THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN EXAMINERS' COMMENTS	
SUBJECT Audit, Assurance and Related Services	**SESSION** Certified Finance and Accounting Professional (CFAP) Examination - Winter 2018

General:

The overall performance in this paper was better than the previous attempt as 21% candidates secured passing marks as compared to 13% in the previous attempt. Still the passing ratio was among the lowest in this attempt's CFAP examination papers.

The most prominent reason for poor performance is that most students try to write as many points as they could think of irrespective of their relevance. In the process they also write the same points in different words. Such wastage of time affects their performance as they are unable to allocate sufficient time to consider the exact requirement of the question and frame their answers in a logical manner.

Question 1

It was a standard sort of a question where the candidates were required to identify audit risks in the given scenario and suggest key audit procedures to be performed in respect of each identified risk.

The performance remained mixed. Though passing ratio was only 29% yet average marks obtained by the candidates were 9.3 which showed that even those students who could not secure passing marks were able to secure some marks.

Majority of the students were able to identify the risks correctly but a common error was the identification of going concern issue as a risk as there was no indication in the question which could lead to doubt over the going concern status of the company. This error had serious repercussions for the erring students as all their focus got shifted to this risk and they wasted time in mentioning a number of audit procedures related to this risk and ignored some very pertinent issues.

Majority of the students showed lack of clarity in identifying the audit procedures. At this stage the students should realize that when they have identified any particular risk, they need to list down discrete, appropriate and relevant audit steps to address the risk. For example, if a risk of under provisioning for a specific obligation is present, the audit step can't just say that auditor will ensure that proper provision has been made by the client.

A common error was with regard to implementation of ERP. The risk of improper implementation was identified by almost all the students but procedures to address this risk were not up to the mark. Many answers listed procedures to be done during testing phase of the new ERP ignoring the fact that the system was already live and operational. Associated risk of incorrect capitalization and amortization were also missed out generally.

Many students appeared confused about correct accounting treatment of the given situations. The candidates cannot suggest appropriate audit procedures unless they clearly understand the correct accounting treatment of a given scenario. This was obvious in case of revenue recognition especially where company had offered tenants to pay 50% of the rent at a later time. Most of the students failed to realise that this would give rise to long-term receivables which would have to be classified as non-current asset and would also need recognition after discounting. Majority of the students were of the view that only 50% of the rent which is actually paid would be recognised as revenue.

Majority of the candidates were also not clear about the accounting issues to be faced where two floors of the building were rented out to a related party i.e. that these floors could be classified as property plant and equipment or as investment property, depending upon certain conditions.

Question 2

This question was based on a short scenario according to which a company had been dumping its waste without appropriate safeguards but had somehow managed to obtain the required certificate from relevant regulatory authority. The candidates were required to explain what course of action the auditor would need to adopt in the given situation.

It was a low-scoring question as only 14% of the candidates secured passing marks. Most of the answers revolved around analyzing the possible penalties through legal advice and their provision and disclosures. They failed to realize that the main point of concern for auditor was assessing the attitude of management towards compliance of laws and regulations necessary for conduct of business which entailed a big question mark on the management's concern for ethical values and also indicated a fraud risk factor. This, in turn, required a review of the audit approach with regard to nature, timing and extent of audit procedures. Possibility of similar non-compliances and unexplained cash payments needed to be critically inspected also. Most of the students missed these critical points.

Question 3

This question consisted of two independent situations (parts) and the candidates were required to discuss the auditor's course of action along with implications on the audit report. The overall performance was poor as only 13% candidates secured passing marks. Performance in each part is discussed below:

Question 3(a)

According to the scenario, previous year's audit report had been qualified by the predecessor auditor for not recording impairment of plant and machinery. However, the impairment loss relating to previous year had been recorded in the current year.

About 50% of the students knew that by making the adjustment in the current year, the current year's profit has been under stated and also that the corresponding figures are also misstated and that if the necessary correction is not made, a qualified report would have to be issued. However, they failed to specify that even if the management agrees to make the correction, an emphasis of matter paragraph would have to be given giving reasons for restatement and reference to the relevant note to the financial statements. The remaining 50% of the students suggested incorrect approach. According to most such students the management was correct and the auditor needed to issue an unmodified report. Some of them were of the view that the matter can only be rectified by asking the previous auditor to revise the audit report. Some of them were totally confused and narrated the procedures to verify the amount of impairment.

