Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

6 December 2018
3 hours – 100 marks
Additional reading time – 15 minutes

Audit, Assurance and Related Services

Q.1 You are the engagement manager in Hasan Abdali and Company, Chartered Accountants. One of your clients is Falcon Limited (FL) which owns six shopping malls and four office building complexes in different cities for rental purposes. FL also constructs and sells residential apartments in major cities of Pakistan.

The following matters were discussed in the planning meeting of the audit for the year ending 31 December 2018:

(i) CFO informed that FL has implemented a new enterprise resource planning system (ERP). He stated that FL has successfully revamped the entire accounting system through this new ERP.

(ii) A shopping mall located in Multan has been witnessing low turnout of customers. FL has been trying to persuade its tenants for not vacating their shops and have offered that they pay 50% of the rent and pay the remaining amount when conditions improve. Some of the tenants have accepted FL's offer and have formally negotiated a two-year relaxation period.

(iii) FL's head office was shifted to a central location in a newly constructed building. Two floors of the building which were surplus to FL's need have been rented out to MM Limited (MML) which is owned by a director of FL. MML provides maintenance services to various building projects. FL and MML have agreed that FL will not charge any rent for the two floors in consideration for free maintenance of Multan shopping mall and the head office.

(iv) Construction of four residential projects started during the year. The projects are in various stages of completion. About 70% of the apartments have already been booked. FL offers different terms to its customers depending upon which option they choose.

(v) The balcony of one of the apartments constructed in 2012 fell off, severely injuring three persons. The news surfaced in the media and caused severe criticism on FL and a show-cause notice was also received by FL from a regulatory authority. FL's management is of the view that the construction was up to the required standards and the residents had made some modifications which caused this incident.

Required:
Discuss the audit risks that exist in the above scenario and suggest the key audit procedures to be performed in respect of the identified risks. **(23)**

Q.2 During the audit of Leather Goods Limited (LGL), it came to the knowledge of the audit team that LGL has been dumping its chemical waste in an open area outside the city, without proper treatment as per the required standards. When confronted, the Chief Financial Officer did not consider it a serious issue and informed that LGL has managed to receive the required certificate from the relevant regulatory authority.

Required:
Evaluate the above situation and explain what course of action the auditor would need to take. **(14)**

Q.3 You are the audit partner of Mansoor Noorani and Company, Chartered Accountants. Following are the audit issues being faced on different clients:

(a) The previous year's audit report of RP Limited was qualified by the predecessor auditor for not recording impairment loss of Rs. 67 million on plant and machinery. However, the management has recorded the impairment in the current year. Profit before tax for current and prior year is Rs. 500 million and Rs. 300 million respectively.

(b) The management of DC Limited has informed you that they have not disclosed a material litigation relating to an oil spill from its vessel as the disclosure would be detrimental to the legal defence of the entity.

Required:
Discuss the auditor's course of action along with implications on the audit report. **(12)**

Q.4 Dildar Textile Limited (DTL) has a factory situated in Faisalabad. DTL has been facing acute shortage of power supply, due to which it has not been able to fulfil its orders within the committed time. Directors of DTL have decided to install gas driven power plant, to resolve the issue of power breakdown and has approached its bank for a loan of Rs. 500 million to finance the required expenditure.

To meet the bank's requirement, DTL has prepared a forecast cash flow for the next three years. The following further information is available:

(i) DTL intends to supply the surplus electricity produced to the national grid. Directors expect an increase in the cash flow due to the proceeds of sale of electricity.
(ii) DTL plans to procure a vacant plot next to its facility for installation of the plant.
(iii) The installation of plant is expected to be completed by 30 June 2019.
(iv) Currently, 40% of the production is exported and the rest is sold locally. DTL is expecting a rise in export as well as local orders by 30% and 20% respectively.
(v) Other major outflows pertain to raw material, payroll cost and marketing costs.

Required:
DTL has asked your firm of chartered accountants to provide a report on the forecast. State the key examination procedures to be used in respect of the cash flow forecast. **(10)**

Q.5 (a) You are the quality control partner in a firm of chartered accountants. Your firm has been approached by Beta (Private) Limited (BPL) for appointment as the auditors for the year ending 30 June 2019.

Your firm was also hired by BPL for valuation of its investment in an unlisted company on August 2018. The valuation engagement had concluded in September 2018 and the amount of investment is material to BPL's financial statements.

Required:
Being the quality control partner, advise whether the audit of BPL could be accepted by the firm. Also discuss the relevant threats, if any. **(06)**

(b) You are the statutory auditor of two listed companies, Alpha Limited and Gama Limited. Both the companies are in conflict with each other and involved in two major litigations.

Required:
Identify the threats involved in the above situation and also suggest related safeguards, if any. **(06)**

Q.6 (a) Explain the difference between:

(i) Type 1 report and type 2 report. **(03)**

(ii) Scope of assurance engagement under the 'Inclusive Method' and under the 'Carve out Method' **(03)**

(b) You have been assigned the area of related parties in an audit of the financial statements of a listed company where there are significant related party transactions.

Required:
Highlight what controls would you expect to be present in the company for the related party transactions. **(05)**

Q.7 (a) Your firm Gul Khan and Company, Chartered Accountants (GK) is the auditor of Yameen Corporation Limited (YCL), a listed company which has three subsidiaries. In the planning meeting, the Chief Financial Officer of YCL informed you about the following developments which took place during the year ending 31 December 2018:

(i) Asia Power Limited (APL) was incorporated in a foreign country named Blueland in January 2018. YCL is the main sponsor and holds 75% shares in APL. Rest of the shares are held by a local sponsor. APL is being audited by a firm in Blueland.

APL is providing project management services to a power plant in Blueland. The fee for project management services is agreed at USD 30 million while the expected cost is USD 22.5 million. The revenue is being recognized on identified milestone basis in the books of APL.

(ii) There was a major reshuffle in one of the business segments of YCL which resulted in several employees being laid off. The reshuffling was carried out when several ghost employees were identified by the internal audit department. Consequently, the management of YCL decided to outsource its payroll processing department along with few other activities related to the finance department to another company.

Required:
In light of the above mentioned information what considerations should be taken into account while devising the over-all audit strategy. **(13)**
Note: Audit procedures are not required

(b) You are the audit manager in a firm of chartered accountants. The audit of a client TC Limited (TCL) is in the finalisation stage. TCL has a foreign subsidiary, WCL.

The financial statements of WCL are not in compliance with IFRS-15 as the regulator in foreign country has deferred adoption of IFRS-15. Your audit team has asked TCL's management to assess the impact due to non-adoption of IFRS-15 and revise the financial statements accordingly. According to the management of TCL, the local auditor of WCL has expressed an unqualified audit report on WCL's financial statements. They believe that the auditor should rely on the report issued by WCL's auditor. In this respect they have referred to previous year's audit report which clearly states that the firm's opinion was based solely on the report issued by the subsidiary's auditor.

Required:
Discuss how you will respond to the argument presented by TCL's management. **(05)**

(THE END)