The Professionals' Academy of Commerce
Pakistan's Leading Accountancy Institute

Certified Finance and Accounting Professional Stage Mock Examinations

24th May 2021
3 hours – 100 marks
Additional reading time - 15 minutes

Advanced Accounting & Financial Reporting

Q.1 The following are the draft statements of profit or loss and other comprehensive incomes of Malta Ltd, Salsa Ltd. and Vegetable Ltd for the year ended 31 May 2020.

	Malta Ltd	**Salsa Ltd**	**Vegetable Ltd**
	Rs.'000'	**Rs.'000'**	**$'000'**
Revenue	6,490.00	4 130.00	304.00
Cost of sales	(2,431.00)	(1,547.00)	(113.00)
Gross profit	4 059.00	2 583.00	191.00
Other income	110.00	-	-
Distribution cost	(1,831.00)	(1,165.00)	(85.00)
Administrative cost	(1,457.00)	(927.00)	(68.00)
Finance cost	(247.00)	(157.00)	(11.00)
Profit before tax	634.00	334.00	26.99
Taxation	(158.00)	(84.00)	(6.00)
Profit for the period	476.00	250.00	21.00
Other comprehensive income			
Revaluation loss	(16.00)	-	-
Total comprehensive Income	460.00	250.00	21.00

Other Information:

(i) Malta Ltd acquired 25% of Salsa Ltd's equity shares on 1 June 2017 for a cash consideration of Rs.89,250. On 1 March 2020 Malta Ltd increased its equity shareholding in Salsa Ltd to 60% for a cash consideration of Rs. 124,950 when the fair value of Salsa Ltd's identifiable net assets stood at Rs. 205,000. On the same date, other components of equity and retained earnings were Rs. 31,000 and Rs.18,000 respectively. The excess in fair value relates to an item of plant and it had a useful life of three (3) years on 1 March 2020.

(ii) Malta Ltd acquired 90% of Vegetable Ltd's equity shares on 1 June 2019 for a cash consideration of $253,000 when the fair value of Vegetable Ltd's identifiable net assets stood at $270,000. On the same date, other components of equity and retained were $45,000 and $26,000 respectively. The excess in fair value relates to non-depreciable land.

(iii) Salsa Ltd and Vegetable Ltd have had issued equity share capital of Rs.150,000 and $195,000 respectively since their respective acquisitions by Malta Ltd. Further, fair value adjustments referred to in **(i)** and **(ii)** above have not been incorporated in the above statements of profit or loss and other comprehensive income.

(iv) Goodwill in Salsa Ltd and Vegetable Ltd has not been impaired since their respective acquisitions by Malta Ltd.It is group policy to value non-controlling interests using proportion of net assets method.

(v) Malta Ltd's closing stock as on 31st May 2020 includes goods sold by Salsa Limited at 20% margin. These were invoiced at Rs. 100 thousand but are included in Malta Ltd's stock at NRV of Rs. 88 thousand.

(vi) On 1 January 2019, Malta Limited entered into an agreement with vaccine Limited to set up Sino-pharm Limited (SPL), a joint arrangement. Malta Limited has 60% rights to the net assets of SPL. During the year ended 31st May 2020 SPL earned Profit after tax of Rs.500 thousand and paid dividend of Rs.100 thousand.

(vii) During the year ended 31st May 2020 SPL sold goods to Malta Limited of Rs.700 thousand at cost plus 25% and closing stock of Malta Limited includes goods at Rs 50 thousand.

(viii) The following exchange rates are relevant:

Date	**Rs. to $1**
1 June 2019	9.6000
31 May 2020	9.8000
Average rate for year to 31 May 2020	9.7000

Required:
Prepare the consolidated statement of profit or loss and other comprehensive income of Malta Ltd group for the year ended 31 May 2020. **(27)**

Q.2 Relevant balances of Isolation General Insurance Limited for the year ended 31st December 2020 are given below:

	Opening	**Closing**
	'Rupees in '000'	
Prepaid reinsurance premium	26,250	27,000
Unearned premium reserve	55,500	54,000
Outstanding claims	36,000	39,000

Following information is available for Isolation General Insurance Limited for the year ended 31st December 2020.

	Rs. in'000
Other expenses	4,500
Income tax expense	5,625
Investment income	14,250
Management expenses	19,500
Net commission and other expenses	9,750
Finance cost	3,375
Other income	675
Reinsurance premium ceded	22,500
Reinsurance and other recoveries revenue	30,000
Share of profit from associate	1,575
Unrealised gain on available for sale investments	4,350
Gross premium	97,500
Claims paid	45,750

Required:
Prepare statement of comprehensive income for the year ended 31st December 2020 along with relevant notes to financial statements. **(12)**

Q.3 The following information has been gathered for preparing the disclosures relating to taxation for the year ended 31 December 2020 related to Sputnik Limited ("SL"):

(i) Profit before tax for the year 2020 was Rs. 450 million and revenue for the year 2020 was Rs. 3,100 million.

(ii) Unused tax losses as on December 31,2019 were Rs.90 million on which deferred tax asset was recognized. Adjustable/unused minimum tax as on December 31,2019 was Rs. 20 million and on which deferred tax asset of Rs.15 million was recognized.

(iii) The tax rate for 2020 and onwards is 26% while it was 28% in 2019 and prior years.

(iv) The movement of property, plant and equipment (other than Right of use asset and plant) and related revaluation surplus for 2020 is as follows

	Accounting WDV	**Tax Base**	**Gross revaluation surplus**
Opening balance	2,500	2,200	200
Additions	500	500	-
Revaluation surplus	150	-	150
Depreciation	(600)	(540)	(70)
Disposals	(100)	(88)	(8)
Closing balance	2,450	2,072	272

(v) On 1 January 2020, SL granted 3,000 share options each to 10 senior executives, conditional upon the executives remaining in SL's employment until 31 December 2022. The exercise price is Rs. 18 per share. On grant date, SL estimated the fair value of the share options at Rs. 120 per option.

As on 31 December 2020 it was estimated that 3 employees would leave SL before 31 December 2022. Fair value of each share as on 31 December 2020 was Rs. 110.

(vi) SL acquired 12% equity shares in Vaccine Limited for Rs. 120 million on 1 October 2020. The investment was irrevocably classified at fair value through other comprehensive income. Transaction cost of Rs.1 million was paid on purchase. Fair value of such investment on December 31 2020 was Rs. 145 million. As per tax laws, gain/loss on investment is taxable/deductible upon sale.

(vii) Liabilities of SL as at 31 December 2020 include an amount of Rs. 30 million which is unpaid since May 2017. As per tax laws, liabilities outstanding for more than 3 years are added to income and are subsequently allowed as expense on payment basis. During the year , Payment of Rs. 5 million related to such liability was made by SL.

(viii) SL is subject to minimum tax of 1.25% of revenue which is adjustable in full from the future tax liability (if any) in subsequent 3years. During the current year , SL was allowed tax credit of Rs.12 million

(ix) Other income includes capital Gain of Rs. 8 million and dividend income of Rs. 7 million. Capital gain is not taxable while dividend income is subject to tax rate of 12%.

(x) On 1st January 2020, SL entered into sale and lease back arrangement of its Plant and sale proceeds were Rs. 190 million. On December 31, 2019, Carrying value and tax base of plant was Rs.170 million and 150 million respectively. Fair Value of plant on 1st January 2020 was Rs.238 million. Plant is leased back under lease term of 3 years with annual rental of Rs.40 million payable in advance on 1st January each year. Transfer of plant satisfies requirement of IFRS-15 to be accounted for as sale.

SL Incremental borrowing rate was 13% per annum on date of sale and lease back

Required:
Prepare notes on taxation expense including reconciliation (Rs & in %) for inclusion in SL's financial statements for the year ended 31 December 2020, in accordance with the IFRSs. **(20)**

Q.4(a) On 1st January 2021 System Limited **("SL")** issued 6000 options to each of its 310 employees. Following information is related to the scheme

(i) Fair value per share is Rs.360 on grant date

(ii) The share options will vest at the end of 2023, provided the employees remain in service until then

(iii) Exercise price is Rs.360

(iv) Share price at end of each year along with number of options exercised at end of relevant year are given below :

	Share price at the end of relevant year	# of options exercised
2021	375	-
2022	390	-
2023	450	-
2024	520	156,000

(v) During the year 2021 twenty employees left the company and during the year 2022 fifteen employees left the company and during the year 2023 ten employees left.

(vi) At end of year 2021 it was estimated that 82% of total employees would be entitled to the scheme and at the end of year 2022 it was estimated that 84% of total employees would be entitled to the scheme

Required:
Calculate remuneration expense for each year and closing balance of equity reserve at end of each year in the books of SL from December 31, 2021 to December 31, 2024 **(10)**

(b) On 1 January 2018, Ali Limited **("AL")** borrowed Rs 2,000,000 from Zafar Bank (**"ZB"**) on the following terms :

i. Loan is classified at amortized cost and total term of loan is four years with coupon rate of 12 % p.a. which will be paid annually in arrears.

ii. Effective interest rate is 15.5748% p.a.

iii. Loan will be redeemed at the end of four years at Rs. 2,360,000

On 1st January 2020, AL has fallen into financial difficulties and renegotiated the terms of the loan. ZB has agreed to extinguish 70% of the loan in exchange for an equity stake in AL. The terms of the agreement as at On 1st January 2020 are as follows:

- Total 82,000 ordinary shares will be issued
- Par value per share is Rs.10 and market value per share is Rs.21 on 1st January 2020
- Remaining portion of debt will be restructured as follows :
  - **i.** Remaining tenure of loan is extended to 4 years
  - **ii.** Following installments (including interest) will be repaid as follows :

Date	Amount (Rs)
31 Dec 2020	260,000
31 Dec 2021	280,000
31 Dec 2022	290,000
31 Dec 2023	270,000

Market rate of interest at the date of restructuring of remaining debt is 18% p.a

Required:
Record journal entries for the year December 31 2020 in the books of AL. **(14)**

Q5 The following information is reflected in draft financial statements of Online Limited (OL) for the year ended December 31,2020.

Rs.(in Million)

Total Assets	5000
Total Liabilities	3500
Total Equity	1500
Profit Before Tax	400

While reviewing the financial statements, the following issues were noted by head of accounts & finance:

(i) On 1 January 2020, OL purchased 1 million options to acquire shares in Fox Limited (FL) , a listed entity. OL paid Rs. 0.25 per option, which allows OL to purchase shares in FL for a price of Rs. 2.00 per share. The exercise date for the options was 30th September 2020. On exercise date, when the market value of a share in FL was Rs.2.60, OL exercised all its options to acquire shares in FL. In addition to the purchase price, OL incurred directly attributable acquisition costs of Rs. 100,000 on the purchase of the 1 million shares in FL. OL regarded the shares it purchased in FL as part of its trading portfolio. However, OL did not dispose of any of the shares in FL by year end.. On 31 December 2020, the market value of a share in FL was Rs. 2.90. OL only recorded purchase of option as an asset in its draft financial statements.

(ii) OL acquired a piece of land on 1 April 2020. The purchase price of the land was Rs. 20 million and recorded as an asset. On the same date, OL incurred legal fees of Rs.1 million in relation to transfer of ownership and recorded as an expense in profit & loss account.
OL intends to keep the land and sell it when the market price increases substantially. The market price of land at 31 December 2020 was Rs 23 million. OL measure Property, plant & equipment at cost model and investment property at fair value model. OL did not record anything related to market value adjustment of land at year end.

(iii) OL issued a four year 12% convertible loan stock on 1 January 2020 for Rs.900,000 and recorded the full amount as loan liability. OL incurred issued costs of Rs 90,000 and debited in loan liability. The convertible loan stock will be redeemed at its par/book value at the end of a four year period. The effective interest of a similar loan stock without conversion rights was 15% p.a. The effect of the issue costs was to increase effective interest rate to 16%. P.a
Interest for the year to 31 December 2020 was paid at year end and recorded as an expense and it was calculated at original par value of loan .

(iv) In December 2020, OL delivered 25,000 units of one of its products to Zero Limited (ZL) for Rs. 25 million. Cost of these product was Rs.18 million and was recorded as cost of sales. ZL obtained the control upon delivery and immediately paid the full amount which was credited to revenue. However, ZL has been allowed to return unused units within 60 days and receive a full refund. Such rights have not been granted by OL to any customer in the past. OL has not recorded anything other than crediting revenue and cost of sales related to it

Required:
Determine the revised amounts of profit before tax, total assets, total liabilities & total equity for the year ended December 31, 2020 after incorporating the impact of above adjustments, if any **(17)**

(The End)

Answer: 1

Malta Limited Group

Consolidated statement of profit or loss and other comprehensive income for the year ended 31 May 2020

	Rs.'000
Revenue 6,490+(4,130 x 3/12)+(304x9.7)-100	10,371.34
Cost of sales 2,431+(1,547x3/12)+(113x9.7)+0.5W1-100+20-12	(3,821.33)
Gross profit	**6,550.01**
Other income (110-60)	50.00
Distribution cost 1,831+(1,165x3/12)+(85x9.7)	(2,946.80)
Administrative cost 1,457+(927x3/12)+(68x9.7)	(2,348.34)
Finance cost 247+(157x3/12)+(11x9.7)	(392.93)
share of associate profit (25% x (250 x 9/12))	46.88
share of joint venture profit	294
Profit before tax	**1,252.82**
Taxation 158+(84x3/12)+(6x9.7)	(237.19)
Profit after tax	**1,015.63**
Other comprehensive income	
Net exchange differences W2	58.10
Revaluation loss	(16.00)
Total comprehensive Income	**1,057.73**
Profit after tax attributable to:	
Equity holders of parent (bal. fig)	978.46
Non-controlling interest (16.8+20.37)W3	37.17
	1015.63
Total comprehensive income attributable to:	
Equity holders of parent (bal. fig)	1,014.95
Non-controlling interest (16.8+25.98)W3	42.78
	1,057.73

WORKINGS

W1

		Rs'000
Fair value of net assets acquired		**205**
Book value of net assets acquired:		
Equity shares	150.00	
Other components of equity	31.00	
Retained earnings	18.00	(199)
Fair Value Gain		6
Excess depreciation of fair value adjustment:		
(6 x 1/3yrs) x 0.25yrs	**0.50**	

W2 Total exchange difference

	Rs.'000
Net assets at 31 May 2020 (270+21)@ 9.8	2,851.80
Net assets at 1 June 2019 (270 @ 9.6)	2,592.00
	259.80
Less: Retained profit for the year (21@ 9.7)	203.70
	56.10
Exchange difference on goodwill **W1**	2.00
Total	58.10

	$'000	$'000
Vegetable Limited		
Cost of investment		253.00
Non - controlling interest at acquisition (10% x 270)		27.00
Fair value of net assets acquired:		
Equity shares	195.00	
Other components of equity	45.00	
Retained earnings	26.00	
Fair value adjustment **(bal. figure)**	4.00	
Fair value of net assets acquired		270.00
Goodwill		**10.00**
Translated @ rate at acquisition (10 x 9.6)		96.00
Exchange differences (bal. fig)		2.00
Translated @ rate at reporting rate (10 x 9.8)		98.00

W3 Non - controlling interests

	Rs'000	
Salsa Limited		
Share of post acquisition in:		
Profit for the period ((250 x 3/12)-0.5W1-20) x 40%	16.80	2
Total comprehensive income	16.80	0.5
Vegetable Limited		
Share of post acquisition in:		
Profit for the period (203.7W2 x 10%)	20.37	1
Total comprehensive income 20.37 + (56.1W2 x 10%)	25.98	1.5

W-4 Sino-Pharm Limited (Share of profit)

	Rs.(000)
PAT (500x60%)	300
URP(upstream) (50/125x25x60%)	(6)
	294

Answer: 2
Isolation General Insurance Limited
Statement of Comprehensive Income
for the year ended 31st December 2020

	Notes	2020 Rs. In '000'	
Net insurance premium	1	77,250	(M-4.5)
Net insurance claims expense	2	(18,750)	(M-3)
Net commission and other costs		(9,750)	(M-0.5)
Management expenses		(19,500)	(M-0.5)
Underwriting results		**29,250**	
Investment income		14,250	(M-0.5)
Other income		675	(M-0.5)
Other expenses		(4,500)	(M-0.5)
Operating Profit		**39,675**	
Finance cost		(3,375)	(M-0.5)
Share of profit from associates		1,575	(M-0.5)
Profit before tax		**37,875**	
tax expenses		(5,625)	(M-0.5)
Profit after tax		**32,250**	
Other Comprehensive income			
gain on AFS investments - net of tax		4,350	(M-0.5)
Total comprehensive income for the year		**36,600**	

Notes to the financial statements for the year ended 31st December 2020

1. Net Insurance Premium	**Rs. In '000**
Gross premium	97,500
Unearned premium – opening	55,500
Unearned premium – closing	(54,000)
Premium earned	**99,000**
Reinsurance premium ceded	22,500
Prepaid reinsurance premium-opening	26,250
Prepaid reinsurance premium-closing	(27,000)
Reinsurance expense	**21,750**
	77,250

2. Net Insurance claim expense

Claims paid	45,750
Outstanding claims - closing	39,000
Outstanding claims - opening	(36,000)
Claims expense	**48,750**
Reinsurance & other recoveries revenue	(30,000)
	18,750

Answer 3

Sputnik Limited
Notes to Financial Statement
For the year ended December 31,2020

25 - Taxation

	Rs. million	
Income Tax		
Current Year	90.66	[M-7]
Deferred tax (W-2)		
-Relating to temporary difference	6.33	[M-8]
-Relating to Rate Change	(4.60)	[M-1]
	92.39	

25.1 - Relationship between tax expense and accounting profit

	Rs	%	
Accounting profit	450.00		
Tax [450 x 26%]	117.00	26.00	
Tax on dividend income [7 x 14%]	(0.98)	(0.22)	
Tax on exempt income [8x 26%]	(2.08)	(0.46)	
Tax effect due to rate change	(4.60)	(1.02)	
Tax Credit	(12.00)	(2.67)	
Adjustment due to Share based payment (0.84-0.64)*.26	0.05	0.01	
Unrecognized minimum tax claimed	(5.00)	(1.11)	
Tax expense for the year / effective rate of tax	**92.39**	**20.53**	[M-4]

		Rs. million
W-1 Current tax		
PBT		450.00
accounting depreciation-ppe		600.00
tax depreciation-ppe		(540.00)
Excess of a/c nbv over tax nbv on disposal		12.00
Exempt Capital Gain		(8.00)
Dividend income		(7.00)
SBP expense(3000x7x120x1/3)		0.84
old liability reversal		35.00
payment of old liability allowed		(5.00)
Transaction cost on purchase of shares		(1.00)
Depreciation on Right of use asset		36.84
interest expense on lease liability		8.67
gain on sale and lease back		(23.79)
tax gain on disposal of plant (190-150)		40.00
lease rental		(40.00)
Taxable profit		**558.56**
Unused Tax Losses		(90.00)
Taxable profit-adjusted		**468.56**
Current tax-Normal(468.56*26%)	26%	**121.82**
Tax Credit		**(12.00)**
Normal Tax		**109.82**
Minimum Tax (3100x1.25%)		**38.75**
Higher of normal tax & minimum tax		109.82
Adjustment of minimum tax		**(20.00)**
Normal Tax -after adjsutment		**89.82**
Current tax on dividend (7*12%)		0.84
Current tax for the year		**90.66**

(W 2) Opening Deferred Tax Liability /Asset 31-12-19

	CA	TB	Diff	DTL / (DTA)	
	----------------	Rs. million	----------------		
PPE	2,500.00	2,200.00	300.00	28%	84.00
Un-used tax losses		-	(90.00)	28%	(25.20)
Unused minimum tax					(15.00)
plant	170.00	150.00	20.00	28%	5.60
old liability	35.00	35.00	-	28%	-
					49.40

(W 2.1) Closing Deferred Tax Liability /Asset 31-12-20

	CA	TB	Diff	DTL / (DTA)	
	----------------	Rs. million	----------------		
PPE	2,450.00	2,072.00	378.00	26%	98.28
Investment	145.00	120.00	25.00	26%	6.50
SBP	-	0.64	(0.64)	26%	(0.17)
Un-used tax losses					-
Unused minimum tax					-
Right of use asset	73.68	-	73.68	26%	19.16
old liability	30.00	-	(30.00)	26%	(7.80)
Lease Liability	75.39	-	(75.39)	26%	(19.60)
					96.37

W-2.2

		Rs. In million
SBP expense	3000*7*120*1/3	0.84

Intrinsic Value 3000*7*(110-18)x1/3 0.64

W-2.3

	Rs. (million)
Present value of lease payments **[40 + 40 x annuity factor]**	106.72
Excess of fair value over sale value **[238 - 190]**	48.00
	154.72
Right of use asset **[154.72 x 170/238]**	**110.51**

W-2.3.1

Date	Rental	Interest	Principal	Balance
				106.72
01-01-20	40.00	-	40.00	66.72
01-01-21	40.00	8.67	31.33	35.39
01-01-22	40.00	4.61	35.39	0.00

W-2.3.2 **Profit on disposal**

Procees	190
ROUA	110.51
plant	(170)
Lease Liability	(106.72)
Profit	**23.79**

(W-2.4) **Deferred Tax**

		B/F	**49.40**
P&L(rate change)(84-25.2+5.6) /28x2	**4.60**	OCI -Fv gain shares (24x26%)	**6.24**
		OCI -Revaluation (150x.26%)	**39.00**
		P&L (bal.)	**6.33**
C/F	**96.37**		
	100.97		**100.97**

