directly by LFL as flagship stores.

Required:
Identify and discuss the areas that would require the auditor's attention arising from LFL's transition to a franchise model, and outline the key audit procedures to be performed in response. **(20)**

Q.3 You are working as an audit manager at a firm of chartered accountants. Currently, you are finalizing the audit of the following two independent listed clients for the year ended 31 March 2025:

(i) **Inno Wave Limited (IWL)**
While reviewing the financial statements, you noted that IWL holds significant goodwill from prior acquisitions. During the current year, IWL performed its annual goodwill impairment assessment in accordance with IAS 36. Using a value-in-use model based on five-year cash flow projections and a discount rate of 9.5% per annum, management recognized an impairment loss of Rs. 240 million.

Your audit team reviewed the underlying assumptions and determined them to be somewhat optimistic, given the prevailing industry slowdowns. Applying more conservative assumptions, such as a slightly lower growth rate and a discount rate of 10.5% per annum, the audit team estimated the impairment to be Rs. 260 million. Following discussions with management and the audit committee, the client chose to retain their original estimate.

IWL's profit before tax for the year is Rs. 1,300 million.

(ii) **NovaChem Industries (NCI)**
You observed that NCI breached a key financial covenant related to a significant long-term loan during the year ended 31 March 2025, making the loan technically repayable on demand as of the reporting date. Management initiated communication with the bank on 15 March 2025 and obtained a formal waiver on 5 April 2025, confirming the bank would not demand immediate repayment.

As the waiver was obtained prior to the date the financial statements were approved, management classified the loan as a non-current liability.

The loan amount is material to the financial statements.

Required:
Analyze each of the above independent situations and discuss the related audit reporting implications. **(10)**

Q.4 (a) Your firm is the auditor of Healthy Oil Limited (HOL), an edible oil manufacturing company, for the year ended 31 March 2025. During the year 2024-25, HOL undertook a strategic decision to streamline its operations by focusing on core competencies. As part of this decision, HOL outsourced certain non-core administrative functions to external service organizations to enhance operational efficiency and gain access to specialized expertise.

HOL has outsourced some of its function to Tech-Pro Limited (TPL), which is a well-established and reputable IT service provider. TPL is responsible for managing HOL's overall IT infrastructure. It provides both remote and on-site technical support, including maintenance of hardware and software systems, server hosting, and network support. Notably, TPL manages HOL's enterprise resource planning (ERP) servers and ensures secure, routine data backups of critical systems, including the ERP database used at HOL's head office. In addition, TPL monitors cybersecurity risks, provides incident response support, and operates a helpdesk for resolving IT-related issues across HOL's locations.

During the planning phase, your team noted that TPL engages a leading audit firm to assess its internal controls annually. A Type 2 report is issued each year, covering the full calendar year.

Required:
Evaluate the services outsourced by HOL and identify the matters that may be of concern to the auditor. Also, discuss the auditor's course of action to address these concerns. **(10)**

(b) In addition to the information in (a) above, HOL has outsourced its payroll processing to PayMaster Limited (PML), a professional payroll processing provider responsible for managing entire payroll system, including salary calculations, statutory deductions, and disbursements.

The following matters have been brought to the notice of the engagement manager:

(i) The Type 2 report issued by the service auditor for TPL includes a qualified opinion, stating that the IT general controls were not suitably designed and were ineffective in operation to provide reasonable assurance that the control objectives would be achieved. This weakness was particularly evident in TPL's failure to prevent or detect a significant cyber-attack, during the year, in a timely manner. As a result, HOL experienced extended system downtime and temporary data loss. Although the data backups were eventually restored, the systems were only brought back online after five days.

(ii) PML has neither provided a Type 1 or Type 2 report. The total amount of salaries and other benefits is Rs. 95 million, whereas draft profit before tax stands at Rs. 900 million.

Required:
Evaluate the issues outlined above and discuss their implications for the audit report. **(10)**

Q.5 Adnan Javed, the audit engagement partner from Adnan & Company, met Sameer Khan, Chief Financial Officer of Golden Foods Limited (GFL), at La-Riche Gourmet, one of the city's most upscale restaurants. The dinner, arranged and paid for by the client, was suggested by Sameer to discuss and finalize several matters, including those related to the audit for the year ended 31 March 2025, in a relaxed setting.

During dinner, Sameer expressed his appreciation for the professionalism and expertise of the audit team. He casually remarked on how one of the senior audit staff had, during the audit, suggested buying the shares of a particular listed company. "That share has nearly doubled since then," Sameer laughed, "I wish I'd bought more. Your team really knows the market."

As the discussion shifted to audit matters, in addition to the several other audit matters, Sameer brought up a recent change in accounting estimates. "We reviewed the wear-and-tear patterns and operational efficiency of our key production assets, and extended their useful lives accordingly. The resulting reduction in annual depreciation has significantly improved our current year's profit margins. I trust you will agree with the adjustments."

The conversation eventually turned to audit fees. Sameer suggested prepaying next year's audit fee as a gesture of goodwill. "We're committed to a long-term relationship with Adnan & Company," he said. "We see no harm in formalizing that now by settling the fee in advance."

He concluded by mentioning that Adnan's brother-in-law had just been elected to the board of directors the day before.

Required:
In light of ICAP's Code of Ethics for Chartered Accountants, identify and evaluate the threats to the fundamental principles. Also, recommend safeguards that should be taken to mitigate the identified threats. **(15)**

Q.6 (a) Your firm has received an engagement inquiry to audit the financial statements of Safe Water Foundation (SWF) for the year ending 30 June 2025. SWF is a not-for-profit organization funded by an international donor agency and is involved in establishing water filtration systems in rural communities.

To comply with the donor agency's reporting requirements, SWF prepares its financial statements using a framework based on detailed donor guidelines, which requires the use of the cash basis of accounting. The donor agency relies on these financial statements not only for oversight purposes but also to attract further contributions to support its programs.

Required:
Discuss the key considerations you would evaluate before accepting this audit engagement. **(05)**

(b) In addition to the information provided in part (a), management has further informed you that SWF was established for a limited operational period. It is expected that SWF's objectives will be fully achieved by March 2026, upon completion of the water filtration projects funded by the international donor agency.

Required:
Discuss the audit reporting implications. **(10)**

(The End)

Rough Sheet