**Certified Finance and Accounting Professional Stage Examination**

**The Institute of Chartered Accountants of Pakistan**

5 December 2019
3 hours – 100 marks
Additional reading time – 15 minutes

# Audit, Assurance and Related Services

**Instructions to examinees:**

(i) Answer all **EIGHT** questions.
(ii) Answer in black pen only.

Q.1 HT Ragib and Company, Chartered Accountants (HTRC) is a member firm of an international firm of chartered accountants, HT Network. HTRC has offices in Karachi, Lahore and Islamabad.

You are the audit manager at Karachi office of HTRC. You are responsible for the audit of Health Pharma Limited and its group financial statements for the year ended 30 November 2019. The extracts of the draft planning memorandum for the group audit prepared by the audit senior are as follows:

| Name of company | Revenue | Profit/(loss) before tax | Total assets | Materiality | Remarks |
|---|---|---|---|---|---|
| | ----------------- Rs. in million | | | ----------------- | |
| Health Group (Consolidated) | 70,127 | 4,764 | 58,304 | 286 | |
| Health Pharma Limited (HPL) | 38,487 | 5,850 | 36,563 | 322 | Refer note 1 |
| Fair Cosmetics Limited (FCL) | 24,773 | (2,371) | 24,484 | 129 | Refer note 2 |
| Services (Private) Limited (SPL) | 273 | (47) | 155 | 2 | Refer note 3 |
| Quality Chemicals Limited (QCL) | - | - | - | - | Refer note 4 |

**Note 1:** HPL is the holding company and owns 100% shareholdings in FCL and SPL.

**Note 2:** FCL is audited by HTRC's Lahore office. Since FCL is being audited by HTRC's Lahore office, no further procedures have been planned for obtaining the understanding of the component auditor.

**Note 3:** SPL was incorporated in 2014 in United Arab Emirates (UAE) and is being audited by a member firm of HT Network in UAE. Since SPL operates in foreign jurisdiction, detailed audit procedures have been planned and confirmation will be sent to assess the component auditor's ethics, competence and the regulatory environment.

**Note 4:** HPL has disposed-off its entire shareholdings in QCL, a wholly owned subsidiary on 30 June 2019 at a gain of Rs. 450 million. QCL is being audited by HTRC's Islamabad office. Since QCL is no more part of the group as at 30 November 2019, no procedures have been planned at the group level.

**Required:**

(a) Critically evaluate the extracts of the planning memorandum prepared by the audit senior and advise the course of action. **(15)**

(b) Suggest **five** key audit procedures to verify the disposal of the subsidiary. **(05)**

Q.2 Rehmat Pakistan Limited (RPL) has share based payment plan for its employees. RPL's employees receive share options subject to certain vesting conditions. Discuss the key controls that RPL is expected to employ while carrying out the valuation of share options. **(07)**

Q.3 You are the audit manager assigned to the audit of Astron Computers Limited (ACL) for the year ended 30 November 2019. Following information is available:

(i) The main business of the company is the importation of servers, laptops, desktop computers, LCD screens and related accessories for sales to large customers and retailers. ACL was incorporated in 2002 and operated profitably until 2016 when it turned into a loss-making entity due to increased availability of refurbished computers in the market.

(ii) Extracts from the draft profit and loss account:

| | 2019 | 2018 |
|---|---|---|
| | ---- Rs. in million ---- | |
| Sales | 430 | 648 |
| Cost of sales | (388) | (583) |
| Loss before taxation | (32) | (64) |

(iii) Draft statement of financial position:

| Assets | 2019 | 2018 | Equity & liabilities | 2019 | 2018 |
|---|---|---|---|---|---|
| | Rs. in million | | | Rs. in million | |
| **Non-current assets** | | | **Equity and reserves** | | |
| Fixed assets | 45 | 51 | Share capital | 6 | 6 |
| Deferred tax | 27 | 24 | Reserves | 27 | 50 |
| | 72 | 75 | | 33 | 56 |
| **Current assets** | | | **Non-current liabilities** | | |
| Inventories - in hand | 97 | 90 | Warranty provision | 9 | 16 |
| Inventories - in transit | 12 | 7 | | | |
| Trade receivables | 90 | 81 | **Current liabilities** | | |
| Cash and bank | 1 | 2 | Payables | 50 | 30 |
| | 200 | 180 | Running finance | 172 | 138 |
| | | | Provisions | 8 | 15 |
| | | | | 230 | 183 |
| | **272** | **255** | | **272** | **255** |

(iv) In June 2019, ACL decided to discontinue import and sale of desktop computers and LCD screens and to concentrate selling servers and laptops. It also decided to introduce an All-In-One PC which is not currently available in the refurbished market. To further boost the sales, ACL has started offering extended warranties in addition to a two-year warranty period for all of its products at a nominal increase in price. ACL is presently negotiating with its bank to enhance the running finance facility in order to meet the additional working capital requirements.

(v) In September 2018, ACL had entered into contracts with two leading chains of schools for supplying 20,000 desktop computers and LCD screens at a nominal margin. ACL has already supplied 6,000 units before deciding to discontinue this product segment. ACL is presently negotiating with the management of both schools to change the contract from the supply of desktop computers and LCD screens to All-In-One PC. One of the schools has agreed to this change while negotiations with other school is in progress. In case, the other school does not agree to the change, ACL would either terminate the contract by paying a penalty of Rs. 6 million or procure the remaining units from any other supplier whose cost might be even more than the contract price.