Answer: 4(a)

		E.R C/F	Excercised @ Intrinsic Value	FTY (P&L)	Cumulative (P&L)	
2021	(6000X310 X 82% X (375-360)X1/3	7,626,000	-	7,626,000	7,626,000	(M-2)
2022	(6000X310 X 84% X (390-360)X2/3	31,248,000	-	23,622,000	31,248,000	(M-2)
2023	(6000X265X (450-360)X3/3	143,100,000	-	111,852,000	143,100,000	(M-2)
2024	(4000*(265-26) X (520-360)	152,960,000	24,960,000	34,820,000	177,920,000	(M-4)

(b)

Date		Debit	Credit	
01-01-20	FL	1,507,888		
	Loss on extinguishment(Bal.)	214,112		
	Share Capital		820,000	(M-6)
	Share premium		902,000	
01-01-20	FL-old	646,238		
	p&l(bal.)	90,959		
	FL-New		737,197	(M-5)
31-12-20	Finance Cost	132,695		
	FL		132,695	(M-1.5)
31-12-20	FL	280,000		
	Bank		280,000	(M-1.5)

(W-1)

Year	Cash flow	Amortized cost b/f	Interest revenue	Amortized cost c/f
2018	2,000,000	0	-	(2,000,000)
2018	-240,000	-2,000,000	(311,495)	(2,071,495)
2019	-240,000	-2,071,495	(322,631)	(2,154,126)
2020	-240,000	-2,154,126	(335,500)	(2,249,626)
2021	-2,600,000	-2,249,626	(350,374)	-
Total	**15.5748%**			

(W-2)

CV	646,238
PV of modified CF using OER	773,756
Variation	127,518
Variation%	**19.732**

Year	Outflow	PVF@15.5748	PV
2020	(260,000)	0.865	(224,963)
2021	(280,000)	0.749	(209,620)
2022	(290,000)	0.648	(187,849)
2023	(270,000)	0.560	(151,325)
			(773,756)

(W-3) Recognition of new Liability 0.1800

Year	Outflow	PVF@18%	PV
2020	(260,000)	0.847	(220,339)
2021	(280,000)	0.718	(201,092)
2022	(290,000)	0.609	(176,503)
2023	(270,000)	0.516	(139,263)
			(737,197)

(W-4)

E	B/F	interest expense @ 18%	payment	C/F
2020	737,197	132,695	(260,000)	609,892
2021	609,892	109,781	(280,000)	439,673
2022	439,673	79,141	(290,000)	228,814
2023	228,814	41,186	(270,000)	-

Answer: 5

		PBT	Total Assets	Total Liabilities	Total Equity	
	As Given	400.00	5,000.00	3,500.00	1,500.00	
(i)	investment in shares		2.90			(M-1)
(W-1)	option-asset		(0.25)			(M-1)
	cash		(2.10)			(M-1)
	Gain on recognition	0.35			0.35	(M-1)
	transaction cost on purchase	(0.10)			(0.10)	(M-1)
	Fair value gain for the year	0.30			0.30	(M-1)

PROFESSIONAL EXCELLENCE

(ii)	capitlization of legal fee	1.00	1.00	-	1.00	(M-1.5)
	Fair value gain	2.00	2.00		2.00	(M-1.5)
(iii)	initial recording of instrument	-	-	(0.07)	0.07	(M-2.5)
(W-2)	interest expense adjustment	(0.01)		0.01	(0.01)	(M-2.5)
(iv)	reversal of revenue	(25.00)		25.00	(25.00)	(M-1.5)
	reversal of cost of sales	18.00	18.00		18.00	(M-1.5)
		396.54	**5,021.55**	**3,524.94**	**1,496.61**	

Working Rs in million

(W-1)

already recorded value	0.25x1	0.25
on exercise date		
Investment in shares-record (2.6x1)		2.60
Option asset -derecognize		**(0.25)**
cash -record (2x1)		**(2.00)**
gain on recognition		0.35
transaction cost on purchase		(0.10)
cash -record		0.10
at year end		
investment in shares to be increased (2.9-2.6)		0.3
Fair value gain in P&L		0.30

(W.2)

	Debt	Equity Reserve
initial value	822,916	77,084
allocation of issue cost	(82,291.60)	(7,708.40)
	740,624	**69,376**

expense for the year	**118,500**
expense paid	**108,000**

Adjustment-initial

Debt debit	69,376
equity reserve credit	69,376

Adjustment-year end

interest expense debit	10,500
debt credit	10,500

(The End)

The Professionals' Academy of Commerce

Pakistan's Leading Accountancy Institute

Certified Finance and Accounting Professional Stage Mock Examinations

26 May 2021

3 hours – 100 marks

Additional reading time - 15 minutes

Corporate Laws

Q.1 Karachi Limited (KL), a listed company, holds 70% shares in Sindh (Pvt) Limited (SPL), which is operating in the pharmaceutical sector. In order to Combat the current pandemic, SPL is considering to import the vaccine for Covid-19, however, the company is facing shortage of funds and it has requested it holding company to facilitate by providing funds:

Following are the extracts from financials of SPL:

Description	Rs. in million
Non-current Assets	7,554
Current Assets	8,000
Share Capital (Rs. 10 each)	2000
Total Equity	4,445
Non-current Liabilities	9,109
Current Liabilities	2,000
Sales	3,321
Profit from operations	1,420
Profit for the year	920

The directors of Karachi Limited have considered the request of SPL and are willing to facilitate its subsidiary by giving short-term loans amounting to Rs. 1,000 million. Mr. Tarik and Mr. Munir are directors in both companies.

Required:

a) Briefly describe the conditions to be complied with by KL for granting such a loan. **(05)**

b) Prepare a statement of material facts to be annexed with notice of meeting to be called for approval of the above loan. **(12)**

Note: You may assume necessary details.

Q.2 Jamapunji Limited (JL) has established a provident fund for the benefits of its employees in 2015 and in order the manage the affairs of the provident fund the company has formed a Trust. The trustees of the provident fund have invested funds of the trust in different avenues. The following information is available in this regard:

Description	Rs. 000
Investment in Government Securities	200
Investmetn in Different Mutual Funds (Note-1)	350
Money Market Collective Investment Scheme	207
Investment in listed shares of different Cement companies	40
Investment in High Cement Limited - A listed Company*	10
Funds in saving accounts in scheduled banks	193
Total Size of the fund	1,000

Note-1: The trustees have made investments in those schemes which invest only in debt securities. Out of the total investment in Mutual Funds, an amount of PKR 255 million is invested in three different mutual funds being managed by "Best Asset Management Company Limited."

Investment in Money Market Collective Investment Scheme is placed in two different schemes namely ABC Cash Fund and ABC Ready Cash Fund. The returns on ABC Cash Fund are higher than the returns of ABC Ready Cash Fund and the trustees have transferred the investment from ABC Ready Cash Fund to ABC Fund.

*The investment in HGL was made by subscribing to shares offered through IPO on 1 January 2021.

Strong Cement Limited (SCL) and Bachat Limited (BL) have recently published their prospectus for IPO on 25 June 2021 and 30 June 2021 respectively. The trustees of the Fund are considering to subscribe for shares in both these IPOs. SCL is a company having a profitable operational record whereas BL is a greenfield project.

Required:
Under the Employees Contributory Funds (Investment in Listed Securities) Regulations, 2018:

a) Identify discrepancy(ies) if any, in investments made by Fund. **(04)**

b) i) Advise the trustees regarding investment in IPO of SCL and BL and maximum amount which the Trustees can invest in IPO. **(06)**

ii) Will there be any change in the maximum amount of investment if IPO date of both companies is 31 July 2021? **(03)**

Q.3 Gama Textile Mills Limited (GTML), a listed company, purchases its major raw material from Standard Spinning Limited (SSL) on credit. The total outstanding amount payable to SSL was Rs. 163 million as on 31 December 2020 which was due to be paid in January 2021 but was not paid despite many follow-ups and written requests.

The following information was extracted from the latest financial statements of GTML:

	2020
	Rs. in million
Non-current Assets	1,200
Current Assets	155
Total Assets	**1,355**
Share Capital – Class A (Rs. 10 each)	150
Share Capital – Class B (Rs. 10 each)	100
Accumulated Losses	(180)
	70
Long Term Liabilities	900
Current Liabilities	330

Current liabilities include creditors amounting to Rs. 250 million and the current market price of GTML's share is Rs. 5.10/Share.

Required:

a) The CFO of SSL has advised its management to file a petition for creditors voluntary winding up, however, the management of the SSL is not interested in GTML's winding up and has sought your advice about the other suitable options available to SSL under the Companies Act, 2017 in the given scenario?. **(06)**

b) Some of the shareholders are also not satisfied with the performance of the Board of Directors and a group of shareholders of GTML holding 1,510,000 Class A shares and 1,285,456 Class B shares are considering to file an application with the Securities & Exchange Commission of Pakistan with an allegation that GTML is being mismanaged by the Directors due to which GTML is incurring losses, further GTML had never declared any dividend even when the profits were available in the past years.

Class B shares have no voting rights.

You are required to explain whether they are eligible to apply to SECP and what are the possible consequences of this application on GTML and its management. **(06)**

Q.4 Following are the extracts from the financial statements of Ahmad Limited (AL), a deposit-taking listed NBFC, having a license for Investment Finance Services.

Description	**Rs. in million**
Ordinary Share Capital	500
Accumulated Profits	425
Redeemable Preference Shares	110
Revaluation Reserve	150
Subordinated Loans	250

Details of investment in listed shares are as follows:

Description	**Total no. of shares (in Million)**	**No. of shares acquired (in Million)**	**Cost of investment (Rs in million)**
Gilgit Limited	160	5	200
Kashmir Limited	200	8	205
Skardu Limited	150	3	215
Multan Limited	100	4	90

- Investment in Skardu Limited was impaired and provision against permanent diminution was created amounting to Rs. 25 million.
- Ahmad Limited (AL) intends to acquire further shares of Multan Limited (ML). The current market price of the share of Multan Limited is Rs.12/Share.

Required:

a) Under the provisions of Non-Banking Finance Companies Regulations determine the maximum number of shares of ML which AL can purchase? **(09)**

b) After acquisition of shares of ML in (a) above, how much further investment AL can make in other listed securities. **(03)**

Q.5 The election of directors of Akhrot Mills Limited (AML), a listed company, was held on 01 October 2020 in which Mr. Ahmad got elected along with other six directors. Mr. Ahmad is also holding the positions of independent directors in M/s Khubani Limited (KL) and M/s Mango Limited (ML). KL is a major raw material supplier to AML. In March 2021, AML started negotiations for purchase of machinery from M/s Banana Limited(BL). Mr. Ali, father of Mr. Ahmad became director of Banana Limited in April 2021.

On 10 May 2021, Ms. Ayesha, wife of Mr. Ahmed sold 2% shares of AML which she had purchased in November 2020.

Required:

You are required to state the responsibilities of Mr. Ahmad and M/s Akhrot Mills Limited in connection with the events mentioned above? **(08)**

Q.6 (a) Pakistan Stock Exchange is a growing market and is attracting investors from all over the world. Mr. Jack, a British Investor, wants to invest in securities listed on Pakistan Stock Exchange. With reference to relevant provisions of Foreign Exchange Manual, you are required to advise Mr. Jack on the following:

i) The procedure to be followed in order to trade in listed shares in Pakistan.

ii) Whether Mr. Jack would be entitled to receive dividends on such securities and are there any restrictions on repatriation of such funds outside Pakistan. **(06)**

(b) Mr. Ateeq, Branch Manager of Sarmaya Bank Limited, received an application for account opening from a client. For the purpose of Customer Due Diligence, Mr. Ateeq asked for some details from the client. Instead of giving full information, the client offered to place a deposit of Rs. 20 million to his branch which will improve the deposit position of the branch. Mr. Ateeq realized that the customer is reluctant in giving his full information is suspicious furher that if he asks more questions the customer will get alert about his suspicion.

Under the provisions of Anti Money Laundering Act, 2010 you are required to guide Mr. Ateeq about his responsibilities in the above-mentioned scenario. **(04)**

Q.7 M/s Candy Limited (CL), a listed company, is facing financial difficulties and needs funds for running its operations successfully. Negotiations with banks could not be finalized due to poor financial position and performance of the CL. As a last resort, the management has decided to issue further shares to meet it funds requirements. The existing paid-up capital of the company consists of 100 million shares out of which 55% shares are owned by sponsors. The management is considering to issue 10% right shares the sponsors are willing to subscribe to their portion of the right issue, however, there is an issue with respect to the proposed price of the right issue. The Market value of the share has reduced below the face value of Rs.10 per share and currently, it is being traded at Rs. 8 per share. The CFO of the company proposed to issue new shares at Rs. 7.10 per share, so that all offered shares are subscribed. The volume-weighted average closing prices for the last 90 days and for the last one year were Rs. 8.66 per share and Rs. 8.90 per share respectively.

Required:
Being corporate consultant of CL you are required to:

a) Evaluate whether the right shares can be offered on the price proposed by CFO your answer should be supported by appropriate calculations? **(03)**

b) How much will be the total subscription amount if the company decides to give the maximum possible discount on the right shares, assuming that 100% right shares are subscribed by the shareholders? **(03)**

Q.8 Keeping in view the recent successful public offers made by different companies, the management of Biscuit Limited has decided to make an IPO for expansion of existing production facilities by offering 100 million shares to the public/investors. M/s SKM Associates were appointed as consultant to the issue following provisions are contained in the draft prospectus to be submitted to PSX and SECP for approval.

- 80 million shares shall be issued through book building while remaining shall be offered to retail investors and subscription of the retail portion shall start from 01 July 2021.
- Prospectus shall be published on 23 May 2021 and registration of bidders for the book-building portion shall commence at the same date.
- The floor price for the book-building portion was fixed at Rs. 24/share with a price band up to Rs. 35/ share.
- The bidders shall be allowed to revise their bids if they want to reduce the bid volume.
- Shares shall be issued to retail investors with a 10% additional premium on the strike price.

Required:
Being consultant of the Company, identify discrepancy(ies), if any, in the information given above and suggest the proposed rectification(s), if any. **(07)**

Q.9 Following extracts are available from the Statement of Compliance of Buzdar Limited (BL), a listed company, prepared under the "Listed Companies (Code of Corporate Governance) Regulations, 2019".

The company has complied with the requirements of the Regulations in the following manner:

1. The total directors are ten (10) as per the following details:

Category	Name of Director
Independent Director	Mr. Hamza
	Mr. Zafar
	Mr. Mohsin
Non-Executive Director	Mr. Amjad (Chairman)
	Mr. Zubair
	Mr. Waqas
Executive Director	Mr. Umair (Chief Executive)
	Mr. Ameen
	Mr. Noor
	Mrs. Nuzhat

2. The Board have a formal policy and transparent procedures for remuneration of directors in accordance with the Act and these Regulations;

3. Chief financial officer and Chairman duly endorsed the financial statements before approval of the Board;

4. The frequency of meetings (quarterly/half yearly/ yearly) of the committee were as per following;
Audit Committee: One meeting half yearly
Human Resource and Remuneration Committee: One meeting quarterly

5. The Board has formed committees comprising of members given below:

(a) Audit Committee:

Name	Designation
Mr. Amjad	Chairman
Mr. Zubair	Member
Mr. Ameen	Member

(b) Human Resource and Remuneration Committee:

Name	Designation
Mr. Umair	Chairman
Mr. Noor	Member
Mr. Waqas	Member

6. The terms of reference of the aforesaid committees have been formed, documented and advised to the committee for compliance.

Required:
Critically evaluate the above extracts of statement and recommend changes, if any, required to made to the Board of BL. **(08)**

Q.10(a) Power Limited (SPL), an unlisted company, is the wholly owned subsidiary of M/s Zaitoon Limited (ZL), a company listed on Pasistan Stock Exchange (PSX).
Following information was extracted from latest financials of SPL.

Description	**Amount (Rs.)**
Share Capital of Rs. 10 each	500
Accumulated Profits/(Losses)	(50)
Revaluation Reserve	10
Non-current Liabilities	85
Current Liabilities	15

On 1 January, 2021 members of ZL approved distribution of SPL's shares as specie-dividend and keeping in view the requirements of the Rules Book of the PSX, the management of ZL applied for listing of share of SPL. However keeping in view the bad performance of SPL the PSX refused to list the shares of SPL on 28 April 2021.

Required:
Describe the responsibilities of ZL in the above situation and the consequences if ZL fails to fulfill its obligations. **(04)**

(b) Azan Limited (AL) is listed on Pakistan Stock Exchange Limited. Its shares are traded on ready as well as on future counter. The Face Value of share is Rs.10/share and Current Market price is Rs. 20.2/share. No trading in shares of AL has taken place since last six months, as the investors consider that the price is much higher than its fair value. The Company Secretary is of the view that company should get it delisted from stock exchange.

Required:
Keeping in view the requirements of relevant regulations, explain how the quoted price can be brought near to the fair value? **(03)**

(The End)

PAC

Answer: 1

(a) General conditions to be complied with under each option:

- Pass a special resolution in the general meeting of the company.
- The investment shall be made within a period of twelve months from the date of passing of special resolution.
- The company shall not invest in its associated company by way of loans or advances except in accordance with an agreement in writing and in accordance with the approval of the members in the general meeting;
- Karachi Limited shall charge and recover interest which shall not be less than KIBOR for the relevant period or the borrowing cost of the company whichever is higher.
- Mr. Tarik and Mr. Munir (Common Directors) shall not take part in discussion regarding grant of loan to SPL.

(b)

Sr. No	NATURE OF INFORMATION REQUIRED TO BE DISCLOSED PURSUANT TO THE COMPANIES (INVESTMENTS IN ASSOCIATED COMPANIES OR UNDERTAKINGS) REGULATIONS, 2017	RELEVANT INFORMATION
(a)	**Disclosure for all types of investments**	
	(A) Regarding associated company or associated undertaking: -	
	(i) Name of associated company or associated undertaking	Sindh (Pvt) Limited (SPL).
	(ii) Basis of relationship	By virtue of shareholding (70%) and common directorship.
	(iii) Earnings per share for the last three years (PKR)	2019: 4.6; 2018: 4.5; 2017: 4.1
	(iv) Break-up value per share, based on the latest audited financial statements	PKR 4,445,000,000 / 200,000,000 = 22.225 per share.
	(v) Financial position, including main items of statement of financial position and profit and loss account on the basis of its latest financial statements; and	Financial Position as of and Financial Performance for the year ended December 31, 2020. Main items of Balance Sheet: (Rs. in million) Non-current Assets: 7,554 Current Assets: 8,000 Total Equity: 4,445 Non-current Liabilities: 9,109 Current Liabilities: 2,000

		Main items of Profit and Loss Account: | | (Rs. in million) | | Sales | 3,321 | | Profit from operations | 1,420 | | Profit for the year | 920 |
	(vi) In case of investment in relation to a project of associated company or associated undertaking that has not commenced operations	Not applicable
	(B) General Disclosure: -	
	(I) maximum amount of investment to be made;	Loan not exceeding PKR 1,000 million
	(II) purpose, benefits likely to accrue to the investing company and its members from such investment and period of investment;	To assist SPL for meeting its working capital requirements. The Company will earn markup income from SPL on the subordinated loan. The income will increase the profitability of the Company.
	(III) sources of funds to be utilized for investment and where the investment is intended to be made using borrowed funds:	
	(I) justification for investment through borrowings;	SPL has commenced its operations in October 2016 and is not seized with sufficient free cash to meet its working capital requirements. Being the sponsor, the Company has an obligation to support Sindh (Pvt) Limited for its working capital funding requirements.
	(II) detail of collateral, guarantees provided and assets pledged for obtaining such funds; and	The funds to be borrowed shall be secured against a Corporate Guarantee or pledge of shares of SPL held by the Company or any other security as per the requirement of the lender.
	(III) cost benefit analysis;	Subordinated Loan will be provided from the borrowed fund for which markup shall be charged at 3MK+2% (being 1% above average borrowing cost of the Company) which will improve the profitability of the Company.
	(IV) salient features of the agreement(s), if any, with associated company or associated undertaking with regards to the proposed investment;	The Subordinated Loan will be unsecured.

PAC
PROFESSIONAL EXCELLENCE

(V) direct or indirect interest of directors, sponsors, majority shareholders and their relatives, if any, in the associated company or associated undertaking or the transaction under consideration;	None of the directors except mentioned below, sponsors, majority shareholders and their relatives have any interest in the associated company or proposed transaction, except to the extent of their shareholding in the associated company or associated undertaking or the transaction under consideration. Further, SPL is a subsidiary of the Company and 2 directors of SPL are directors of the Company as follows: Mr. Tarik: 1,000 shares Mr. Munir: 1,154 shares SPL does not hold any share in the Company.
(VI) in case any investment in associated company or associated undertaking has already been made, the performance review of such investment including complete information/justification for any impairment or write offs; and	The Company currently holds 70% of shareholding in SPL and during FY 2020, profit attributable to the Company amounted to PKR 920 million. No impairment on investment in SPL has been recognized by the Company.
(VII) any other important details necessary for the members to understand the transaction;	None

(b)	**In case of investments in the form of loans, advances and guarantees, following disclosures in addition to those provided under clause (a) of sub-regulation (1) of regulation 3 shall be made:**	
	(I) category-wise amount of investment;	Loan not exceeding PKR 1,000 million provided to SPL.
	(II) average borrowing cost of the investing company, the Karachi Inter Bank Offered Rate (KIBOR) for the relevant period, rate of return for Shariah compliant products and	The current borrowings of the company are at rates up to 3MK + 1%.
	(III) rate of return for unfunded facilities, as the case may be, for the relevant period;	Not applicable.