Question 3(b)

According to the situation in this part, the management had informed the auditor that they have not disclosed a material litigation as the disclosure would be detrimental to the legal defense of the entity. Only few students knew that according to IAS-37, in extremely rare circumstances, this can be allowed. Consequently, the auditor needed to assess the validity of the management's point of view.

Instead, answers kept orbiting around legal confirmations, assessments of amount to be provided in financial statements, conclusions that management has to disclose it in any case and even doubts on integrity of management in case of non-disclosure.

Question 4

This was a simple question requiring steps to verify cash flow forecast. The performance was satisfactory as 47% candidates secured passing marks. The common mistake was that students copied exact wording from the standard and did not structure their answers according to the scenario. Most of the students mentioned steps like checking the reliability of data and reasonableness of assumptions but missed specific steps such as those related to draft loan agreement, vendor quotations for machinery, cost and time frame for installation of generators, foreign exchange rates and bids received for construction of building for installation of generators.

Question 5

This question was based on code of ethics for Chartered Accountants. The question consisted of two parts. The overall performance was satisfactory as 50% candidates secured passing marks. Part wise performance is discussed below:

Question 5(a)

According to the given scenario, a firm of chartered accountants was offered appointment as auditors by a company whereas the firm had been previously involved in the valuation of the company's investment in an unlisted company. The requirement was to discuss whether the firm could accept the appointment and the threats involved.

The performance in this part was not satisfactory as majority of the students did not pay attention to the fact that valuation service was provided prior to appointment as auditor so the appointment could have been accepted. Consequently, they also did not mention the correct safeguards as they concluded that no safeguards can reduce the threat to an acceptable level.

Question 5(b)

According to the given scenario, two clients of an audit firm were involved in major litigations. The requirement was to identify the threats in the given situation and the related safeguards.

This part was attempted well as most of the students mentioned the correct threats i.e. objectivity and confidentiality; and the related safeguards.

Question 6

This question consisted of two parts. The overall performance was good as 62% candidates secured passing marks. Part wise performance is discussed below:

Question 6(a)

In sub-part (i), almost all of the students were able to point out two basic differences between type 1 report and type 2 report; however, most of them missed an important point i.e. that in type 1 report, no opinion is expressed whereas type 2 report includes an opinion, summary of procedures carried out and results of tests of controls also. Same was the case in sub-part (ii) which required differentiating between inclusive method and carve out method. An important difference i.e. in inclusive method the service auditor mentions that his procedures extend to controls at subservice organization whereas in carve-out method it's the opposite; was normally missed out.

Question 6(b)

This part was also well attempted as majority of the candidates were able to correctly identify the controls for identification and reporting of related party transactions.

Question 7

This question consisted of two parts. The performance was very poor as only 10% candidates secured passing marks. Part wise performance is discussed below:

Question 7(a)

According to the scenario given in this part, a company had three subsidiaries. One of the subsidiaries had been incorporated in the current year, in a foreign country. Further, ghost employees had been identified by the internal audit in one of the company's business segment and as a result, a major reshuffle had been carried out and payroll processing department had been outsourced. The requirement was to discuss the matters which needed to be considered while devising the overall audit strategy.

Though this part of the question was attempted by almost all the students and some basic factors to be considered for devising the overall audit strategy of a group audit were pointed out by majority of the students, only a few secured passing marks. The main reason was that candidates produced answers based on general factors that are to be considered in any group audit. There was very little focus on the fact that one new subsidiary was added to the group during this year and several ghost employees were identified in the parent company.

Considerations like requirement of any specialized knowledge especially the expertise needed for calculating or estimating the agreed milestones to ensure correct revenue recognition were hardly discussed. Similarly, actions like less reliance on internal controls and increasing the extent of substantive testing along with need to exercise professional skepticism were rarely touched upon.

Question 7(b)

According to the given scenario, the financial statements of a client's foreign subsidiary were not in compliance with IFRS 15 as the regulator there had deferred the adoption of IFRS 15. The management does not agree that any change is necessary as the previous year's audit report stated that in giving the opinion the auditor had relied solely on the report issued by subsidiary's auditor.

The performance remained below average as majority of the students missed the point that Auditors (Reporting Obligations) 2018 Regulations have eliminated the previous concept of division of responsibilities, thus making the group auditor solely responsible for the audit opinion on the consolidated financial statements.

(THE END)