(vi) In May 2019, ACL ordered desktop computer accessories at a landed cost of Rs. 20 million from a company based in Hong Kong. Due to the political unrest in Hong Kong, the shipment was delayed for more than five months despite the ordered units were manufactured on time. On discontinuance of the business of desktop computers and LCD screens, ACL asked the manufacturer to cancel the order. However, the manufacturer refused to cancel the order. In November 2019, the manufacturer shipped the ordered units which were received by ACL on 2 December 2019. CEO has informed that they are under negotiation with a local distributor to dispose of the entire desktop computer accessories.

**Required:**
Discuss the audit risks that exist in the above scenario and suggest the key audit procedures that you would perform to address those risks. **(22)**

Q.4 Basit and Company, Chartered Accountants has been appointed as auditor of Toys Pakistan Limited, a subsidiary of a listed company incorporated in China, for the year ended 30 September 2019.

Basit and Company is required to audit following two sets of financial statements:

(i) Financial statements prepared to meet the statutory requirements of Pakistan. The audit report is expected to be issued on 10 December 2019.
(ii) Financial statements prepared to meet the requirements of consolidation in China. These financial statements would only be used by the group management in China. The framework that has been used for the preparation of these financial statements is a special purpose framework. The audit report is expected to be issued on 20 December 2019.

**Required:**
Discuss the additional matters that Basit and Company may include in its audit report on the financial statements prepared for consolidation purpose. **(06)**

Q.5 Your firm has been appointed as the auditor of Helsinki Limited (HL), a listed company, for the year ended 30 September 2019. The previous year's audit was performed by another firm of chartered accountants who expressed an unmodified opinion. In a recent meeting with the client, it has been agreed that audit report will be signed on or before 20 December 2019.

The materiality has been determined at Rs. 10 million. Your audit team has brought the following significant matters to your notice on the completion of audit field work:

(i) A receivable balance of Rs. 6 million with a related party has been identified which has not been disclosed in the financial statements. HL's management is of the view that since the balance is not significant, there is no need to disclose the amount, nature of transaction and nature of relationship.
(ii) While reviewing the previous year's annual report, your team has noticed that there were number of reports and analysis which formed part of the annual report. On asking the management regarding the date when the current year's information would be available to the audit team, the management responded that directors' report would be provided on 10 December 2019 and all remaining reports would be provided on 18 December 2019.
(iii) While reviewing the provision for employees' compensated absences, the audit team has noticed that the working is prepared on the basis of basic salary, whereas the employees are entitled for compensated absences on the basis of gross salary. On further investigation it is found that the same error was made in the last year as well. The management has agreed to adjust the entire amount in current year.

**Required:**
Evaluate the above matters and discuss your firm's course of action along with implications on the audit report, if any. **(20)**

Q.6 Your firm, Hatim Manzoor and Company, Chartered Accountants is the auditor of Paints Limited (PL) for the year ending 31 December 2019. On 1 December 2019, PL has acquired controlling interest in Brush Limited (BL). Your firm also has a contract with BL for providing accounting and bookkeeping services until 31 December 2020. BL has requested your firm to keep providing the services until an alternate solution is worked out.

**Required:**
Evaluate the threat(s) in the above scenario and discuss whether the firm can continue providing the services to both the clients till conclusion of the audit. **(10)**

Q.7 While conducting the audit of financial statements of Ghurair Limited, it has been discovered that the company has received a material amount in bank, recorded as sales. On inquiry, the finance department has informed that this amount represents a price increase claim received from a foreign customer. It has also confirmed that there is no previous history of receiving such claim from any foreign customer. Documentary evidence relating to the transaction has been requested but has not been provided yet.

**Required:**
Discuss the implications of the above transaction on the completion of the audit. Also recommend the action(s) in this regard which the firm should take. **(05)**

Q.8 Masala (Pvt.) Limited (MPL) produces a range of packed spices for last many years. Currently, MPL sells its products in Karachi and Lahore only. MPL is now planning to expand its business to all major cities of Pakistan and United Arab Emirates. For this purpose, it intends to seek a financing of Rs. 2 billion from a local bank. MPL's CFO has prepared a five year cash flow forecast and has presented it to your firm for review.

The following further information is available:

(i) MPL signed a three-year contract with a distributor, Asif Brothers (AB) under which AB was given exclusive right of distribution in Karachi and Lahore. The contract is about to expire in June 2020. AB makes payment to MPL within 45 days from the date of sales. The contract specifies AB's rights to bonus on achieving the sales target.

(ii) MPL is in negotiation with many distributors in Islamabad, Peshawar, Quetta, Multan and Dubai for distribution of its packed spices. The directors wish to sign a five-year contract with a credit period of 30 days. It is expected that contract will be finalised by February 2020.

(iii) In order to meet the additional demand to be raised through expansion, MPL is planning to set up additional manufacturing facility in Karachi.

**Required:**
Discuss the key examination procedures that your firm would perform in respect of the information from (i) to (iii). **(10)**

**(THE END)**