	(IV) rate of interest, mark up, profit, fees or commission etc. to be charged by investing company;	3MK +2% or maximum borrowing rate of the company +1%, whichever is higher.
	(V) particulars of collateral or security to be obtained in relation to the proposed investment;	The facility is unsecured as the Company has full oversight and is very well versed with the operations and plans of the borrowing company.
	(VI) if the investment carries conversion feature i.e. it is convertible into securities, this fact along with terms and conditions including conversion formula, circumstances in which the conversion may take place and the time when the conversion may be exercisable; and	No conversion feature.
	(VII) repayment schedule and terms and conditions of loans or advances to be given to the associated company or associated undertaking.	SPL to repay the loan with the accrued Profit from time to time (in full or parts therefore) within thirty (30) days of it receiving money in its Rupee Distribution Account in accordance with its Financing Agreements.

Answer: 2

(a)

i) Investment in mutual funds managed by a single asset management company can be up to 25% of the size of fund. In above scenario, the investment in mutual funds management is single Asset Management Company is 25.5% (255/1000*100). Hence the Fund is non-compliant with the requirement of law and should consider disinvestment from any of the mutual funds managed by Best Asset Management to bring the aggregate investment to PKR 250 M.

ii) Total investment in any single money market collective investment scheme shall not exceed twenty percent of the size of the Fund or Trust. In above scenario, the investment in money market collective investment scheme is 20.7% (207/1000*100). Hence the Fund is non-compliant with the requirement of law and should consider disinvestment from Money Market CIS to bring the aggregate investment to PKR 200 M.

(b)

i) BL is a greenfield project so trustees can not invest in IPO of BL. Investment can be made in IPO of SCL and maximum limit for this investment is lowest of the following:

Nomenclature	Total Limit	Already Used	Balance Limit
Amount which can be invested in listed equity securities = 30% of 1,000	300	50	250
Amount which can be invested in single listed securities i.e. LSL = 10% of 300	30	0	30
Amount which can be invested in IPO in 6 months = 5% of 300 =	15	10	5
Amount which can be invested in a single sector = 20% of 300=	60	50	10

PAC PROFESSIONAL EXCELLENCE

Limit for investment in a single IPO 2% of 300 =	6	N/A	6
Based on above the lowest available limit is Rs. 5 million which can be invested in IPO of Strong Cement Limited (SCL)			

b)

ii) If IPO date of SCL is 31st July 2021

Nomenclature	Total Limit	Already Used	Balance Limit
Amount which can be invested in listed securities = 30% of 1,000	300	50	250
Amount which can be invested in single listed securities = 10% of 300	30	0	30
Amount which can be invested in IPO in 6 months = 5% of 300 =	15	0	15
Amount which can be invested in a single sector = 20% of 300=	60	50	10
Limit for investment in a single IPO 2% of 300 =	6	N/A	6
Based on above the lowest available limit is Rs. 6 million which can be invested in IPO of Strong Cement Limited			

Answer: 3

a) SSL have an interest in the company equivalent to 65% (163/250) of paid-up share capital of the company which makes it eligible to request the appointment of Administrator since it is more than 60% threshold as prescribed under Section 291 of Companies Act, 2017.

Further, SSL may request to Commission for the appointment of Administrator on the following grounds:

i- Accumulated losses are 72% of the paid up capital i.e. exceed 60% of the paid up capital.

ii- Debt equity ratio of GTML have deteriorated beyond 9:1 i.e. 12.8:1

iii- Current ratio has deteriorated beyond 5:1 i.e. 0.47:1 respectively.

The Commission may, after giving GTML an opportunity of being heard, by order in writing appoint an Administrator, within 60 days of the date of receipt of the representation, from a panel maintained by it on the recommendation of the State Bank of Pakistan (SBP) to manage the affairs of the company subject to such terms and conditions as may be specified in the order.

b) Shareholders holds more than 10% of Class A voting shares having voting power i.e 10.06% so, they are eligible to apply to SECP and SECP on the basis of application, supported by the evidence and after giving an opportunity to GTML of being heard may appoint an inspector to investigate the affairs of NL and shall define the scope of such investigation. On the report of the investigator, if SECP finds it appropriate, it may refer the matter to the Court.

When the case would be referred to the Court, the Court may:

i) remove from office any director including the chief executive or other officer of the company; or

ii) direct that the directors of the company should carry out such changes in the management or in the accounting policies of the company as may be specified in the order; or

iii) direct the company to call a meeting of its members to consider such matters as may be specified in the order and to take appropriate remedial actions; or

iv) direct that any existing contract which is to the detriment of the company or its members or is intended to or does benefit any officer or director shall be annulled or modified to the extent specified in the order.

Provided that any director, including a chief executive or other officer who is removed from office, unless the Court specified a lesser period, shall not be a director, chief executive or officer of any company for a period of five years from the date of his removal.

Answer: 4

a)

		In million
	Equity	
	Share Capital	800
	Accumulated Profits	425
	Subordinated Loans	250
	Total Equity	1475
A	Investment allowed upto 50% of AL's equity.	737.5
	Already held investment*	685
	Limit available for further investment	52.5
	Current Market Price	12
	No of shares which can be purchased	4.38
	*(200+205+215+90)-25	
B	**Limit of 10% of AL's equity**	
	Investment permitted in single company upto 10% of AL's equity	147.5
	Amount already invested in ML	90
	Limit available for further investment	57.5
	Current Market Price	12
	No of shares which can be purchased	4.79
C	Total number of shares of ML which AL can hold (10% of 100 million)	10
	Shares already held	4
	Additional shares which can be purchased	6

Based on above working AL can purchase 4.38 million shares of ML which is lower of A, B and C.

b)

	Rs. in million
Investment allowed upto 50% of AL's equity.	737.5
Already held investment*	685
Further Investment in ML (4.38*12)	52.5
Limit available for further investment in listed securities	zero

Answer: 5

Responsibilities of Mr. Ahmad:

i) On becoming director Mr. Ahmad shall give notice in writing to company of his beneficial ownership in listed securities of company. Such notice shall be given by Mr. Ahmed on or before 08 October 2020.

ii) On sale of shares by his wife a notice of change in his beneficial ownership shall also be filled by Mr. Ahmad which shall state the number, amount and description of shares. Such notice shall be filled on or before 17 May 2021.

iii) A general notice can be given to the board to the effect that Mr. Ahmad is director in Mango Limited and Khubani Limited and is regarded to be interested in any contract or arrangement with these companies.

iv) Mr. Ahmad became indirectly interested in transaction for purchase of machinery from Banana Limited in April 2021 when his father became director in Banana Limited. He should give notice to company of his interest in Banana Limited.

v) Disclosure regarding Banana Limited shall be given at first board meeting in which agreement for purchase of machinery is to be discussed after he became interested.

vi) Mr. Ahmad shall not take part in the discussion of, or vote on, contract of purchase of machinery from Banana limited and his presence shall not be considered for quorum of meeting.

Responsibilities of AML:

i) The company shall maintain a register in which details of directors' beneficial ownership shall be entered. Company shall enter all details on the date when notice is received from Mr. Ahmad regarding beneficial ownership.

ii) Company shall maintain a register in which details regarding all contracts and arrangements in which directors are interested shall be entered and for this purpose Mr. Ahmad shall, within a period of thirty days of his appointment disclose to the company the particulars relating to his concern or interest in the other associations.

Answer: 6

(a)

i) Mr. Jack will be required to open a "Special Convertible Rupee Account" with any authorized dealer.

- Such account can be fed by:
  - Remittances from abroad
  - Transfer from a foreign currency account maintained in Pakistan by Mr. Jack
- Mr. Jack shall be allowed to trade freely in any shares quoted on Pakistan Stock Exchange from this account.
- Payment from such purchases may be debited to the account on production of stock broker's memo.
- Disinvestment proceeds may be credited to the account on provision of stock broker's memo.
- Transfer from one such account to another may also be made in case of transfer of shares.

ii) Yes, Mr. jack is entitled to receive dividends which shall also be credited into special convertible rupee account.

There are no restrictions on repatriation of funds outside Pakistan and the funds available in such special accounts can be transferred outside Pakistan or credited to a Foreign Currency Account maintained in Pakistan at any time without prior approval of SBP.

b) According to Section 7D of Anti Money Laundering Act,2010 If Mr. Ateeq is unable to complete CDD requirements:

- **i)** He shall not open the account, commence business relations or perform the transaction and
- **ii)** shall promptly consider filing a Suspicious Transaction Report in relation to the customer.

c) Where a reporting entity forms a suspicion of money laundering or terrorist financing, and reasonably believes that performing the CDD process will tip-off the customer, the reporting entity shall not pursue the CDD process and shall file a STR. So, Mr. Ateeq should not perform CDD and promptly file a STR.

Answer: 7

a) As per section 82 of Companies Act, 2017 Commission's approval is required for issue of shares at discount and the Commission cannot grant permission to issue shares at discount if offer price is less than 90% of the volume weighted average closing price for last 90 days. Hence price proposed by CFO cannot be accepted as the management of Kidney Limited cannot issue shares at any price below Rs. 7.79 per share (90% of 8.66).

b) Total amount of subscription shall be as follows:

Description	**Shares**	**Price**	**In million**
Total Issued Shares			100
Right issue (10%)			10
Sponsors portion (55%)	5.50	8.66*	47.63
General Public portion (45%)	4.50	7.79	35.055
Total Subscription amount			**82.685**

*Sponsors are required to subscribe their portion at the volume weighted average closing price for last 90 days.

Answer: 8

According to the provisions of Public Offering Regulations, 2017:

i) Maximum seventy-five percent of the offer size can be allocated to book building portion and the remaining minimum twenty-five percent to the retail investors. 80 million shares can not be issued through book building.

ii) The prospectus shall be issued, circulated and published not less than seven days and not more than thirty days before the commencement of the subscription period for the retail portion of the Issue. Date of publication of prospectus is not in accordance with provisions of law. Prospectus should be published at any date between 01 June 2021 and 23 June 2021.

iii) The Issuer shall publish the Prospectus at least one day before the commencement of registration of bidders by the Book Runner. Registration of bidders can not be started at date of publication of prospectus.

iv) Price Band can be fixed with an upper limit of 40% to floor price. As floor price is Rs. 24/ share, price band cannot be more than Rs. 33.6/share.

v) Bidders cannot make downward revision both in terms of Bid Price and Bid Volume. Such permission in prospectus is not in accordance with law.

vi) The issuer may offer the shares to the retail investors at a certain discount to the strike price.

vii) The issuer may offer the shares to the retail investors at a certain discount to the strike price. Premium on strike price can not be charged from retail investors.

PAC PROFESSIONAL EXCELLENCE

Answer: 9

- According to Code of Corporate Governance Regulations, 2019 it is mandatory that each listed company shall have at least two or one third members of the Board, whichever is higher, as **independent directors**.

  For the purposes of this sub-regulation, a listed company shall explain the reasons, in the compliance report, if any fraction contained in such one-third number which is not rounded up as one.

  Hence BL should add the following explanation in the statement:

  While calculating the minimum number of Independent directors the fraction was not rounded upwards to 1. The reason being that as per general rule only number exceeding 0.5 shall be rounded to next number.

- It is mandatory that the executive directors, including the chief executive officer, shall not be more than one third of the Board. BL have to reduce the number of executive directors.
- It is mandatory that the audit committee of a company shall meet at least once every quarter of the financial year. These meetings shall be held prior to the approval of interim results of the company by its Board and after completion of external audit. BL is not compliant in this case.

- Chief financial officer and chief executive officer duly endorsed the financial statements before approval of the Board. Hence Chief Internal Auditor shall not endorse the financial statements.

- **Chairman of Audit Committee** shall be an independent director, who shall not be the chairman of the Board. Mr. Amjad being Chairman of Board and not being Independent Director **shall not become** the Chairman of **Audit Committee**. Hence any independent Director among Mr. Hamza, Mr. Zafar, Mr. Mohsin should be Chairman of **Audit Committee.**

- Audit Committee should comprise of **non-executive directors**. Mr. Ameen being executive director should not be included in audit committee.

- HR & Remuneration Committee should comprise a majority of non-executive directors of whom at least one member shall be an **independent director** who shall be chairman of the committee and Mr. Umair being the chief executive officer may be included as a member of the committee not chairman.

Answer: 10

a) According to the Pakistan Stock Exchange Limited (PSX) Rule Book, ZL was responsible to get SPL's shares listed on or before 01 May 2021 (i.e. 120 days from 1 January 2021) within a period of one hundred twenty (120) days from the date of approval of such distribution by the shareholders at a meeting of such company. As listing was refused by Exchange ZL is required to purchase the shares of SPL at the option of the recipients at a price of Rs. 10/ share (being higher of the current break-up value (460/50 = 9.2, or face value (Rs. 10/ share), whichever is higher, till 28 May 2021 (i.e within 30 days after the expiry of 120 days or from the date of refusal of listing whichever is earlier). In the event of default, the trading in the shares of ZL may be suspended by the Board or the company may be de-listed.

b) Where no trading has taken place on the Exchange in the securities of a Listed Company for a continuous period of 180 days, the Exchange, if it is satisfied that the prices quoted are not in accordance with the market realities, may except in cases where the earlier quotation is below par value and, with the prior approval of the Commission, quote such companies at par from the one hundred and eighty first day irrespective of the price earlier prevalent. As share price is Rs. 11.2/share, it can be quoted at Rs. 10/ share by exchange.

(The End)

PROFESSIONAL EXCELLENCE

The Professionals' Academy of Commerce
Pakistan's Leading Accountancy Institute

Certified Finance and Accounting Professional Stage Mock Examinations

28 May, 2021
3 hours – 100 marks
Additional reading time - 15 minutes

Business Management and Strategy

Q.1 Pharma Limited is a leading pharmaceutical company in the developed country of Ruzania. The firm is in a process of expanding its business in developing country of Xina. It has conducted an environmental scan and following information has been acquired from the environment.

The pharmaceutical industry in Xina is regulated through Drug Regulatory Framework. The overall health environment is not conducive. Due to overly populated country, people of Xina are constantly facing health issues due to lack of medical facilities. Recent outbreak of Covid-19 has further aggravated the sensitivity of health issues. Despite increasing rate of inflation and reducing disposable income, demand for pharmaceutical products has shown a considerable increase. Over 25% of the population comprise of children and old age people who are more prone to health issues. Interest in healthy lifestyle is also getting popular amongst the youth.

The government of Xina is introducing many business-friendly policies for pharmaceutical industry by allowing tax holidays as an incentive for new investments. Government has also initiated grants of loans at subsidized interest rates to encourage research and development activities.

The trend of e-commerce is also emerging, and it has affected the overall healthcare and pharmaceutical industry. People are using online apps for ordering medicines, making appointment with doctors, and using social media to share their experiences with different stakeholders. Key players in pharmaceutical industry are also making use of social media to market their products and CSR activities; such as use of renewable energy, conducting free public health awareness programs, sponsoring treatments of deserving people etc.

a. Perform PESTEL analysis for pharmaceutical industry in Xina **(10)**

b. Briefly explain how Pharma Limited can capitalize on any two available opportunities and how any two existing threats may affect their performance. **(04)**

Q.2 Apple Corporation was in a process of manufacturing a new variant of iPhone 11 that was planned to be launched in September 2020 in more than 5000 outlets across the world, when Covid-19 hit china and production was halted in all the industries for more than two months. Apple took a bad hit as the supply chain was disrupted and orders from retailers went to backlog. Such uncertainty was never anticipated. An urgent meeting of board of directors was called to discuss alternate strategies. The board unanimously agreed on the fact that they might not be able to achieve production targets. The board unanimously agreed on the fact that they might not be able to achieve production targets to launch the new iPhone in all 5000 stores, so they decided to launch the new product at selected outlets and replenish the inventory of iPhone 11 in the remaining outlets and offering special discounted price to increase inventory turnover. The directors were hopeful to get production back on track by December 2020.

a. In the context of the scenario above, explain the concept of intended and emergent strategy. Briefly list any **three** core competences of Apple that might help them in achieving the desired targets of the new strategy. **(06)**

b. What is enforced choice? In the context of the scenario, is the concept of enforced choice is valid for Apple? **(05)**

c. Differentiate between goals and objectives. List any **two** goals and objectives for Apple Corporation. **(05)**

Q.3(a) You are hired as a recruitment & selection consultant in a leading hospital in Karachi. Senior management has asked you to invite application for lab technicians to be appointed at various facilities of the hospital. List **six** important items that you MUST consider putting in newspaper advertisement to attract suitable applicants. **(03)**

(b) Shakoor Ahmed (Shakoor) has been hired as Training & Development manager at Chimes Limited, a leading electric bells manufacturer in Pakistan. Despite the state-of-the-art technology and increasing customer demands, the firm is facing constant decline in profitability. The issue has aggravated, and Human Resource manager has compiled a report highlighting training and development issues of employees in various departments that might be significant reason behind poor performance. CEO has asked you to conduct training need assessment of employees in various departments and come up with a comprehensive T&D plan to improve the performance of employees.

Required:

a. Explain the process Shakoor will go through in conducting training need analysis. **(06)**

b. Briefly explain any **three** training and development methods that Shakoor may come up with in his T&D plan. **(06)**

Q.4 LifeX has introduced a chain of gyms, restaurants, wellness clubs, and spas across the city. They offer two different types of membership plans i.e., basic, and premium. A basic plan is for a single individual giving access to regular gym, limited timings for wellness clubs, restaurants, and spas whereas premium membership plan gives access to a family of up to four people. Unlimited access to executive gym, wellness clubs, restaurants and executive spas. You are hired as a marketing manager to develop a marketing plan for LifeX. Briefly highlight the key dimensions of an effective marketing plan focusing on different aspects of:

- Product
- Price
- Place
- Promotion

(12)

Q.5 Speedo Automobile is an American based company that produces sports cars. The company sources subassemblies, directly from limited suppliers and through some intermediaries, across the world. Once subassemblies reach the assembly plant, a team of seasoned engineers assemble the cars that are inspected, tested, and shipped to the showrooms across the country.

Required:

Explain the supply chain of Speedo Automobile. Whether the firm relies of parallel or network sourcing? Explain briefly. **(08)**

Q.6(a) In this era of Information technology, there exists an apparent need for a reference framework for security and control in IT. Organizations with growing business needs are becoming increasingly dependent on IT and as a consequence they require an appreciation for and a basic understanding of the risks and constraints of IT at all levels within the enterprise in order to achieve effective direction and adequate controls. A modern day's management has to take frequent decisions such as, what and how much to invest for security and control in IT and how to balance risk and control investment in an often unpredictable IT environment. It is pertinent to note that while information systems security and control help manage risks, they do not eliminate them. Moreover, the exact level of risk can never be ascertained with reasonable certainty as there always remains certain degree of uncertainty which can not be mitigated by any sort of controls and as a consequence, the management must decide on the level of risk it is willing to accept keeping in view the cost required to implement such controls.

COBIT, being a framework of overall IT governance and control, is a solution to such problems.

Required:

a. List down four different audience of COBIT and briefly describe as to how it helps them. **(04)**

b. Briefly explain the key components of COBIT. **(06)**

(b) Almas Grocers is a chain of grocery stores in Lahore. They have been operating for the last 20 years with traditional retailing business model where customer visits, purchases products, pays the bill and leaves. Almas Munir (Almas) is CEO of this grocer chain. He has been facing a lot of issues earlier regarding inventory management, stockouts, customer complaints and overly busy floor operations. Recent shift in business landscape due to pandemic has led Almas to introduce online shopping. This e-commerce platform has opened new horizons for Almas in his business. Almas is now able to understand customer needs in a better way. Inventory management has also improved because sales trend helps the operations manager to plan the inventory accordingly. Product customization has also improved, and customer services has shown remarkable satisfaction for customers. With the website data, Almas can also monitor the customer preferences and stock the goods accordingly. Further, a chat software is provided in the app where customer can directly communicate with customer care officer for any queries. Online buying has also allowed Almas to arrange for such products that were not available in the store otherwise. If customer demands a certain product that is not stocked, Almas instantly arrange it for delivery from the suppliers directly, thereby eliminating the intermediaries. The market reach has also increased because online buying is independent of physical store constraint where only customer visiting the stores can purchase.

Required:
Based on the scenario above, explain how 6 Is of e-marketing may have enhanced the business operations at Almas Grocers. **(08)**

Q.7(a) Arman is an accountant working in public practice and has been assigned to the audit team to do the annual audit of Anzee Bank. Ahmed has a large mortgage loan from Anzee Bank that he has obtained six months ago to buy his new house. Arman has been given a responsibility to audit Anzee Bank. Briefly explain the key stages of resolving ethical threats Arman is facing. **(10)**

(b) Differentiate between social footprint and carbon footprint. Enlist **four** key performance indicators to measure each. **(07)**

(The End)

PAC

Answer:1(a)
PESTEL analysis of the pharmaceutical industry in Ruzania is as follows:
Political
- Business-friendly policies of government.
- Tax holidays as incentive for new investments.
- Subsidized interest rate loans to encourage research and development activities.

Economic
- Increasing rate of inflation.
- Declining consumer disposable income.
- Increasing demand for pharmaceutical products.

Social
- Overall health environment is not conducive.
- Over 25% population of country comprises of children and old age people who are more prone to health issues.
- Interest in healthy life style is getting popularity among youth.

Technological
- Trend of e-commerce is emerging in the country.
- More and more people are using mobile apps and social media for making online orders.
- The key players in pharmaceutical industry have been using social media to market their products and CSR activities.

Environmental / Ecological
- Use of renewable energy.
- Conducting free public health awareness sessions.
- Sponsoring treatment of needy patients.

Legal
- Pharma industry is regulated by Drug Regulatory Framework.

Answer:1(b)
Pharma Limited may capitalize on following opportunities:
- Business friendly practices of a government particularly for pharmaceutical industry mean that CL can enjoy certain privileges such as tax holidays and subsidized interest rate loans.
- Demand for pharmaceutical products has been increasing which would mean that CL can generate high revenue or find easy entry to the existing and new markets.

The following threats may impact Pharma Limited:
- Increasing rate of inflation and declining consumer disposable income may result in price pressure or low profit margins.
- Incentives of government may result in more competition as new entrants would find it easy to enter and compete in the market.

Answer:2(a)
Intended Strategy: Intended strategy is a strategy that is planned in advance through a formal planning process. The choice of strategy is a conscious decision by senior management.
In the scenario mentioned the plan to launch variant of Iphone 11 in September 2020 is their intended strategy

Emergent Strategy: Emergent strategy is new strategy that develops or 'emerges' without formal approval being given in advance. It is the result of reaction to changes in the environment and might be a response to changes as they occur.

In the scenario, the decision of launching new variant on selected stores and replenishing the inventory in other stores is emergent strategy.

In order to achieve the desired targets of the new strategy, following core competences are highly imperative/significant:

- Availability of skilled labor
- Supplier relationship for consistent supply of raw material
- Enhanced production capacity to make-up the time loss during shutdown
- Customer relationship management

Answer:2(b)
In some cases, management might take the view that they have no real choice of strategy, and that they are 'forced' to adopt a particular strategy. The reasons for having to select an enforced strategy might be that:

A key stakeholder, such as a major shareholder, is insisting on a particular strategy, or every competitor is doing the same thing.

In the scenario, concept of enforced choice **is not valid** for apple as every organization in the world has been equally affected by the pandemic and Apple corporation must also manage their strategies to cope with the changes.

Answer:2(c)
Goals are aims for the entity to achieve, expressed in narrative terms. They are broad intentions. For example, an entity might have the goal of maximising the wealth of its shareholders or the goal of being the world's leading business entity in one or more markets.

Objectives are derived from the goals of an entity and are aims expressed in a form that can be measured and there should be a specific time by which the objectives should be achieved.

For Apple corporation, following are the examples of goals and objectives

Goals	**Objectives**
Increase market share	Achieve 20% growth in the market by the end of 2021
Enhance product development across the world	Launch three new product lines in Asian market by 2022
Increase EPS	Increase share price by 15% in the next fiscal year

Answer: 3
For the application of Lab Technician, following items must be put in newspaper advertisement:

1. Job responsibilities
2. Minimum qualification required
3. Personal qualities required
4. Job starting date
5. Salary package
6. Reporting line
7. Placement region (city)
8. Experience required
9. Any specific training needed

Answer:3(a)
A responsibility of the training manager (or human relations manager) is to analyse training needs, which is stage 1 of the training and development process. This analysis of training needs should be linked to the human resources plan for the organisation, which provides a forecast of the numbers of employees the organisation expects to have through the planning period, and the types of job that they will be doing.

Training needs are the training requirements that ensure that the organisation has an appropriate number of employees with the required level of skill, knowledge and ability to do the jobs in the HR plan.

Shakoor will analyze training needs by comparing:
- the skills, knowledge and abilities that the organisation will require from employees in all its jobs, with
- the skills, knowledge and abilities that the organisation's employees will have if there is no training, and allowing for:
  - the promotion of some employees to more senior positions
  - movements of employees between jobs in the organization
  - staff turnover, as existing employees resign or retire and are replaced
  - changes in the job structure and total employee numbers
  - recruiting employees from outside the organisation, who already have the required skills and abilities.

The **training gap** is the difference between the skills that the work force will have if there is no training and the skills that the organisation expects that it will need.

A responsibility of the training manager is to plan how to eliminate the gap. The training gap therefore identifies the training needs of an organisation. The training needs are detailed in the training needs analysis document, which details all the information that has been gathered.

In addition, there might be some **legal requirements** to provide particular types of training. For example, it might be a legal requirement for employers to give all employees regular training in fire drill and the procedures to follow in the event of a fire in the premises. Similarly, there might be a legal requirement for banks to give employees training in anti-money laundering procedures.

Answer:3(b)
Shakoor may come up with following methods of training and development for his team in T&D plan:

Methods of training
1. **Formal training:** This type of training is provided to enhance the skills of team members in a formal setting such as delivering lectures or talks, group discussions, training films, case studies, role play activities and business games.
2. **On-job training:** Training in the work place is directly related to the work that the trainee will be doing. It helps the individual to acquire technical or practical skills for doing particular jobs. Work place training might be provided by a coach (a skilled and more experienced colleague) or the supervisor.
3. **Induction:** Induction means 'leading in'. An induction training programme might be given to individuals who have just joined an organisation. The purpose of induction is to teach the individual about the organisation and its business operations, and about the work that is done in each division or department of the organisation.

Methods of Development
1. **Job rotation:** Job rotation means moving an individual from one job to another at fairly regular intervals, so that the individual gains familiarity with the work done in each job. For example, a trainee accountant in the accounts department might be given a job for three months or six months in the payables ledger section,

before being moved to the receivables ledger, then to the payroll department, then to the costing department, and so on. Job rotation gives the individual a broad range of experience in the activities of the organisation. This should be useful when he or she is eventually ready for promotion to a more senior position.

2. **Secondment:** An individual might be 'seconded' to work somewhere else for a period of time. Secondments are periods of time spent away from the normal working environment, in another department or as part of a project team. For example, an accountant might be seconded from the accounts department to work with the sales team for a while. Similarly, an accountant might be seconded to join a project team that has been set up to design and implement a new computer system. Individuals benefit from secondments because they gain experience from working with people from different parts of the organisation, or with external consultants.
3. **Mentoring:** An individual might be given a 'mentor'. The mentor provides guidance and assistance to the individual, and may occasionally discuss the individual's work and work problems.

Answer:4

The marketing strategy for LifeX for each of the given 4 P's of the marketing mix is recommended below:

Product

- It is recommended to adopt following marketing strategy for products:
- For premium variant, marketing strategy could be 'product differentiation' i.e. marketing products as different from competitors.
- For economy variant, marketing strategy could be 'cost leadership' i.e. marketing products as low costs when compare to competitors.

Price

- It is recommended to adopt following marketing strategy for price:
- For premium variant targeting high-end customers, marketing strategy could be 'market skimming price' i.e. to charge high prices initially from customers willing to pay premium price because of new or different product.
- For economy variant targeting middle-class and low income customers, marketing strategy could be 'market penetration price' i.e. to charge low prices to win a large share of potential market at the early stage of product life cycle.

Place

It is recommended to adopt following marketing strategy for place:

- LifeX should ensure their presence in all major cities and affluent areas of the country. They should also allow online membership options for the customer who want to save time from hassles

Promotion Strategy

- It is recommended to adopt following marketing strategy for promotion:
- For members, marketing strategy for promotion could be pull strategy i.e. getting end-consumers to want to buy the product through advertisement and sales promotions.

Answer:5

Supply chain is defined is the chain of all activities from raw material procurement to manufacturing to distribution of the product to the end consumer. The supply chain of Speedo Automobile will include the following channels:

- Raw material from suppliers
- Inhouse manufacturing of cars
- Distribution of cars to showroom
- Customers

The firms rely on network sourcing. **Network sourcing** originated in Japan (although is not yet prevalent in the West) and has the following features:

- Network sourcing is founded on a tiered network of small business suppliers
- A small number of relationships exist between each tier which creates a pyramid structure of suppliers within a network.
- An organisation benefits from access to a large number of supplier firms but only needs to service a relationship with firms in the next tier down
- Combines the key benefits of both single sourcing and dual sourcing arrangements
- Risk is shared between supplier and customer – asset investment to support single customers is prevalent
- Outsourcing should be maximised within the network
- Networks demonstrate high degrees of bilateral design (cost/quality collaborations) and supplier innovation
- Network members tend to form long-term relationships founded on co-ordination and mutual trust
- Members of the network are able to focus on strategic issues rather than transactional/operational aspects as activities are better co-ordinated

Answer:6(a)
COBIT is used by those who have the primary responsibilities for business processes and technology; those who depend on technology for relevant and reliable information, aswell as those providing quality, reliability and control of information technology.

Audience of COBIT include:

- Marketing managers
- HR managers
- IT managers
- CEO
- Production managers

Answer:6(b)
COBIT comprises six specific components:

- Management Guidelines;
- Executive Summary;
- Framework;
- Control Objectives;
- Audit Guidelines; and
- Implementation Tool Set.

Management Guidelines
To ensure a successful enterprise, one has to effectively manage the union between business processes and information systems. The Management Guidelines are composed of:

Maturity models, to help determine the stages and expectation levels of control and compare them against industry norms

Critical Success Factors, to identify the most important actions for achieving control over the IT processes

Key Goal Indicators, to define target levels of performance; and Key Performance Indicators, to measure whether an IT control process is meeting its objective.

Executive Summary
Sound business decisions are based on timely, relevant and concise information. Specifically designed for time pressed senior executives and managers, COBIT includes an executive overview which provides thorough awareness and understanding of COBIT's key concepts and principles. Also included is a synopsis of the Framework providing a more detailed understanding of the concepts and principles, while identifying COBIT's four domains (Planning & Organisation, Acquisition & Implementation, Delivery and Support, and Monitoring) and 34 IT processes.

Framework
A successful organisation is built on a solid framework of data and information. The Framework explains how IT processes deliver the information that the business requires to achieve its objectives. This delivery is controlled through 34 high-level control objectives, one for each IT process, contained in the four domains. The Framework identifies which of the seven information criteria (effectiveness, efficiency, confidentiality, integrity, availability, compliance and reliability), as well as which IT resources (people, applications, technology, facilities and data) are important for the IT processes to fully support the business objective.

Control Objectives
The key to maintaining profitability in a technologically changing environment is how well control is maintained. COBIT's Control Objectives provide the critical insight needed to delineate a clear policy and good practice for Information Technology controls. Included are the statements of desired results or purposes to be achieved by implementing the specific and detailed control objectives throughout the 34 Information Technology processes.

Audit Guidelines
To achieve desired goals and objectives one has to constantly and consistently audit one's procedures. Audit Guidelines outline and suggest actual activities to be performed corresponding to each of the 34 high level IT control objectives, while substantiating the risk of control objectives not being met. Audit Guidelines are an invaluable tool for information system auditors in providing management assurance and/ or advice for improvement.

Implementation Tool Set
Implementation Tool Set contains:
- Management Awareness and IT Control Diagnostics;
- Implementation Guide FAQs;
- Case studies from organisations currently using COBIT; and
- Slide presentations that can be used to introduce COBIT into organisations.

The Tool Set is designed to facilitate the implementation of COBIT, relate lessons learned from organisations that quickly and successfully applied COBIT in their work environments, and lead management to ask about each COBIT process: Is this domain important for our business objectives? Is it well performed? Who does it and who is accountable? Are the processes and control formalised?

Answer:6(b)
Business of Almas Grocer has been enhanced by the use of 6Is in following ways:

Interactivity
A website is a pull medium. The interaction of the company with customers has increased. When customers visit the website, they can get in contact with the company's representative to enquire about any particular product or any ongoing promotion. Almas Grocers can benefit from:
- getting visitors to the site to provide details about themselves (and agree to receive e-mails from the website owner in the future), perhaps in exchange for additional information or a free service

- getting visitors to buy a product or service and pay for it using the internet. Having obtained the e-mail address of an individual, opportunities exist for the continuation of the dialogue in the future, through e-mail marketing messages and information updates'. This connection with the customer helps to establish a long-term relationship, which companies can try to benefit from.

Intelligence
The internet can be used as a relatively low-cost method of collecting market research data and data about customers and other visitors to a website. This data can be analysed to produce marketing information about what customers buy, and what information on a website interests them most.'Clickstream analysis' of data on a website log file can be used to build up a picture of customer preferences, and possibly also to identify different market segments.

Individualization
In traditional media the same message tends to be broadcast to everyone. Communication via the internet can sometimes be tailored or 'personalised' to the individual. For example, the activities of every customer who visits a site can be recorded and whenever a customer next visits the site, relevant information will be retrieved from the data files and used to produce an individualised message. (In contrast, advertising messages in media such as television are 'one-to-many' messages, and the same marketing message is sent to every potential customer.)

Integration
The internet provides scope for integrated marketing communications: how can the internet complement other marketing channels to deliver customer service? Many companies are now considering how they integrate e-mail response and website call-back into their existing call-centre or customer service operation. This may require a substantial investment in training and new software.

Industry restructuring
The internet can lead to a re-structuring of the industry supply chain. Disintermediation is the removal of intermediaries such as distributors or agents: this occurs for example when a company starts selling directly to end-consumers through its website, and reduces or abandons its use of sales agents, distributors and sales representatives. Examples include online banks and online newspapers.

In other markets there has been re-intermediation, where new intermediary companies sell the products of other suppliers, when the suppliers had previously sold direct to customers. An example is the use of intermediaries such as lastminute.com to sell holidays, travel arrangements, book hotel accommodation and buy theatre tickets and tickets to other entertainment events.

Independence of location
The internet introduces the possibility of increasing the impact of an entity on a global market. Users of a website cannot easily tell from the website whether it is owned by a small local company or a large multinational or global company. This gives small companies opportunities to sell into global markets.

Answer:7(a)
Step 1:
The first step is to identify the ethical issue. Arman is being asked to conduct audit of a bank that has given him mortgage loan for his new house.

Step 2:
Consider the threat that this creates for Arman compliance with the fundamental ethical principles. In this case, self-interest threat is the major ethical threat that may affect Arman's objectivity in the task assigned.

Step 3:
Arman needs to consider the significance of the threat to his compliance with the fundamental principles. The significance of the threat will depend upon the amount of loan Arman has acquired from the bank.

Step 4:
Arman should therefore consider safeguards to the ethical threat and find a solution to your problem.

The first step should be to discuss the ethical problem with Aman's boss. If the employer is sympathetic to ethical issues he/she likely to agree that Arman should not be asked to be the part of the team that applies to do the work. Another colleague should be appointed in his preplacement

Answer:7(b)
Social footprint

A social footprint is the effect of economic activity on society and people. In general, economic activity is seen as providing benefits for society, although some companies are much more 'people-friendly' than others. Some companies, for example, use child labour and/or pay subsistence-level wages to their workers.

Key performance indicators:
- Total numbers employed or increase in the total number of employees
- The proportion of the total work force employed in different parts of the world
- The proportion of the total work force that is female or from different ethnic groups
- Health and safety at work (for example, numbers of employees injured each year per 1,000 of the work force).

Carbon footprint
A **carbon footprint** is the total greenhouse gas (GHG) emissions caused by an individual, event, organization, service, place or product, expressed as carbon dioxide equivalent. Greenhouse gases, including the carbon-containing gases carbon dioxide and methane, can be emitted through the burning of fossil fuels, land clearance and the production and consumption of food, manufactured goods, materials, wood, roads, buildings, transportation and other services.

Key performance indicators:
- the amount of raw materials that it uses to make its products or services, where the raw materials are subject to depletion
- non-renewable resources that it uses to make its products or services
- the quantity of wastes and emissions that it creates in the process.
- 'green' procurement policies

(The End)

The Professionals' Academy of Commerce
Pakistan's Leading Accountancy Institute

Certified Finance and Accounting Professional Stage Mock Examinations

25 May, 2021
3 hours – 100 marks
Additional reading time - 15 minutes

Business Finance Decisions

Q.1 Loads Ltd, a listed company based in Pakistan, has been involved in manufacturing motor vehicle parts for many years.

Company has spent Rs 5m developing prototypes of the new component of Sports engine. The research studies came to the conclusion that the component will have a significant commercial potential in USA for a period of five years. Company will sell these parts to leading Motor bike manufactures of USA.

It is estimated that in the first year, the selling price would be $ 1,000 per component, the variable costs would be Rs 60000 per component and the total direct fixed costs would be Rs 15 million. Thereafter, while the selling price is expected to increase by 8% per year, the variable and fixed costs are expected to increase by 5% per year, for the next four years. Training and development costs are expected to be 120% of the variable costs in the first year, 40% in the second year and 10% in each of the following three years.

The estimated average number of engine components produced and sold in year 1 is 1400 units it will increase by 10% for next two years and then 5% for remaining years.

Machinery costing Rs 300,000,000 will need to be installed prior to commencement of the component production. Tax allowable depreciation is available on the machinery at 40% initial depreciation and 10% normal depreciation on reducing balance basis. It can be assumed that, the machinery is expected to be sold for Rs 40,000,000. Loads ltd makes sufficient profits from its other activities to take advantage of any tax loss relief available from this project.

Initially, loads Ltd will require additional working capital for the project of 20% of the first year's sales revenue. Thereafter every Rs 1 increase in sales revenue will require a 10% increase in working capital.
LOAD'S CO shares have a face value of Rs 10 per share and are currently trading at Rs 350 per share. LOAD'S CO's beta has been quoted at approximately 1.3 over the past year.

Current Spot Exchange rate 150 Rs/$. General inflation in USA is 4% and 8% in Pakistan.

Tax rate is 28%, It can be assumed that tax is payable in the same year as the profits on which it is charged.

Estimated risk-free rate of return	7%
Historic equity market risk premium	8%

Above estimates are according to the marketing Directors and it ignore the possibility of a Covid-19 third wave, which has a 40% probability of occurring. In third wave of Covid-19, the total present values for the five years of production are likely to be 40% lower. The finance director also believes that if USA market goes under lock down there are alternatives, to sell the product in some European markets depending upon regulatory approval from European union This alternative option would incur an investment cost of Rs 150m to regulatory license but generate annual, inflation adjusted, post-tax cash flows of Rs 55.3m over its Ten-year life from year two onwards.

Required:

(i) Assess whether Load should undertake the project of developing and commercializing the innovative engine component without considering Marketing Directors concern and impact on NPV after considering Marketing directors' concern. Show all relevant calculations. **(12)**

(ii) Calculate the net present value of the finance director's alternative option for European market and advise the board whether this is worth pursuing. **(03)**

(iii) Discuss the approaches taken and assumptions made for the above parts and discuss the possible decision taken by management.

(05)

Q.2 Buland Co is a very successful entity and listed on Pakistan stock exchange. Company has progressed over the period using inorganic growth and normally buys undervalued poorly managed companies. Buland has maintained its price earnings (P/E) ratio on the stock marketat 15.5. Shareholders of company has trust over the management decisions of Company.

Buland's 2021 figures show a profit after tax of Rs 886m and it has 375m shares inissue. If Buland co able to acquire the Venis co it will generate pretax synergy of Rs 120m on per year basis. Co will also generate cash-based savings of 200m for next three years if merger goes successful. One off redundancy cost is Rs 20m.

Venis Pvt is a well-established owner-managed business. Over the past five years, its profits have fallen each year with the2021 values standing at:

	Venis	**Buland**
	Rs m	Rs m
Revenue	1500	3731
Operating Profit	480	1306
Interest	(137)	(125)
Profit before tax	343	1181
Tax @ 25%	(86)	(295)
Profit after tax	257	886
Shares	150	375
Long term loan	913	1566
Cash & cash equivalent	140	320

Company can further borrow at 11% and after-tax return on cash is 7.5%

However, with economists predicting an upturn in the economy, Venis's management team feel that revenue will increase by 7% per annum up to and including year 2025.The company's operating profit margin is not expected to change for the foreseeable future.

Operating profits are shown after deducting non-cash expenses (including tax allowable depreciation) of Rs 125m. This is expected to increase in line with sales. However, the company has recently spent Rs 210m on purchase of non-current assets. Venis's management believes this value will have to increase by 10% per annum until 2025 to enable the company to remain competitive. Venis has estimated its overall cost of capital to be approximately 12%, but this assumes it will maintain its debt-to-equity ratioat 40:60.

Some of Venis's major shareholders are not so confident about the future and would like to sell the business as a going concern. The minimum price they would consider would be the fair value of the shares, plus a 27% premium in case of share for share exchange and 15% premium in case of Cash offer. Venis's CFO believes the best way to find the fair value of the shares is to discount the forecasted free cash flows of the firm, assuming that beyond 2025 these will grow at half of original growth per annum indefinitely.

Required:

1. Prepare a schedule of Venis's forecast free cash flows for the firm. Ascertain the fair value of the Venis's equity on a per share basis. **(05)**

2. Buland intends to make an offer to Venis based upon a share for share swap. Assuming that Buland can maintain its earnings rating at 15.5, calculate the percentage gain in equity value that will earned by both groups of shareholders and how many shares should be offered by Buland co to Venis co in Share exchange? **(05)**

3. Calculate Earnings per share, Gearing and funds required by company both in share for share and Cash offer. **(05)**

4. What factors should the Venis shareholders consider before deciding whether to accept or reject the offer made by Buland? **(05)**

Q.3 Kabir Co is a nationwide chain of grocery store and currently has 25 million Rs 10 shares in issue, with a current share price of Rs 5·56 per share. It also has 0·45 million six monthly 6·5% bonds in issue. Each 6·5% bond has a nominal value of Rs 100, and is currently trading at Rs 104 per Rs 100. The premium on redemption of the bonds in three years' time is 4%.

Kabir Co's quoted equity beta for its existing garden center business is 0·9.

Kabir Co plans to issue 0·06 million, 7·5%, new TFCs, each with a nominal value of Rs1000. These certificates will be redeemable in Three years' time at a premium of 8%. The coupon on these bonds will be payable on an annual basis. These bonds are anticipated to have a credit rating of BB–. The issue of the new

7·5% bonds will not affect the market value of Kabir Co's shares or the existing 6·5% bonds.

The market value of the new bonds will be determined by using information relating to Kabir Co's credit rating and the four bonds which the government has issued to estimate Kabir Co's yield curve. All the bonds are of the same risk class. Details of the bonds are as follows:

Bond	Annual yield(based on spot rate)	Redeemable in
A	3.5%	1 year
B	4·1%	2 years
C	4·7%	3 years

Credit spreads, shown in basis points, are as follows:

Rating	1 year	2 years	3 years
BB–	66	88	126

Kabir Co plans to invest Rs 60m in non-current assets for the Food shops. Currently, Kabir Co's non-current assets have a net book value of Rs150m. It is assumed that the proportion of the book value of non-current assets which will be invested in the Food shops and the grocery stores will give a fair representation of the size of each business within Kabir Co. The asset beta of similar companies in the Food sector is assumed to be 0·88.

The corporation tax rate applicable to all companies is 28% per year. The current risk-free rate of return is estimated to be 4% and the market risk premium is estimated to be 9%.

Required:

a) Estimates the company's cost of capital before the new bonds are issued and revised cost of equity and revised cost of capital if the new bonds are issued; **(10)**

b) Discuss the circumstances under which it is appropriate to use the current WACC of Kabir Co in appraising an investment project. **(04)**

c) Discuss the problems estimating the appropriate data inputs for using the capital asset pricing model in investment appraisal. **(06)**

Q.4(a) CTC is a Pakistan based Multinational Co having operations in USA, Europe, Dubai and Malaysia. Company has transactions historically in all currencies of the countries in which it has operations. Following transactions are due in four months' time with four different companies and CTC is planning to hedge these transactions with different available hedging instruments.

	Receipts from	Payment to
Company 1	USD 1,150,000	EUR 425,000
Company 2	EUR 525,000	AED 450,000
Company 3	MR 250,000	EUR 100,000
Company 4	Rs 1,450,000	MR 450,000

Exchange Rates

SPOT rates		Forward	
PKR/USD	150.50-150.60	4-month premium	2.70-2.80
USD/EUR	1.2060-1.2070	4-month Premium	0.0020-0.0025
AED/USD	3.67		
MR/USD	4.30-4.50	4-month Discount	0.20-0.30

*AED is pegged against USD.

Currency options

USD traded currency options have a contract size of USD 100,000 and are priced on 1 July 2021 [premiums are quoted in PKR/USD] as follows:

Strike Price	September contact		December Contract	
RS/USD	Call Option	Put option	Call option	Put option
155	1.4	2.2	2.1	3.2

Required:

Advise which hedging option CTC should adopt if expected spot rate after four months is PKR/USD 153.20-153.30 **(13)**

(b) CTC Co plans to borrow an amount of Rs 48m on 1 December, to finance a major construction project, for a period of up to three years. Its treasury department has decided to hedge the risk associated with this borrowing, as there is some uncertainty about how interest rates will move over the rest of this year. The current central bank base rate is 6·7%, but predictions in the media suggest that it could rise or fall by 0·8% by 1 December

Discuss the advantages and drawbacks for CTC Co of interest rate swaps compared with Interest rate future and forward rate agreement. **(07)**

Q.5 Oscar Co designs and produces tracking devices. The recent financial information of company is as follows.

	Rs M
Sales (15% cash sales)	2,800
Cost of sales (20% fixed)	2,100
Trade Receivables	584
Inventory	332.50
Bad debt	2% of sales

Its major customers are large multinational car manufacturing companies and are often late in paying their invoices. Oscar Co has focused on product development and customer service, and managing trade receivables has been neglected. Partly as a result of poor credit control, the company has suffered a shortage of cash and has recently reached its overdraft limit. Company has the following options now to manage this liquidity issue

Option 1
Factor will manage Oscar Co's invoicing, sales accounting and receivables collection, on a full recourse basis or non-recourse basis

Under both arrangements, the average trade receivables collection period would be 60 days.

	With Recourse	**Non-Recourse**
Factor Fee	0.5%	1.5%
Bad debt	1.5%	1.75%
Advance	80%	70%
Factor interest	Kibor +200 basis	Kibor plus 250 basis

Company is confident that due to allocation of receivable department to factor company has managed to get enough time to focus on marketing and confident that credit sales will increase by 10%.

Option 2
Offer early payment discount of 1% to all debtors who would make the payment within 30 days and 3% off to those who pay within 10 days.

Under this option, it is estimated that:

- Credit sales will be increased by 5% and cash sales will decrease by 10%
- 40% of the customers will pay within 10 days and 30% will avail early payment discount of within 30 days.
- Average debtor days will be 31.

Company will impose 5% penalty on all debtors having outstanding days over 50.

- Bad debts will be reduced to 1 % of the credit sales.

Although there is increase in sales, however in this option co will reduce the inventory days by 15 days by managing the inventory efficiently.

Company normal borrowing cost is Kibor Plus 35 basis from a local bank and Kibor is 7%.

Required:
Calculate the costs and benefits of each of Option 1 and Option 2 and comment on your findings. **(14)**

Discuss reasons (other than costs and benefits already calculated) why Oscar Co may benefit from the services offered by the factoring company. **(06)**

(The End)

Answer: 1							
part a							
'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	Marks
Years	0	1	2	3	4	5	
Sales revenue Rs (000)	-	218,077	269,040	331,912	390,865	460,289	2
Vaibale cost	-	84,000	97,020	112,058	123,544	136,207	1
Fixed cost @ 5% inflation		15,000	15,750	16,538	17,364	18,233	0.50
Training cost		100,800	38,808	11,206			0.50
Depreciation	-	138,000	16,200	14,580	13,122	11,810	1
Capital loss						26,288	1
Taxable profit		(119,723)	101,262	177,531	236,835	267,751	
Tax @ 28%		33,522	(28,353)	(49,709)	(66,314)	(74,970)	1
Depreciation	-	138,000	16,200	14,580	13,122	11,810	
Capital loss						26,288	
working capital	(43,615)	(5,096)	(6,287)	(5,895)	(6,942)	67,837	1
Investment	(300,000)					80,000	
Net cashflows	(343,615)	46,703	82,821	136,507	176,701	378,715	
17.40%	1	0.852	0.726	0.618	0.526	0.448	
PV	-343615.38	39781.17	60090.47	84362.74	93017.71	169813.50	
NPV	103450.21						1
Workings							
'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	
Years	0	1	2	3	4	5	
Units sold		1400	1540	1694	1778.7	1867.635	
selling price		1000	1080	1166.4	1259.712	1360.489	
$ sales revenue ($ 000)		1400	1663.2	1975.8816	2240.6497	2540.8968	
Exchange rate	150	155.77	161.76	167.98	174.44	181.15209	
Sales revenue Rs (000)		218,077	269,040	331,912	390,865	460,289	
Variable cost/unit		60000	63000	66150	69457.5	72930.375	
Vaibale cost		84000	97020	112058.1	123544.06	136207.32	
Investment	300000						
Scrap value						80000	
Depreciation		120000					
		18000	16200	14580	13122	11809.8	
Depreciation		138000	16200	14580	13122	11809.8	
Capital loss						26288.2	
working capital	(43,615.38)	(5,096.29)	(6,287.25)	(5,895.27)	(6,942.37)	67,836.57	

(i)

Ke	17.400%						
Rf	7%						
beta	1.3						
Rm	8%						
Probability of third wave	40%						
Pv of cashflows @ 60%	268,239.36						1
Probabilty of no third wave	60%						
Pv of cashflows	447,066						1
Excpected Pv	375,535.10						
NPV	31,919.71						1
part b	Rs m						
Annual Cashflows	55.30						
Annuity factor @ 17.4%	3.91						
Pv of cashflows	216.28						
Investment	150.00						
NPV Rs m	66.28						3

(ii) Discuss the approaches taken and assumptions made for the above parts and discuss the possible decision taken by management. **(5 marks)** **(Total 20 marks)**

Based on the marketing assumptions, the project generates a positive NPV of Rs 103.45 million and should therefore be accepted in preference to the other options. On the other hand, when probable third wave estimation incorporated into the appraisal, the expected NPV is only Rs 31·9 million and should therefore be rejected in favour of the option to sell. It should be noted that the expected NPV of Rs 31·9 million is an average. In other words, it is the average NPV if the project is carried out repeatedly which may not be useful in the case of a one-off development opportunity. Based on the calculations above, there is a 40% chance of third wave and if that happened NPV will be negative which may pose a risk the directors are not prepared to take. The directors' attitude to risk will be an important factor in the final decision. Furthermore, the analysis largely depends upon the values of the probabilities prescribed, the range of possible outcomes and the accuracy of the revenue and cost assumptions. Sensitivity analysis may be useful in testing the impact of variations in each of these variables on the final outcome.

In this estimate ,number of assumptions have been taken, for example growth in sales volume and inflation and tax will remain constant for the 5 year period. Project life is five year and at the end of fifth year project will be ended.in evaluation of part a it is assumed that there will be smooth operations and there will be no possibility of Covid.

Business Finance Decisions

Certificate in Accounting and Finance – Mock Summer 2021

Suggested Answers

Answer: 2							
Part a							
'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"	'Rs 000"			Marks
Year	**1**	**2**	**3**	**4**	5 onwards		
Sales	1605.00	1717.35	1837.56	1966.19			1
PBIT @32%	513.60	549.55	588.02	629.18			1
Tax @ 25%	-128.40	-137.39	-147.01	-157.30			
Depreciation	133.75	143.11	153.13	163.85			
Capex	-231.00	-254.10	-279.51	-307.46			1
Net Cashflows	287.95	301.18	314.64	328.28	4132.40		
Wacc @ 12%	0.89	0.80	0.71	0.64	0.64		
PV	257.10	240.10	223.95	208.62	2626.22		
MV of Business	3555.99						
Mv of Equity	2133.59						1
shares	150						
MV/share	14.22395						1
working							
profit margin	0.32	480/1500					
sales	1500						
PBIT	480						
Part b	Rs m	Marks					
Combine MV							
Combine earnings	1233	1					
earnings of Buland co	886						
earnings of Venis co	257						
after tax saynergy	90						
Group P/E ratio	15.5						
Combine mv	19111.5	0.5					
Pv of after tax cash based synergy	390.0789	0.5					
After tax redundancy	-15	0.5					
Overall combine value	19486.58	0.5					

Business Finance Decisions

Certificate in Accounting and Finance – Mock Summer 2021

Suggested Answers

Part B

	Pre -Acq Vlaue				**Psot -Acq Value**			
Companies	**Shares**	**Mv/share**	**Total MV**	**Shares**	**Mv/share**	**Total MV**	**Gain**	**%**
Buland co	375	36.62	13733	375.00	44.74	16776.92	3043.92	22%
Venis	150	14.22	2133.592427	60.57	44.74	2709.66	576.07	27%
				435.57		19486.58		
				Share Exchange ratio	0.40		2 marks	

Part C

	Current	Share offer		Cash offer	
Funds Required		Nil	current value of venis	2133.592427	1 Mark
			Premium	320.038864	
			Cash required	2453.631291	
			Cash & cash equivalent	460	
			Net cash required	1993.631291	

Part D

	Rs m					
Earnings	886	Combine earnings	1233	Combine earnings	1233.00	
Share	375			increase in interest	164.47	
				1993.63*11%*0.75		
				Decrease in return on cash	34.50	
				(120+320)*7.5%		
				Net earnings	1034.03	
Shares	375		435.5667552		375	
EPS	**2.362666667**		**2.83**		**2.76**	2 marks
Gearing						
Equity Value	13733		19486.57886	w	16402.47285	
Debt	1566	1566+913	2479	1566+913+1993.63	4472.631291	
Debt/Debt+equity	10.24%		11.29%		21.43%	2 marks
Working						
Group P/E ratio	15.5					
Combine mv	16027.39399	1034.03*15.5				
Pv of after tax cash based synergy	390.078861					
After tax redundancy	-15					
Overall combine value	16402.47285					

What factors should the Venis shareholders consider before deciding whether to accept or reject the offer made by Buland?

(D) Factors to considers for Venis share holders

- Venis shareholders wanted a gain of at least 27% on the fair value of the shares. Based upon the figures, they are gaining nearly 27%, if they get 4 new shares for every ten existing shares and 17% in case of cash offer
- The share for share exchange may be beneficial for tax planning. Any capital gain earned on the sale of the shares will be rolled over until the gain is realized in cash.
- Venis may decide to reject this bid believing that Buland will make a more lucrative offer in the future.
- The fair value of the Venis shares has been based upon forecasts and estimates. Some sensitivity analysis needs to be carried out to ensure the value is robust.
- There is no guarantee that Buland can maintain its P/E ratio at 15.5. There may well be an element of dilution given the much lower P/E of Venis. Hence, the post-acquisition value is then uncertain.
- Not all Venis shareholders want to sell the company. The constitution of the company may allow the takeover to be blocked unless a certain percentage majority of the shareholders agree.
- Venis shareholders may also feel that as the economic conditions are improving, their business prospects and value will get better. They may reject Buland's approach and stay as an independent company.

Answer: 3					
Part a					
Current COST of CAPITAL					
Rf	4%	Mv of equity	139	Mv of bonds	45
Market premium	9%	shares	25	bonds	0.45
Beta	0.9	Mv/share	5.56	Mv/bond	100
Ke 4%+0.9*9%	12.100%				
	Cost	MV	WACC		
KE	12.100%	139	16.819		
Kd	4.68%	45	2.106		
		184	18.925		
		WACC	10.29%	1 mark	
calculation of KE	1 mark				
calculation of total mv of euity	1 mark				
calculation of total mv of debt	1 mark				
calculation of WACC	1 mark				
Revised COST of CAPITAL					
MV of new Bond					
Years	1	2	3		
Cash flows	75	75	1155		
Discount rates	0.96	0.91	0.84		
PV	72.00	68.05	970.86		
MV	1110.92				
Total MV	66.66				
New KD					
Year	Cash flows	5%	PV	3%	PV
0	-1110.92	1.00	-1110.92	1.00	-1110.92
1 to 3	54.00	2.72	147.06	2.83	152.75
3	1080.00	0.86	932.94	0.92	988.35
			-30.92		30.18
Kd	3.99%				

Ungear the current Be of grocery shops	0.730				
current Be	0.9				
Mv of equity	139				
Mv of debt	45				
Ba of food shops	0.88				
Asset value of food shops Rs m	60				
Asset value of Grocerry shops Rs m	150				
Weighted avergae Ba	0.77				
Regear it with current gearing					
Equity	139				
old debt	45				
New debt	66.66				
Total Debt	111.66				
Be	1.220				
	cost	MV	WACC		
Revised KE	14.98%	139.00	20.82		
Old Kd	4.68%	45.00	2.11		
New Kd	3.99%	66.66	2.66		
		250.66	25.58		
		WACC	10.21%		
Calculation of mv of new debt	2				
Calculation of kd of new debt	1				
calculation of new average beta	2				
Calculation of new WACC	1				

- Discuss the circumstances under which it is appropriate to use the current WACC of Kabir Co in appraising an investment project.**(4 marks)**

The current WACC of Kabir Co represents the mean return required by the company's investors, given the current levels of business risk and financial risk faced by the company. The current WACC can be used as the discount rate in appraising an investment project of the company provided that undertaking the investment project does not change the current levels of business risk and financial risk faced by the company. The current WACC can therefore be used as the discount rate in appraising an investment project of Kabir Co in the same business area as current operations, for example, an expansion of current business, as business risk is likely to be unchanged in these circumstances. Similarly, the current WACC can be used as the discount rate in appraising an investment project of Kabir Co if the project is financed in a way that mirrors the current capital structure of the company, as financial risk is then likely to be unchanged. The required return of the company's investors is likely to change if the investment project is large compared to the size of the company, so the WACC is likely to be an appropriate discount rate providing the investment is small in size relative to Kabir Co.

- Discuss the problems estimating the appropriate data inputs for using the capital asset pricing model in investment appraisal. **(6 marks)(20 marks)**

Practical problems estimating data inputs for the CAPM The CAPM is an ex-ante model.

It is difficult, if not impossible, to forecast accurate future returns of the company, project, or market. For practical purposes, ex-post data is normally used in the CAPM. Even if the use of ex-post data is considered to be acceptable, it is difficult to estimate the appropriate data inputs:

Rf – What is the appropriate risk-free rate? A short-term government bill? A long term government stock?

Rm – What is the market return? Do returns on companies comprising the PSX All Share Index (or similar 100 share index) provide a satisfactory estimate of returns on the market as a whole?

Beta – The use of an historical beta assumes that future risk is the same as past risk. Evidence for individual companies suggests that this is not the case. Timescales – Over what period should historic data be considered? How frequently should returns be calculated?

Answer: 4						
Part a						
	Receipts	Payment	Pegged amount	Net Receipts/payments		
USD	1,150,000		115,804	1,034,196		
EUR	525,000	425,000		-		
		100,000				
MR	250,000	450,000		200,000		
AED is pegged against USD			450000/3.67			
Note: whenever two currencies are pegged, convert minor cuurency into major current and hedge it						Marks
USD Receipts		1,034,196				2
MR payments		200,000				1
Forward						
USD Receipts			**MR Payments**	RS/USD	MR/USD	
spot rate RS/USD	150.5		Spot rate	150.50-150.60	4.30-4.50	
4 month premium	2.7		4 month	2.7-2.8	0.2-0.3	
4 monthforward	153.2		premium/Discount			
			4 month forward	153.20-153.40	4.1-4.2	
Expected receipts	158,438,856	1 mark		153.20/4.2	153.40/4.1	
1,034,196*153.20			Rs/MR	36.48	37.41	
			Expected Payments	7,482,000		
			200,000*37.41			2
Options						
Fcy	USD 1,034,196					
Option	Put option @ 155 Rs/USD					1
Settlement	Dec Contract					
No of contracts	10.34196	10 contracts				1
Premium RS	3200000					1
10*USD 100000*3.2 PKR/USD						
Decide to exercise the option or not						
	Rs/USD					
Strike rate	155					
Closing Spot	153.2					
Gain	1,800,000.00	(155-153.2) x 10 x 100,000				2
Actual selling at Market rate	158,438,827	1,034,196*153.2				
Gain on Option	1,800,000					
Premium Cost	3,200,000					
Expected Receipts	157,038,827					2

(b) CTC Co plans to borrow an amount of Rs 48m on 1 December, to finance a major construction project, for a period of up to three years. Its treasury department has decided to hedge the risk associated with this borrowing, as there is some uncertainty about how interest rates will move over the rest of this year. The current central bank base rate is 6·7%, but predictions in the media suggest that it could rise or fall by 0·8% by 1 December

Discuss the advantages and drawbacks for CTC Co of interest rate swaps compared with Interest rate future and forward rate agreement. (07)

Advantages of swaps

As swaps are over-the counter arrangements, they can be arranged in any size. The Interest rate future and Forward rate agreement available may last for a short period, perhaps up to one years, less than the period of the loan. Swaps can be arranged for a much longer period. IF CTC Co swapped here a commitment to pay a variable rate of interest that is uncertain with a guaranteed fixed rate of interest. This allows CTC Co to forecast finance costs on the loan with certainty. CTC co can also arrange swap in such a way to reduce its normal interest rate if there would be no swap which is not possible in other hedging techniques. CTC Co can borrow in the market where the best deal is available to it.

Disadvantages of swaps

Swaps are subject to counterparty risk, the risk that the other party may default on the arrangement. This should not generally be a problem if CTC Co arranges the swap through the bank. It may, however, be a problem if it arranges the swap itself. There will be no counter party or default risk in future contracts because of margin requirements. As swaps are over-the-counter instruments, they cannot be traded or allowed to lapse if they are not needed. The Future contracts can be traded on a derivative market

Question 5

(a) Calculate the costs and benefits of each of Option 1 and Option 2 and comment on your findings. **(14)**

Answer: 5						
	Current		Option 1		Option 2	
			With Recourse	Without recourse	Discount	
Cost of debtors	-42.92	Cost of debtors	-31.416	-29.02	Cost of debtors	-15.82
584*(7%+0.35%)		2618*80%*60/360*(7%+2%)			2499*31/360*7.35%	
Bad debt	-47.6	2618*70%*60/360*(7%+2.5%)				
2380*2%		Cost of remaining debtors	-6.4141	-9.62		
		2618*20%*60/360*(7%+0.35%)				
		2618*30%*60/360*(7%+0.35%)				
		Bad debt	-45.815	-	Bad debt	-24.99
		2618*1.75%			2499*1%	
		Factor fee	-13.09	-39.27	Discount Allowed	
		2618*0.5%			2499*40%*3%	-29.99
		2618*1.5%			2499*30%*1%	-7.50
		Increase in contribution	95.2	95.20		6.43
		(2618-2380)*0.4				
					interest savings on reduction of inventory days	
					2100*15/360*7.35%	
					Penality	20.83
					2499*60/360*5%	
					increase in contribution	30.80
					(2877-2800)*40%	
Net Benefit/(cost)	**-90.52**	**Net Benefit/(cost)**	**-1.54**	**17.29**		**-20.24**

		Option without recource is best					
working		**Workings**				Current sales	Proposed sale
Credit sales	2380		increase in sale	2618	Total Sales	2800	2877
					Credit sales @ 85%	2380	2499
sales	2800				Cash sales @ 15%	420	378
Variable cost of sale	1680						
Contriubution	1120					%	days
contribution %	0.4				Average days		31
					paying within 10 days	40%	10
					paying within 30 days	30%	30
Current option	Marks				remaining days	30%	X
Cost of debtor	1					31=(10*40%+30*30%+>	60
Bad debt	1						
Option with recource							
Cost of debtor	1						
Bad debt	1						
fee	0.5						
contribution	1						
Option without recource							
Cost of debtor	1						
fee	0.5						
contribution	1						
Discount option							
Cost of debtor	1						
Bad debt	1						
contribution	1						
Discount cost	1						
Panality cost	1						
Interest savings on inventory days	1						

Page 2

(b) Discuss reasons (other than costs and benefits already calculated) why Oscar Co may benefit from the services offered by the factoring company. **(06)**

Oscar Co may benefit from the services offered by the factoring company for a number of different reasons, as follows:

Economies of specialization
Factors specialize in trade receivables management and therefore can offer 'economies of specialisation'. They are experts at getting customers to pay promptly and may be able to achieve payment periods and bad debt levels which clients could not achieve themselves. The factor may be able to persuade the large multinational companies which Oscar Co supplies to pay on time.

Scale economies
In addition, because of the scale of their operations, factors are often able to do this more cheaply than clients such as Oscar Co could do on their own. Factor fees, even after allowing for the factor's profit margin, can be less than the clients' own receivables administration cost.

Free up management time
Factoring can free up management time and allow them to focus on more important tasks. This could be a major benefit for Oscar Co, where directors are currently spending a large amount of time attempting to persuade customers to pay on time.

Bad debts insurance
The insurance against bad debts shields clients from non-payment by customers; although this comes at a cost, it can be particularly attractive to small companies who may not be able to stand the financial shock of a large bad debt. This could well be the case for Oscar Co. As a small company which supplies much larger car manufacturing companies, it is particularly exposed to default by customers. On the other hand, it could be argued that large multinational companies are financially secure and default is unlikely, rendering bad debt insurance unnecessary.

Accelerate cash inflow
Factor finance can be useful to companies who have exhausted other sources of finance. This could be useful to Oscar Co if it cannot negotiate an increase in its overdraft limit.

Finance through growth
Although factor finance is generally more expensive than a bank overdraft, the funding level is linked to the company's volume of sales. This can help to finance expansion and protects the company against overtrading. In a rapid growth company such as Oscar Co, this could be a major advantage of factor finance.

(The End)

The Professionals' Academy of Commerce
Pakistan's Leading Accountancy Institute

Certified Finance and Accounting Professional Stage Mock Examinations
29 May, 2021
3 hours – 100 marks
Additional reading time - 15 minutes

Advanced Taxation

Q.1 Babar Azam Limited (BAL) is a listed company engaged in the business of manufacturing and supply of multiple products across the country. Following information has been extracted from BAL's records for the year ended 30 September 2020.

Particulars	"Rupees"
Gross Sales	160,000,000
Cost of sales	(112,000,000)
Gross profit	48,000,000
Administrative and selling expenses	(20,000,000)
Financial and other charges	(5,000,000)
Other income	2,000,000
Profit before taxation	25,000,000

Gross Sales includes:

(i). Scrap sales of Rs. 10,000,000 by auction to Fakhar on 31 August 2020. Fakhar is registered under the Income Tax Ordinance, 2001. BAL failed to collect any advance tax.

Cost of sales includes:

(i). Rs. 600,000 for an export quota licence for the period of three years commencing on 1 April 2020. However, no exports were made in the six-month period to 30 September 2020.

(ii). Salary and wages of Rs. 150,000 spent on the repair and maintenance of a car owned by the company. The car is used by the head of production for both personal and business purposes as per the terms of his employment.

(iii). Sales tax payment of Rs. 500,000 and default surcharge of Rs.50,000 thereon. The amount was determined while carrying out sales tax audit of tax year 2017 during the year.

Administrative and selling expenses include:

(i). Rs. 300,000 on account of the write off of a discarded delivery van. This delivery van with a Tax written down value of Rs. 300,000 was discarded during the year following a severe accident on 31 December 2019. The scrap value of this delivery van has been estimated at Rs. 75,000 but it has not been sold yet.

(ii). Rs. 290,000 incurred on advertising in social media. The amount paid was Rs. 29,000 to each of ten persons. No tax was deducted when making any of these payments

Financial and other charges includes:

(i). Rs.1,000,000 spent on the free treatment of people in the Thar area at the request of the Federal government.

(ii). Profit on debt amounting to Rs. 1,000,000 paid on funds borrowed to finance work in progress

(iii). Workers welfare fund of Rs. 480,000

Other income includes:

(i). Capital gain on securities amounting to Rs. 150,000. Breakup is as follows:

• On redemption of stock fund units	100,000
• from trading on Pakistan Mercantile Exchange(PMEX)	200,000
• from trading on Pakistan Stock Exchange (PSX)	(150,000)

(ii). Refund of Rs. 225,000 which was created as a result of order of Appellate Tribunal Inland Revenue (ATIR) dated 14 September 2020 pertaining to tax year 2014.

(iii). Rs. 250,000 remitted by branch in a foreign country. The gross income of the branch was Rs. 300,000, however Rs. 250,000 was remitted after making provision for taxation of Rs. 50,000.

(iv). Brokerage and Commission of Rs. 500,000 received from sole proprietor Sharjeel for introducing new clients to him.

Tax paid u/s 147 amounted to Rs. 9,000,000. Assume that tax depreciation on all assets is the same as their accounting depreciation.

Required:
Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute under the correct head of income the total income, taxable income and net tax payable by or refundable to BAL for the tax year 2021. **(20)**

Note:

- Your computation should commence with the profit before tax figure of Rs. 25,000 K.
- Show all relevant exemptions, exclusions and disallowances

Q.2 Being tax consultant, the following information is furnished to you by, the executor to the estate of late Mr. John Keith (JK).

(i). JK died on 01 June 2021.

(ii). On the basis of JK's return of income for the tax year 2020 furnished to the tax department, the position of RK's unadjusted losses was as follows:

(a). Rs. 768,640 loss for the tax year 2020 on account of forward trading in a raw cotton on the cotton exchange. The forward contract was settled otherwise than by actual delivery of cotton.

(b). Rs. 560,650 capital loss sustained under the head capital gain which is made up as follows:

- Accounting year ending on 30 June 2015 Rs,215,650
- Accounting year ending on 30 June 2014 Rs. 345,000

(iii). At the time of JK's death, he was survived by his three children whose details are as follows:

- Semi his daughter, is an actress. She left Pakistan for Australia on 30 December 2020 and has been living in Australia since then.
- Kriston, his son is an artist living in Paris. During the year ended 30 June 2021, he came to Pakistan for the Eid holidays on 20 May 2021 for a week.
- Amreli, his daughter was living in Pakistan for last 10 years but she left for USA on 15 August 2020 and did not return till end of the year.

(iv). 0n 20 June 2021, the executor, in accordance with the last will and testament of JK, transferred the following assets of JK to the beneficiaries:

To Semi

- 1,000 shares in Dee (Pvt.) Ltd which JK had acquired on 02 July 2020 for Rs.20,000. Breakup value of one share on date of transfer was Rs.5.
- A personal vehicle which had been inherited by JK in 1960 and was then valued at Rs.10,000,000. Market value of the vehicle on date of transfer was Rs.5,000,000.

To Kriston

- The rupee equivalent of US $ 40,000 which was kept by JK in a safe deposit vault. The US $ 40,000 was converted in Pakistan rupee through an authorized dealer in foreign exchange at the rate of US $ 1 = Rs. 164. The US $ 40,000 had been purchased by RK in 1985 for Rs. 800,000.
- Rs. 3,419,017 being the credit balance in RK's bank account.

To Amrerli

- A rare manuscript which had been purchased by JK in 1960 for Rs.7,000,000. The manuscript was considered by JK to be his own personal asset. On the date of transfer the Chines manuscript was valued at Rs. 1,000,000. The condition of the manuscript had deteriorated due to careless storage.

(v). JK had retired from the employment of Altern Limited (AL) on 31 December 2019. JK was hospitalized for a month prior to his death. Despite JK's terms of employment not providing for any medical benefits after retirement, the hospital bill of Rs.1,174,300 was paid by Altern Limited (AL) directly to Hospital on 30 May 2021.

(vi). On 01 May 2021 RK had donated Rs. 2,000,000 to a hospital in Karachi run by the Federal Government.

Required:

(i). Compute taxable income and tax liability of late **John Keith** (JK) under the appropriate heads of income for the tax year 2021. **(10)**

(ii). Give comments/reasons for the inclusion or exclusion in the computation of taxable income of each of the item listed above. **(13)**

Q.3(a) Being a tax consultant, you have been asked by Mr. Faheem to file his return of income along with wealth statement for tax year 2021. While reconciling his net wealth you have discovered the existence of two immoveable property. Details of the properties is as follows:

- Property 1 is an agriculture property which was acquired by Faheem in tax year 2017.
- Property 2 is a commercial property which was acquired by Faheem in tax year 2013

Mr. Faheem wants to know about the consequences of non-disclosure or inaccurate disclosure of his property in the wealth statement or failure to offer any explanation about the nature and source of his investment in such properties. **(06)**

(b) Mr. William a non-resident individual furnishes the following particulars of his income earned during the tax year 2021:

Interest on UK development Bonds (two third is received in Pakistan)	120,000
Dividend paid by resident company but received outside Pakistan	110,000
Pension from Government of Pakistan but received in London	58,000
Remittance from London on 1 November 2020 out of past profits earned and received there	150,000
Salary from a Pakistani company received in London (one half is paid for rendering services in Pakistan)	360,000

Required:

(i). In the light of the provisions of the Income Tax Ordinance, 2001 compute the taxable income of Mr. William.

(ii). What would be your answer in (i) above if Mr. William was in Pakistan for 120 days for tax year 2021 and was also present in Pakistan for 90 days in tax year 2020, 130 days in tax year 2018 and 150 days in tax year 2017. **(06)**

Q.4 An CA firm has a client company, HASCO, which operates a motor racing circuit. The CA firm has discovered that the tax director of the firm looking after the tax affairs of HASCO keeps a racing car at HASCO's circuit and uses the race track regularly. Because they are the tax director, HASCO allows them 50% off normal charges for garaging the car and for use of the race track.

Required:

What is the ethical position and what measures should the firm take to deal with this situation? **(05)**

Q.5(a) On 2 June 2020, Azeem Limited inadvertently issued a tax invoice with an incidence of sales tax amounting to Rs. 25,000 as against the applicable tax of Rs. 45,000. The error was detected on 15 February 2021 i.e. after expiry of 180 days.

Required:

Advise Azeem Limited in the light of Sales Tax Act, 1990 read with Sales Tax Rules, 2006. **(03)**

(b) In the light of the provisions of Sales Tax Act, 1990 read with Sales Tax Rules, 2006 briefly explain the sales tax implication with respect to chargeability/adjustment in respect of each of the following independent situations:

(i). 0n 01 May 2021 WAVA Limited found that it did not charge sales tax on supply of electricity inadvertently and as a general practice, however company has started paying tax on the said supplies from 02 May 2021.

(ii). MLC Limited a manufacturer cum exporter has imported raw material of Rs. 12,200,000 for further manufacture of goods meant for export. **(04)**

(c) Under the provisions of the Sales Tax Act, 1990 and rules made there under, briefly explain whether the person under each of the following situations are required to be registered with Inland Revenue Department:

(i). A retailer whose annual turnover during the last twelve months is Rs. 3,000,000.

(ii). A commercial importer whose value of supplies during the last twelve months is below Rs. 5 million

(iii). A distributor whose annual turnover during the last twelve months is Rs. 13,000,000.

(iv). A Wholesaler making exempt supplies **(02)**

(d) Raheel, an unregistered person, runs a garment shop in the posh area of Karachi. He has received a notice from the Commissioner Inland Revenue requiring him to register with the sales tax authorities within 30 days. Under the provisions of the Sales Tax Act, 1990 and Rules made thereunder, advise Raheel regarding the following:

(i) Whether the Commissioner is justified in issuing the notice to him.

(ii) Would it be necessary for him to respond to the notice **(04)**

Q.6 Babar Limited (BL), registered under the Sales Tax Act, 1990 is engaged in the import, export and distribution of vide range of goods for last several years. Following transactions were carried out by BL during the month of May 2021:

(i). Imported 8000 boxes of a Sovaldi Injection at Rs. 500 per box, each box contain 5 small injections and sold as complete box in market. 5000 imported boxes were sold by BL in local market at Rs. 600 per box whereas 500 of imported boxes were re-exported to Iran and Malaysia at Rs. 2,500 per box.

(ii). Purchased 6000 packs of another product Toothpaste from local suppliers at a cost of Rs.135 per pack. Toothpaste is included in the items listed on the Third Schedule to the Sales Tax Act, 1990. The retail price of Toothpaste is Rs. 150 per pack. BL sold the entire stock to a retailer at a price of Rs. 140 per pack during the month. This includes discount of 10%.

(iii). Sanitary fittings worth Rs. 200,000 to be used in renovation of factory building was purchased from Wahab Limited, a wholesaler on 10 May 2021. Wahab Limited told BL that with effect from 15 May 2021 their registration has been suspended by Commissioner Inland Revenue.

(iv). BL received an amount of Rs. 175,000 from Amla Limited representing 75% of balance payment against delivery of solar panels. 25% advance was paid in April 2021. Solar panels were exempt from sales tax under Sixth Schedule of the Sales Tax Act, 1990. However, with effect from 01 May 2021 the Board issued a notification withdrawing such exemption.

(v). Tiles worth Rs. 500,000 were provided to company’s managing director for use at his residence. Thees tiles were purchased from commercial importer in March 2021 against payment of sales tax of Rs. 35,000.

(vi). BL’s retail division imported worn clothing worth Rs.500,000. The same was sold to unregistered distributors for Rs. 800,000.

(vii). BL paid Sindh sales tax of Rs. 50,000 on telecommunication services @ 19.5% and Punjab Sales tax of Rs. 35,000 on account of foreign technical services received.

(viii). Locally manufactured cellular mobile phones worth Rs. 300,000 were sold to unregistered persons.These mobiles were purchased from manufacturer in May 2021 by paying sales tax of Rs. 25,000.

Required:

(i). In the light of the provisions of the Sales Tax Act, 1990, Federal Excise Act, 2005 and Rules made thereunder, compute the amount of sales tax payable by or refundable to BL for the tax period May 2021. Also compute withholding tax, wherever applicable. **(16)**

(ii). State the time period and type of mistakes found in an assessment order which can be rectified by the Commissioner under the Sales Tax Act, 1990 and the situation(s) in which a taxpayer must be given an opportunity of being heard by the Commissioner before he can make a rectification order. **(02)**

Q.7 Under the provisions of the Federal Excise Act, 2005 briefly describe the tax treatment in each of the following independent cases:

(i) Kohli Limited (KL) is engaged in the manufacturing of aerated beverages/water from flavours and concentrates. 100% of flavours and concentrates are manufactured in house. During the month of May 2021, the open market price of the flavours consumed amounted to Rs. 500,000.

(ii) Smith Limited (SL) paid Rs. 200,000 to HUM Advertisers for advertisements in newspapers and periodicals regarding its product and Rs. 1,000,000 as advisory fee to a bank for arranging Musharika facility of Rs. 100 million.

(iii) Williamson Limited (WL) supplied edible oil worth Rs. 500,000 to a manufacturer in export processing zone for further manufacturing and worth Rs. 300,000 to retailer in Lahore.

(iv) Root Limited (RL) sold 100 boxes of Cuban cigars at US$ 356 per box (equivalent to Rs. 51,620) on board of a Pakistan International Airlines flight chartered by tourists from USA. The tourists were traveling from Islamabad to Dubai. Input tax paid by RL at the time of import of cigars amounted to Rs. 1,423,460. RL repacked these cigars in special packing at its facility. All payments were received in foreign exchange.

(v) Waugh Limited (WL) is registered with Balochistan Revenue Authority as stockbroker for sales tax purposes. In May 2021, WL rendered brokerage services to one of its clients in Quetta and charged a fee of Rs. 284,000. WL paid provincial sales tax of Rs. 42,600 on such services. **(09)**

(The End)

PAC

Answer: 1

Babar Azam Limited (BAL)				
Computation of taxable income				
Tax Year: 2021				
	Notes			
Income from business				
Accounting profit before tax			25,000,000	
Add: Inadmissible expenses/Admissible incomes				
Export quota licence	2	600,000		1
Repair and maintenance of car	3	-		1
Sales tax payment	4	-		1
Default surcharge	4	50,000		1
Loss on sale of vehicle	5	75,000		1
Advertising expense without tax deduction	6	-		1
Free treatment in Thar area	7	1,000,000		1
Profit on debt to finance work in progress	8	1,000,000		1
Workers wefare fund-Accounting entry disallowed		480,000	3,205,000	0.5
Less: Admissible expenses/inadmissible incomes				
Capital gain on securities-taxable as separate block		150,000		1
Brokerage and Commission-taxable under Income from other source		500,000		0.5
Foreign source income-To be shown separtely on gross basis		250,000		0.5
Refund-claimable as advance tax		225,000	1,125,000	0.5
			27,080,000	
Foreign source income-Gross			300,000	1
			27,380,000	
Income from Other source				
Brokerage and Commission- Taxable under NTR as payer is not a withholding agent			**500,000**	1
Total income			27,880,000	
Less: WWF @ 2% of taxable income			557,600	1
Taxable income			**27,322,400**	
Capital gain on mutual funds	9		50,000	0.25
Capital gain on PMEX	9		100,000	0.25
Computation of tax liability:				
Corporate tax				
1.25% of turnover 160,000,000		A	2,400,000	0.25
30% of taxable income		B	7,923,496	0.25
Alternative corporate tax (ACT)				
17% of accounting profit (Rs. 25,000,000-150,000-225,000+50000)		C	4,194,750	0.5
Normal tax liability higher of corporate tax or alternative corporate tax			7,923,496	
Add: WWF as computed above			557,600	0.5
Capital gain on PMEX Rs. 100,000 x 5%			5,000	0.5
Capital gain on mutual funds Rs. 50,000 x 10%			5,000	0.5
			8,491,096	
Less already deducted				
Advance tax			9,000,000	
Foreign tax credit (Lower of Rs. 50,000 or 300,000 x 29%)			50,000	1
Refund			225,000	0.5
			9,275,000	
Balance tax refundable			**(783,904)**	
Sale by auction (10,000,000 x10%)	1		**1,000,000**	1
Default surcharge (365+30) days @ 12%	1		**129,863**	0.5
			1,129,863	**20**

Workings:

W-1:

BAL was required to collect advance tax on auction sale @ 10% under section 236A of the Ordinance. Failure to collect will result in default surcharge @ 12% to be calculated from 01 September 2020 till the date return is filed i.e 30 September 2021. This amount will have to be deposited separtely as it is advance tax of Imad.

W-2:

Export quota is included in definition of Intangible. However since the it was not used during the tax year 2021, no amortisation of this intangible is admissible in the year. Hence, the cost claimed is fully added back. [S.24]

W-3:

Use of the car by the head of production is in accordance with the terms of his employment and any expenditure incurred on the car provided to him will be part of his salary paid and fully allowable. Further no apportionment is required.

W-4:

Sales tax paid as a result of audit of prior period cannot be recovered from the customer. Sales tax which is neither recoverable from customer nor refundable from FBR is allowable expense.

Default surcharge paid for violation of sales tax law is inadmissible expense.

W-5:

When a business asset is discarded, it is treated as having been disposed of [s.75(3A)]. The fair market value of the asset is treated as the consideration received and the income or loss is computed on this basis, which in the case of delivery van discarded during the year is:

Consideration received	75,000
Tax written down value	300,000
Loss to be charged	225,000

Therefore the excess amount charged as an expense/loss of Rs. 75,000 (300,000 – 225,000) is disallowed and added back to income.

W-6:

Since the individual payment to each person was below Rs. 30,000, no tax was deductible. [s.153 read with relevant SRO 586 (I)/91 dated 30 June 1991] The expenditure being for the purpose of business was fully allowable. [s.20]

W-7:

Expenditure on the treatment of poor in Thar was not incurred to earn income from business, hence it is not an admissible deduction. Further, the amount spent is not admissible for any tax credit as it was not a donation or payment to any approved institution.

W-8:

Profit on debt relating to work in progress are not revenue expenditure for the purpose of carrying out business during the year. Further, BAL is not entitled to any capital allowance like depreciation, initial allowance etc. as work in progress does not constitute an eligible asset.

W-9:

Loss in allowed to be adjusted in case of securities. All three fall in the definitin of securities but since tax rates are different therefore loss will be allocated proportionately in the following manner:

	Fund	**PMEX**	**PSX**
Gain/(loss)	100,000	200,000	(150,000)
Proportionate loss	(50,000)	(100,000)	150,000
	50,000	100,000	-
Tax rates	10%	5%	

Answer: 2

Mr. John Keith			
Computation of taxable income			
Tax Year: 2021			
			Marks
Salary			
Benefit of free medical treatment from Altern Limited		**1,174,300**	1.00
Capital gain			
To Seemi			
on shares	-		1.50
on vehicles	-		1.00
To Kriston			
On conversion of US $ 40,000 into Rupee	4,320,000		2.00
Cash	-		1.50
To Amreli			
Loss on sale of rare manuscript	-		1.00
Less brought forward capital loss	(215,650)	**4,104,350**	1.00
Taxable income		**5,278,650**	
Computation of tax liability:			
Upto Rs. 4,000,000		620,000	
Balance (Rs. 5,278,650-4,000,000) x 30%		383,595	
		1,003,595	
Tax credit on donation (Rs.1,003,595/5,278,650 x lower of 30% of Rs.5,278,650 or Rs.2,000,000		301,079	1.00
Balance payable		702,517	
			10.00

(b)

Salary received from Altern Limited

An amount or perquisite is treated as received by an employee from an employment regardless of whether amount or perquisite is paid or provided by a past or prospective empoloyer. **1.00**

A perquisite includes any amount paid by an employer to discharge an obligation of an employee of another person. The Rs. 1,174,300 paid by Altern Limited (past employer) to the hospital is therefore chargeable to tax under the head "salary"

Transmission of assets to Semi

Shares of Dee(Pvt.) Limited

The transmission of asset by succession or under a will is treated as disposal of the asset by the deceased at the time the asset is transmitted. Under non recognition rule no gain or loss is taken to have arisen on disposal of an asset on the transmission provided the person acquring the asset is a resident person. As Semi was resident person at the time of acquiring of shares (she was present in Pakistan for 183 days), no gain or loss would arise. **1.50**

Personal vehicle		
A gain or loss under the head capital gain can only arise on disposal of capital asset. Personal moveable assets are excluded from the definition of capital assets. Therefore the question of computing any gain or loss on transmission of personal vehicle does not arise.		1.00
Transmission of assets to Kriston		
Non recognition rule will not be applicable on Kriston since he was non resident during tax year 2021.		1.00
Foreign currency		
Foreign exchange held as an investment is a capital asset and when it is converted into rupees it is considered as disposal of the capital asset. As US $ 40,000 had been held by JK since the time of its purchase in in 1985, the US $ 40,000 is a capital asset. Capital gain will be calculated as under:		
Consideration received on conversion of US $ 40,000	6,560,000	
Cost	800,000	
Gain	5,760,000	
75% of above as holding was greater than 1 year	**4,320,000**	2.00
Cash		
There can be no gain or loss on the transfer of cash from one person to another. Therefore, the transmission of the amount of Rs.3,419,017 will have nil impact on the computation.		1.50
Transmission of assets to Amreli		
Gain will be fully taxable on transmission as Amreli was non resident during the year.		1.00
Rare Manuscript		
Any gain on disposal of rare manuscript is fully taxable, however loss is not allowed to be recognized. Therefore, it will not be included in the computation of taxable income.		1.00
Capital loss brought forward		1.00
Any unadjusted capital loss can be carried forward for six years immediately succeding the tax year in which the loss was sustained to be set-off only against the profits under the head "capital gain".Therefore unadjusted loss for tax year 2015 is set off againt profit for tax year 2021. Loss for tax year 2014 cannot be adjusted as it lapsed in tax year 2020.		
Speculation loss		1.00
Loss from forward contract for purchase of cotton which was settled otherwise than by actual delivery is speculation. An unadjusted speculation loss can be carried forward for six years and adjusted against speculation gain only. Normally speculation loss could have been carried forward upto 2026 but as JK died on 01 June 2021, the loss of Rs. 768,640 lapsed on that date, since only the person who has sustained any loss can carry forward the loss.		
Donation		1.00
The donation of Rs.2,000,000 to a hospital run by the Federal Government is entitled to tax credit. The tax credit is allowed at average rate of tax on the lower amount of the donation or 30% of the taxable income of the individual.		
		13.00

Answer: 3 (a)

For property acquired in tax year 2013, since 5 years would have elapsed in tax year 2019 therefore it is time bared and no proceedings can be initiated u/s 111. **(1 Mark)**

For property acquired in tax year 2017,if Mr. Faheem offers no explanation about the nature and source of his investment in immoveable property or the explanation offered is not, in Commissioner's opinion, satisfactory, the value of the investment shall be included in Mr. Faheem's income chargeable to tax under the head "Income from other sources" to the extent it is not adequately explained.

The amount of the above investment shall be included in the income chargeable to tax in the tax year to which such amount relates. Further, if the declared cost of his investment in immoveable property is less than reasonable cost of the investment, the Commissioner may, having regard to all the circumstances, include the difference in Mr. Faheem's income chargeable to tax under the head "Income from other sources" in the tax year to which the investment relates. **(2 Marks)**

Valuation of asset (0.5 Marks)

For purpose of section 111, average sale price of the sales recorded in the revenue record of the estate in which agriculture land is situated for relevant period of time will be used.

Penalty: (1 Marks)

If Mr. Faheem conceals his investment in immoveable property or furnishes inaccurate particulars of his investment, in the course of any proceeding under the Ordinance before any Income Tax Authority or the Appellate Tribunal, he shall pay a penalty of Rs.100,000 or an amount equal to the tax evaded whichever is higher.

Prosecution for concealment of investment in property: (1 Marks)

Moreover, in the course of any proceedings under the Ordinance, Mr. Faheem, either in the course of that proceeding or in any earlier proceedings conceals his investment or furnishes inaccurate particulars of his investment and the revenue impact of such concealment or inaccurate particulars is five hundred thousand rupees or more, he shall be guilty of an offence punishable on conviction with imprisonment up to two years or with fine or both.

Default surcharge: (0.5 Marks)

Mr. Faheem shall also be liable to pay default surcharge at a rate equal to 12% per annum on the tax or penalty unpaid computed for the period commencing on the date on which the tax or penalty was due and ending on the date on which it was paid.

(b)

(i) Mr. William is non-resident			
			Marks
1	Interest on UK development bonds	-	0.5
2	Dividend paid by resident company but received outside Pakistan (taxable section 101(6)	110,000	0.5
3	Pension from Government of Pakistan but received in London- taxable under section 101(11)	58,000	0.75
4	Remittance(not in the nature of income brought to Pakistan)- no question of taxability arise	-	0.75
5	Salary from a Pakistani company received in London (one half is paid for rendering services in Pakistan)- 1/2 taxable for rendering services in Pakistan	180,000	1
		348,000	
(ii)			
The aggregate period of stay in Pakistan for last four years is greater than 365 days, hence William will become resident for tax year 2021.			1
His worldwide income will become taxable in Pakistan. However remittance from London is not taxable because it does not amount to receipt of income.			0.5
His taxable income will be (Rs.120,000 + 110,000 +58,000 + 360,000)		648000	1
			6

Answer: 4 (5 Marks)

The transaction between HASCO and the Tax director is a normal commercial transaction for HASCO, but it is not at arm's length because the tax director gets 50% off normal prices. The transaction may not be material for HASCO, but it is likely to be material for the tax director. Consequently, there has been a breach of the ethical code by the tax director. The tax director has created a self-interest threat (and possibly a familiarity threat) by entering into the transaction with HASCO.

The ethics partner of the firm should be consulted and asked to assess the materiality of the transaction between HASCO and the tax director and to consider whether disciplinary action is appropriate. The tax director should be removed immediately from HASCO Tax team and replaced by someone else.

In view of the threat to the objectivity and independence, the tax plan should also be reviewed and amended if this is considered necessary.

The ethics partner may also wish to check whether the former tax director has entered into commercial arrangements on favourable terms with any other client.

Answer: 5

(a) **(Three marks)**

Time limitation of 180 days shall not apply in the given case as it is applicable only in the case of decrease in output tax and increase in input tax. The above increase of output tax may be declared without any time limitations. Since Azeem Limited has already accounted for the output tax in the sales tax return for the supplies, it can issue a debit note in the month of February 2021 when the error was detected, and increase the amount of output tax in the return for February 2021 by Rs. 20,000. Azeem Ltd will also have to pay default surcharge @ 12%.

(b) **(two marks each)**

(i). Tax along with default surcharge shall be recoverable in respect of previous period. However if in respect of any supply the Federal Government is satisfied that inadvertently and as a general practice tax has not been charged on any supply which was otherwise taxable and registered person started paying the tax from the date when it was found that the supply was chargeable to tax, it may by notification in the official gazette direct that tax not levied or short levied as a result of that inadvertent practice shall not be required to be paid for the period prior to the discovery of such inadvertent practice. (Ref: Sec 65).

(ii). Subject to such restrictions as it thins fit to impose, the Federal Government may authorize the import of goods without payment of whole or any part of the tax payable thereon to registered manufacturer cum exporter. (Ref: Sec 60)

(c) **(0.5 marks each)**

(i). Registration not required. A retailer is only required to get itself registered if it falls in any of the category mentioned in Tier-1 retailer.

(ii). An importer is required to get itself registered irrespective of the value of supply.

(iii). A distributor is required to get itself registered irrespective of the value of supply.

(iv). Although it is compulsory for every wholesaler to get itself registered yet only those persons are required to be registered who are making taxable supplies (including zero rated). Since wholesaler is making exempt supplies, hence he is not required to be registered

(d)

(i). **(2 marks)**

Yes, the Commissioner is justified in issuing the notice to Raheel. According to STR 2006 if the Commissioner Inland Revenue or any other officer, as may be authorized by the Board, after such inquiry as deemed appropriate, is satisfied that a person is required to be registered, but does not apply for registration. He may issue a notice to such person.

(ii) (2 marks)

Under the STR 2006, Raheel may submit his response within the specified time, contesting his liability to be registered. Based on his response, the Commissioner shall grant him opportunity of personal hearing, if so desired by him, and shall there after pass an order whether or not such person is liable to be registered compulsorily. He shall cause the said person to be registered through computerized system.

However, if Raheel fails to respond within the time specified in the notice, the Commissioner shall cause to compulsorily register him through computerized system.

Answer 6

Babar Limited

Computation of Sales Tax-Cum-Federal Excise liability

Tax Period: May 2021

Particulars	Workings	Value of supply	Tax rate	Sales tax	Sales tax withheld	Marks
INPUT TAX						
Imported goods		4,000,000	20%	800,000		0.75
Purchase of Tooth Paste-Third Schedule items		900,000	17%	153,000		1
Residual input disallowed on imported goods	1			(235,294)		1.5
Sanitary fittings from inactive wholeslaer-input disallowed however withholding required @ 5% of value		200,000			8,547	1
Private use of tiles-Specified goods	4	500,000		(35,000)		1
Imported Worn clothing-8% schedule plus 3% value addition not payable		500,000	5%	25,000		1
Telecommunication services-Input allowed to the extent of 17% under SRB (50,000 x 17/19.5)				43,590		1
Foreign technical services- Input not allowed on provincial sales tax charged under reverse charge mode				-		1
Purchase of mobile phones from manufacturer-Input disallowed under 9th Schedule				-		1
		6,100,000		**751,296**		
OUTPUT TAX						
Sale of imported boxes		3,000,000	17%	510,000		0.75
Export to Iran and Malaysia		1,250,000	0%	-		0.75
Sale of tooth paste- tax chargeable on retail price		900,000	17%	153,000		0.5
Supply of solar panels	3	233,333	17%	39,667		1.5
Sale of worn clothing-3% further tax not payable		800,000	5%	40,000		1
Sale of cellurar mobile-Sales tax chargeable by manufacturer only under 9th Schedule		300,000	exempt	-		0.75
		6,483,333		**742,667**		

Calculation of tax liability				
Output tax			742,667	
Less actual input	2		751,296	1
Balance refundable			**(8,629)**	
Sales tax refundable on zero rated supplies			**(235,294)**	0.5
				16.00
Workings:				
W-1:				
Apportionment of input tax				
Taxable supplies				
Zero rated supplies		1,250,000		
Taxable supplies		3,000,000		
		4,250,000		
Residual input tax		800,000		
Sales tax Refundable on zero rated supplies (1,250/4,250 x 8000)		235,294.12		
W-2:				
Restriction on input tax (should not exceed 90% of output tax) is not applicable in this case as value of commercial imports subject to minimum value addition exceed 50% of taxable purchases.				
W-3:				
Any part payment received for exempt supply shall be accounted for in the return during which exemption is withdrawan.				
75% payment		175,000		
100% payment (100/75)		233,333		
W-4:				
Private use of procured goods is not supply but related input is disallowed.				

(b)
(ii) (0.5 marks for each point)
The officer of Inland Revenue, Commissioner, the Commissioner (Appeals) or the Appellate Tribunal may, by an order in writing, amend any order passed by him to rectify any mistake apparent from the record on his or its own motion or any mistake brought to his or its notice by a taxpayer or, in the case of the Commissioner (Appeals) or the Appellate Tribunal, the Commissioner.

No order which has the effect of increasing an assessment, reducing a refund or otherwise applying adversely to the taxpayer shall be made unless the taxpayer has been given a reasonable opportunity of being heard.

Where a mistake apparent on the record is brought to the notice of the officer of Inland Revenue, Commissioner or Commissioner (Appeals), as the case may be, and no order has been made under sub section (1), before the expiration of the Financial year next following the date on which the mistake was brought to their notice, the mistake shall be treated as rectified and all the provisions of this Act shall have effect accordingly.

No order under shall be made after five years from the date of the order sort to be rectified.

Answer: 7 (1 mark for point (v), 2 marks each for (i) to (iv))

(i). Any goods which are manufactured, produced in house by a registered person and used for manufacture and production of goods on which duty of excise is paid, are exempt from duty under 3rd schedule of the Federal Excise Duty Act, 2005.

(ii). As per Table II of the Third Schedule, no federal excise duty is chargeable on advertisements in newspapers and periodicals and services provided by banks on account of Musharika financing. However, as these services are also taxable in respective provinces therefore treatment may change keeping in view the provisions of the respective provincial ordinances.

(iii). Goods for further manufacturing of goods in export processing will be exempt from tax. However, WL shall have to collect excise duty, at applicable rate, on edible olive oil supplied to retailer in Lahore. The excise duty on edible olive oil shall be payable in sales tax mode.

(iv). Cigars supplied, against payment in foreign exchange, on board international flight by the Pakistan International Airlines is exempt from the levy of excise duty subject to the same conditions and procedures as are applicable for the purposes of exemption of customs duty. JL shall not be entitled to claim any adjustment or duty draw back in respect of input tax of Rs. 1,423,460 paid at the time of import.

(v). Services provided or rendered by WL as a stockbroker in Balochistan is chargeable to excise duty at the rate of 16% of the charges received. But since WL is registered with the provincial sales tax authority and has also paid provincial sales tax on such services, excise duty on brokerage services shall not be levied.

(The End)

Certified Finance and Accounting Professional Stage Mock Examinations
27 May, 2021
3 hours – 100 marks
Additional reading time - 15 minutes

Audit, Assurance & Related Services

Q.1 Your firm is the external auditor of Stingray Haulage Limited (SHL) for the year ended 30 November 2020. SHL provides national and international road haulage services. You are the audit senior responsible for planning the audit. Following are extracts from the draft financial statements:

Statement of profit or loss for the year ended 30 November (extract)

	2020 Draft Rs. in million	**2019 Audited** Rs. in million
Revenue		
Freight Network		
-budgeted volume customers	2,176	1,740.3
-pay by load customers	1,035	749
	3,211	**2,489.3**
Truckshare fees	30	-
	3,241	**2,489.3**

	2020 Draft Rs. in million	**2019 Audited** Rs. in million
Intangible assets		
Goodwill	2,560	2,560
Development costs	31.70	-
Trade receivables	**366**	**220**

Additional information:

- **i.** Customers who pay by budgeted volume are invoiced monthly as per agreed amounts in contracts. A spreadsheet is maintained to compare actual volumes with budgeted volumes to identify any under or over payments. Each quarter, journal entries are used to adjust customers' accounts for any additional invoices or credit notes required.
- **ii.** Customers who pay by load are invoiced as soon as the service is provided.
- **iii.** Standard credit terms are 30 days for both types of customer.
- **iv.** SHL increased the number of trucks from 120 in the prior year to 144 as at 30 November 2020.
- **v.** In July 2020, due to competition, there had been a cumulative increase in unused capacity of trucks. At the August board meeting, the directors expressed concern that unused capacity would have a detrimental effect on profitability as SHL has high fixed costs.
- **vi.** In September 2020, SHL introduced 'Truckshare', a new service which allows smaller road haulage companies to make use of spare capacity in SHL's trucks. To use services, subscription is required for initial two years. An annual fee of Rs 1 million is payable from the first day of the month in which membership is taken out. No other fees are payable during the two-year period.
- **vii.** At 30 November 2020, 30 hauliers had subscribed (September 4, October 12 and November 14)
- **viii.** Goodwill relates to the premium paid on the acquisition of the trade and assets of a haulage company in June 2019. Amortisation is not charged on goodwill but an annual impairment review is undertaken.

The impairment review involves estimating future cash flows generated by the trade and assets acquired.

ix. Development costs relate to ‘Timetrack’, an internally developed software system designed to track vehicles and provide customers with access to real-time delivery times. After some technical difficulties experienced by SHL’s IT department, an external consultant was engaged to manage the project. The system was launched in October 2020. Development costs include the salaries of IT employees who worked on the project and costs of the external consultant. The software is being amortised over 15 years.

x. Mr. X, major foreign customer, is refusing to pay its outstanding balance of Rs. 17.8 million, which is included in trade receivables. He claimed that, on two occasions, its goods were damaged during transit.

xi. Directors’ remuneration includes a bonus based on SHL’s profits.

Required
Identify key areas of audit risk and describe the procedures that should be included in the audit plan to address those risks. **(26)**

Q.2(a) It is 1st July 2020. You are the manager responsible for the audit of Cod Limited (CL), a listed company and you are in the process of completing the audit of the financial statements for the year ended 31 March 2020. The auditor’s report is due to be signed in the next few weeks. The company’s principal operating activity is the publication of trade and scientific journals. The draft financial statements recognise revenue of Rs. 108 billion (2019 - Rs.102 billion), profit before tax of Rs. 9.3 billion (2019 - Rs. 8.2 billion) and total assets of Rs. 150 billion (2019 - Rs. 149 billion).

You are in the process of reviewing the audit working papers and have identified the following potential issue:

Sale of division

CL is at the advanced stage of negotiations to sell its scientific publishing division to a competitor. This division contributed revenue of Rs. 13 billion and profit before tax of Rs. 1.4 billion during the year to 31 March 2020. The draft sale agreement which is due to be finalised by 1 August 2020 shows an agreed sale price after costs of disposal of Rs. 42 billion. The division is a separate cash generating unit of CL. None of the assets of the division are held under a revaluation policy and depreciation is charged on a straight-line basis over the determined useful life of the assets.

The finance director of CL has not made any disclosures with respect to the upcoming sale in the financial statements for the year ended 31 March 2020 as he considers it to be part of next year’s accounting transactions. However, the division has been written down from its current carrying amount of Rs. 45 billion to its estimated value in use of Rs. 41 billion in the financial statements for the year ended 31 March 2020.

Required:
Evaluate the above situation, describe your course of action and impact (if any) on auditor’s report if no adjustments are made to the financial statement. **(10)**

(b) As part of your review of Cod Limited (CL), you have also been presented with an extract from the draft chairman’s statement which will be published in the annual report alongside the financial statements for the year.

Extract from chairman’s statement

> The company’s results for the year are extremely positive. Our year on year revenue growth is 5·9% and our profit growth is even stronger at 13·4%. All our revenue streams have performed well, especially the scientific publishing division, and we are looking forward to exciting and sustained growth levels again next year. As you can see from our auditor’s report, the auditors agree that our results are strong and a sound basis for taking the company to an even greater place next year.
>
> We have also made significant progress with our social and environmental aims of reducing our carbon footprint and encouraging re-use and recycling across our divisions. We are proud to announce that we have now moved all our printed products to recycled paper.

To help with your review of the information, you also have the following analysis of the results for the year.

	Year ended 31 March 2020			Year ended 31 March 2019		
	Other Divisions	Scientific Publishing Division	Total	Other Divisions	Scientific Publishing Division	Total
	Rs. in billion			Rs. in billion		
Revenue	95	13	108	93	9	102
Profit before tax	7.9	1.4	9.3	7.5	0.7	8.2

A file note from the audit supervisor states that at least three of the publications CL sells are not prepared on recycled paper.

Required:
Evaluate the above situation, describe your course of action and impact (if any) on auditor's report. **(10)**

(you may also refer to the information given in part a in your evaluation.)

Q.3 Your are quality control partner of Zamad and Co. Chartered Accountants (ZC) currently reviewing the audit work performed for Grouper Limited (GL) for the year ended December 31st 2020. You have gathered the following information from your review of the audit file:

(i) ZL is a listed company operating in the construction industry. The company complies with corporate governance regulations and has an audit committee. ZL has been an audit client of ZC for eight years, and Zamad Zahid has been associated with ZL from last eight years (first four years as engagement quality control reviewer and last four years as engagement partner including current year. Time management system shows following time spent on ZL audit;

Zamad Zahid – audit engagement partner	2 hours
Furqan – senior audit manager	6 hours
Inaya – audit manager	35 hours
Six audit assistants	130 hours
Total time spent on audit	173 hours

It is apparent from your review that almost all of the detailed review of the audit working papers was completed by Inaya, who has evidenced her review by stating 'final review' on each page of the audit file. She has recently been promoted to audit manager.

You are also aware that Zamad booked a total of 40 hours to ZL in respect of non-audit work performed. The only information you can find in the documentation is that the non-audit work related to a 'special investigation', and that Zamad confirms that it does not create a threat to auditor objectivity. The total fee charged for the audit was Rs. 2.5 million and the fee for the 'special investigation' was Rs. 8.9 million

(ii) From reviewing the audit working papers, you are aware that going concern was identified as a significant audit risk at the planning stage of the audit due to low profit margins or losses being made on many of the company's construction contracts and increasing economic uncertainty. The company typically has 20 contracts ongoing at any time.

Most of the audit work on going concern was performed by Maira, an audit assistant who has just taken her first attempt of CFAP exams. The majority of the audit work performed on going concern focused on a review of five major contracts to determine their profitability. The management of ZL identified the major contracts for review and provided Maira with forecasts indicating that the contracts would all make a small profit. Maira confirmed that the assumptions used in the forecasts agreed to assumptions used in previous years and concluded that the contracts which she had reviewed support the going concern status of the company. Having reviewed these major contracts, Maira completed the conclusion on going concern, stating that there is no significant uncertainty over going concern.

Required:
Comment on the quality of the planning and performance of the audit of GL, discussing the quality control, ethical and other professional issues raised and recommending appropriate actions to be taken. **(15)**

Q.4 Your firm, Salma and Co. Chartered Accountant (SC) has been approached by Flapper Group (FG) for the appointment as external auditor. The parent company, Flapper Limited (FL), is a listed company, and the FG has a total of 14 subsidiaries, 10 of which are foreign subsidiaries. The FG is a food processor, and each of its foreign subsidiaries provides a particular ingredient used in the FG's main processing plant, which is based in

Pakistan. The subsidiaries produce raw ingredients including corn, wheat, vegetables and nuts.
If SC decides to accept the appointment, it will provide the audit for the FG consolidated financial statements, and for the individual financial statements of some of the subsidiaries. The FG audit committee has suggested that to keep the audit fee as low as possible, SC could audit the companies based in Pakistan, but the foreign subsidiaries would be audited by local firms. These foreign subsidiaries contribute 60% to the FG's total assets.

The FG has recently become involved with a business in Togo, a remote country, which produces tropical fruit. The business is not incorporated as a company and local regulations in Togo only require financial statements to be prepared or an audit to be performed for companies. From an internet search regarding the FG, you have also obtained the following information:

i. One subsidiary, Mango Limited (ML), has been accused of environmental damage, due to its operations impacting on the rainforest and causing harm to wildlife. There have been some protests by concerned citizens in the country where ML is located. Digital recordings of these protests have spread world-wide on social media.

ii. The FG has recently expanded its operations in a certain country by acquiring a large area of land on which to grow wheat. To receive government approval for the acquisition, a significant 'incentive payment' was made to a government minister. This has been reported widely in the media.

Required:
Evaluate the above matters which should be considered before SC accepts the audit of the Flapper Group.
(10)

Q.5 Food Easy Limited (FEL) provides a weekly recipe box delivery service to customers in Pakistan. Each recipe box contains measured quantities of fresh ingredients for meals which customers cook at home. Customers subscribe to the recipe box delivery service via FEL's website where they select the number of meals per week they wish to receive and how many people they are cooking for.

Customers' credit card details are saved on the website and their credit card is charged with the price of the recipe box the day before it is delivered. Customers can choose to cancel their subscription at any time. FEL started operations in in 2018 and has grown rapidly. It is planning to expand its operations to Qatar.

FEL's finance director has prepared cash flow forecasts, in Qatari riyals, for its expansion into Qatar for the three years ending 31 March 2024. These will be submitted to FEL's bank in support of a loan application to fund the expansion. FEL's bank has requested that the forecasts are independently examined. FEL has appointed your firm to perform the independent examination and provide an assurance report.

It has provided you with the following information about the expansion into Ireland:

i. FEL will launch its recipe box service to customers in Qatar on 1 September 2021. It expects revenue from the sale of recipe boxes to grow at a similar rate to the growth experienced in Pakistan.

ii. The average price of a recipe box will be consistent with the price charged by FEL's competitors in the Qatari market.

iii. An advertising campaign, starting in August 2021, will include a 20% discount voucher for customers to use against their first month's subscription.

iv. In June 2021, FEL will acquire the leasehold for a distribution centre and offices in Ireland from which to operate.

v. The distribution centre will be fitted with specialist storage facilities and equipment. Three firms have submitted tenders to FEL for the fitting of the facilities and supply of equipment.

vi. Contracts for the supply of ingredients will be negotiated with local farmers and food distributors. FEL anticipates that it will negotiate volume-based rebates which are likely to take effect from September 2022.

vii. FEL will contract with local delivery companies to collect recipe boxes from its distribution centre and deliver them to customers. When the number of customers in Qatar reaches 10,000, FEL will purchase its own fleet of delivery vehicles.

You are the senior responsible for planning the examination of the forecasts for the expansion into Qatar.

Required

(a) Identify the specific matters you would consider when reviewing the reasonableness of the assumptions underlying each item. **(13)**

(b) State, with reasons, the implications for your firm's assurance report if it believes that significant assumptions in the cash flow forecasts do not provide a reasonable basis for the prospective financial information. Also, draft conclusion/opinion paragraph of the assurance report if significant assumptions do not provide reasonable basis for the prospective financial information. **(06)**

Q.6 You are reviewing the audit working papers of Simplisafe Pvt. Ltd. (SPL) for the year ended December 2020, which installs and maintains security systems for businesses and residential customers and have gathered the following information: (Materiality for the audit of the SPL financial statements has been determined to be Rs. 4 million)

(a) The SPL finance director has informed the audit team that during the year, a fraud was carried out by a manager, Tauqeer, in procurement departments. The manager had raised fictitious supplier invoices and paid the invoiced amounts into his personal bank account. When questioned by the SPL's finance director, Tauqeer confessed that he had stolen Rs. 400,000 from the company. The finance director asked th audit team not to perform any procedures in relation to the fraud, as the amount is immaterial. He also stated that the financial statements would not be adjusted in relation to the fraud.

The only audit evidence on file is a written representation from management acknowledging the existence of the fraud, and a list of the fictitious invoices which had been raised by the manager, provided by the finance director. The audit working papers conclude that the fraud is immaterial and no further work is needed.

Required:

Discuss the implications of the fraud for the completion of the audit, and the actions to be taken by the auditor. **(05)**

(b) In August 2020, SPL commenced development of a new security system, and incurred expenditure of Rs. 6 million up to the financial year end, which has been capitalized as an intangible non-current asset. The only audit evidence obtained in relation to this balance is as follows:

- Agreement of a sample of the costs included in the Rs. 6 million capitalised to supporting documentation such as supplier invoices.
- Cash flow projection for the project, which indicates that a positive cash flow will be generated by 2024. The projection has been arithmetically checked.
- A written representation from management stating that 'management considers that the development of this new product will be successful'.

You are aware that when the SPL finance director was asked about the cash flow projection which he had prepared, he was reluctant to answer questions, simply saying that 'the assumptions underlying the projection have been agreed to assumptions contained in the SPL's business plan'. He provided a spreadsheet showing the projection but the underlying information could not be accessed as the file was password protected and finance director would not provide the password to the audit team.

Required:

Comment on the sufficiency and appropriateness of the audit evidence obtained and recommend the actions to be taken by the auditor, including the further evidence which should be obtained. **(05)**

(The End)

Answer. 1 ***(Total Allocated Marks – 26)***
Freight ***(Maximum 10 Marks)***
Risks: *(Maximum 5 Marks, 1 mark for each point)*

i. The budgeted volume revenue has increased by 25% and the by load revenue has increased by 38%. (Alternatively, total revenue has increased by 30.2%/freight revenue has increased by 29%).

ii. However, the number of trucks has only increased by 20% and revenue per truck has increased from

iii. Rs. 20.74 million to Rs. 22.3 million.

iv. The increase in revenue is inconsistent with competition and the unused capacity within the fleet of trucks.

v. The use of a spreadsheet for calculating adjustments for under/over-payments is susceptible to formulaic errors.

vi. Quarterly adjustments for under/over payments may result in cut-off errors if post-year end invoices and credit notes are not adjusted for in the correct accounting period.

Audit Procedures: *(Maximum 5 Marks, 1 mark for each point)*

i. Evaluate and test the internal controls over invoicing and recording.

ii. Enquire of management the reason for the increase in revenue and ascertain whether it is due to:
   a. new customers/contracts
   b. utilisation of new trucks
   c. changes to pricing.

iii. Inspect contracts relating to any new customers and price increases.

iv. Use data analytics software to analyse monthly revenue and identify outliers.

v. Review journal entries/adjustments performed post year end and compare to the spreadsheet workings.

vi. Reperform the calculations produced by the spreadsheet.

vii. Inspect customer contracts for details of the budgeted volumes.

viii. Inspect credit notes and invoices issued post year end and confirm that those relating to services provided prior to the year-end are reflected in pre year-end figures.

ix. Compare previous transactions based on budgeted volume to final agreed amounts to determine accuracy/proximity to actual.

x. Match invoices issued either side of the year end to job/delivery schedules to ensure they are reflected in the appropriate period.

Truckshare ***(Maximum 4 Marks)***
Risks: *(Maximum Marks 2, 1 mark for each point)*

i. Customers pay the annual membership fees in advance and it appears that these fees have been recognise in full in the current period.

ii. Income recognised should be Rs. 4.2M [(3/12 x Rs. 4M) +(2/12 x Rs. 12M) +(1/12 x Rs. 14M)]

iii. There is an overstatement of Rs. 25.8M (Rs. 30M – Rs. 4.2M) which is 0.8% of total revenue and therefore material.

Audit Procedures: *(Maximum 2 Marks, 1 mark for each point)*

i. Inspect Truckshare contracts to confirm the amount of the annual payment.

ii. Agree amounts to bank statements.
iii. Request management to recognise the income as earned instead of when received.

Goodwill ***(Maximum 4 Marks)***
Risks: *(Maximum Marks 2, 1 mark for each point)*
i. There is a risk of overstatement.
ii. No impairment has been reflected in the goodwill figure despite the business experiencing increased competition and unused capacity.
iii. Judgement is involved in estimating future cash flows which are subject to uncertainty.

Audit Procedures: *(Maximum 2 Marks, 1 mark for each point)*
i. Inspect the documents relating to management's impairment review.
ii. Examine the cash flow forecasts, consider reasonableness of the assumptions underlying the forecasts and perform sensitivity analysis on key variables.
iii. Discuss with management their intentions to address the competition and unused capacity.
iv. Obtain written representations on the completeness and the plausibility of their assumptions.

Timetrack/Development costs ***(Maximum 4 Marks)***
Risks: *(Maximum Marks 2, 1 mark for each point)*
i. There is a risk of overstatement.
ii. Inappropriate costs may have been capitalised particularly if abortive costs have been included.
iii. The useful life is an estimate and 15 years appears high as software is susceptible to obsolescence and amortisation may not have been charged from the appropriate date.
iv. The costs capitalised during the year represent 0.98% of revenue and are material.

Audit Procedures: *(Maximum 2 Marks, 1 mark for each point)*
i. Obtain a schedule of costs capitalised and review to ensure that the costs meet the relevant criteria.
ii. Confirm that the costs associated with the technical difficulties are not included.
iii. Vouch external consultant's costs to invoice(s)/contract and employee costs to payroll details.
iv. Challenge management's basis for the 15-year useful life and compare to other haulage companies' amortisation polices.
v. Recalculate the amortisation charge.
vi. Determine whether amortisation has been charged from the appropriate date.
vii. Obtain a written representation confirming management's justification of the useful life.

Trade Receivables ***(Maximum 4 Marks)***
Risks: *(Maximum Marks 2, 1 mark for each point)*
- There is a risk of overstatement.
- Trade receivables days have increased to 41.6 days from 32.3 days (39.8 days if Mr. X is omitted)
- which is inconsistent with the 30-day credit period allowed.
- Mr. X is refusing to pay Rs. 17.8 million which represents 0.55% of revenue and is therefore material.
- There may be other customers in dispute if goods are damaged in transit.

Audit Procedures: *(Maximum 2 Marks, 1 mark for each point)*
i. Direct confirmation of receivables balances and investigation of differences.
ii. Inspect bank statements for after date cash to provide assurance on recoverability of outstanding amounts.

iii. Review aged trade receivables listing to identify overdue balances, assess the reasonableness of the allowance for receivables and recalculate the allowance for receivables.
iv. Inspect correspondence between SHL and Mr. X to determine the validity of their complaint and the likelihood of receiving payment.
v. Inspect legal correspondence to understand the likely outcome.
vi. Inspect other customer correspondence for evidence of disputes.
vii. Review board minutes for information relating to Mr. X and any other disputes.
viii. Use data analytics software to match work schedules/orders with invoices and receipts from customers.
ix. Obtain a written representation on the completeness of the allowance for receivables.

Compensation of Directors' linked with profitability *(1 bonus mark subject to total marks not breached)*
Directors' bonuses linked to profits gives rise to potential window dressing and/or aggressive application of accounting standards.

Answer. 2
(a) ***(Total Allocated Marks – 10)***
Evaluation: *(Maximum 5 Marks)*
The company is at an advanced stage of negotiations with a competitor to sell its scientific publishing division. Currently the finance director has not included any reference to the sale in the financial statements for the year ended 31 March 2020.

The revenue of the scientific publishing division of Rs. 13 billion represents 12% of total revenue and the profit of the division of Rs. 1.4 billion represents 15.1% of profit before tax. The division is therefore material to the statement of profit or loss. The assets of the division are also material, as they represent 27.3% of the company's total assets, based on their value in use which is recognised in the financial statements.

Conditions for asset classified as held for sale are fulfilled in respect of the scientific publishing division, as management has decided to sell the division and a buyer has been found. The advanced stage of negotiations would suggest the sale is highly probable. There is a material misstatement as the scientific publishing division has not been classified as held for sale and its profit presented as a discontinued operation and the necessary disclosures have not been made in the financial statements.

As for as valuation is concerned the recoverable amount would be Rs. 42 billion representing the fair value less costs of disposal. Management has valued the disposal group based on its value in use at Rs. 41 billion which means that assets and profit are currently understated by Rs. 1 billion. This represents 10·7% of profit before tax and is material to the profit for the year.

After classification as held for sale, non-current assets or disposal groups are measured at the lower of carrying amount and fair value less costs which would continue to be Rs. 42 billion. Depreciation ceases to be charged when an asset is classified as held for sale.

Course of Action: *(Maximum 2 Marks)*
- The auditor should request that management adjusts the financial statements to recognise the discontinued operation and to separately disclose the assets held for sale in accordance with IFRS 5.
- In addition, the client should be requested to amend the carrying amount of the assets to the recoverable amount of Rs. 42 billion in line with IFRS 5 requirements.
- If management refuses to adjust the financial statements, the auditor should communicate the misstatements to those charged with governance

Auditor's report implications *(Maximum 3 Marks)*

If the adjustments are not made then there is a material misstatement in the financial statements. The matters above have resulted in an understatement of assets and profits by Rs. 1 billion. This would result in a qualified audit opinion in which the report.

However, there are also several important disclosures which are omitted. As such, it would be a matter of judgement as to whether the lack of disclosures in conjunction with the material misstatement mentioned above have a pervasive impact on the financial statements. Depending on the auditor's judgement on this issue, this may give rise to an adverse opinion if the auditor considered the impact of these issues to result in the financial statements being wholly misleading.

Depending on the opinion provided, a basis for qualified or adverse opinion paragraph would be added underneath the opinion paragraph to describe and quantify the effects of the misstatements.

(b) ***(Total Allocated Marks – 10)***
Evaluation. *(Maximum 5 Marks)*
In this case, the chairman's statement refers to strong growth in the year, in particular the scientific publishing division and suggests that the growth will continue. In the current year, the scientific publishing division represented 12% of revenue and 15% of profit before tax and is a material component of the company. As the scientific publishing division will be disposed of early in the next financial period, it will not continue to form part of the basis for revenue or growth, and the chairman's statement could be considered misleading. Further, as a result of the disposal, on a like for like basis it is more likely that the financial statements for the year ended 31 March 2021 will include a reduction in revenue rather than growth.

In addition, the remainder of the business has experienced a lower level of growth in revenue and profits in the period than the scientific publishing division. Revenue growth of continuing business is 2% compared to 44% in the scientific publishing division. Profit growth of the ongoing business is 5% compared to 100% for the scientific publishing division.

The chairman has also made inappropriate reference to the view of the auditor, implying that the auditor's report validates this assertion. The statement also appears to inappropriately pre-empt that the auditor's report will provide an unmodified opinion which based on the assessment above may not be the case given the material misstatement and lack of disclosures. This is inappropriate and all reference to the auditor's report should be removed.

In addition, there is also an issue arising with respect to the use of recycled paper. The chairman's statement in this case is inconsistent with the knowledge obtained during the audit. Whether the auditor considers this to be material would be a matter of judgement, depending on how many publications there are in total and the proportion using non-recycled paper and whether the issue may be material by nature rather than by size.

Course of Action *(Maximum 2 Marks)*
The auditor should discuss with management and the chairman the information in the statement which appears inaccurate or inconsistent. Following further investigations and discussions, the auditor should then request that any information which is inaccurate, inappropriate or inconsistent is removed or amended in the chairman's report.
If management refuse to make the changes, then the auditor's request should be escalated to those charged with governance. If the issue remains unresolved then the auditor should take appropriate action, including:

- Considering the implications for the auditor's report and communicating with those charged with governance about how the auditor plans to address the issues in the auditor's report; or
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.

Implications for the auditor's report *(Maximum 3 Marks)*
If the other information remains uncorrected the auditor would use the Other Information section of the auditor's report to draw the users' attention to the misstatements in the chairman's statement by including an additional statement that describes the uncorrected material misstatement of the other information.

As the inconsistency is in the chairman's statement rather than the audited financial statement the audit opinion is not modified as a result.

Answer. 3

(i) ***(Total Allocated Marks – 9)***

Audit partner rotation *(Maximum 3 Marks)*

Zamad Zahid has been associated with ZL from last eight years (first four years as engagement quality control reviewer and last four years as engagement partner including current year). As ZL is a listed company this goes against the requirements of the code of ethics which requires that an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years unless the law prescribes a shorter period (the "time-on" period):

- The engagement partner;
- The individual appointed as responsible for the engagement quality control review; or
- Any other key audit partner role.

The problem is that long association of the engagement partner with the client leads to a self-interest threat to auditor objectivity, whereby the audit firm's judgement is affected by concern over losing the long-standing client. There may also be a familiarity threat due to close relationships between the audit engagement partner and management of ZL.

The fact that ZC has been allowed to continue in above mentioned roles for longer than the period allowed by the Code indicates that it does not have appropriate policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, as required by ISQC 1. The firm should implement appropriate policies to monitor length of time for which an individual can be associated with an audit client.

Supervision and review *(Maximum 3 Marks)*

Zamad has booked only two hours for audit work performed on ZL. This is not sufficient time for the audit partner to perform their duties adequately. The audit partner is required to take overall responsibility for the supervision and performance of the audit. He should have spent an appropriate amount of time performing a review of the audit working papers in order to be satisfied that sufficient appropriate audit evidence had been obtained as per ISA 220. Instead, it appears that most of the final review was performed by a newly promoted audit manager who would not have the necessary experience to perform this review.

The detail review could have been delegated to Furqan instead of Inaya. However, Furqan only recorded six hours of work on the audit. Thus, confirming that too much of the review has been delegated to the junior audit manager, especially given that going concern was identified as a significant audit risk, meaning that the audit partner has even more reason for involvement in the final review of audit work.

There is also an issue around the overall amount of time which has been recorded for the audit work performed on this client. A total of 173 hours does not seem sufficient for the audit of a listed company, suggesting that audit quality could have been impacted by inadequate time spent in planning and performing the audit work.

Special investigation *(Maximum 2 Marks)*

Zamad's focus appears to have been on the special investigation performed for ZL, to which he booked 40 hours of time. ZL is a listed company, and the Code prohibits the audit firm from providing certain non-audit services. The lack of documentation means that ZC could have provided a prohibited service and therefore be in breach of the Code.

The fact that Rs. 8.9 million was charged for this special investigation indicates that it was a substantial engagement and just the matter of inadequate documentation is a cause for concern.

There is also a possibility that in fact no work has been performed, and the firm has accepted this money from the client but provided no service. This would be a very serious issue, could be perceived as a bribe, and it should be investigated with urgency.

However, there are also possible threats to auditor objectivity including a self-interest threat due to the monetary value of the service provided. His additional involvement with ZL by providing this work compounds the familiarity threat also discussed previously. Depending on the nature of the work performed for the client there may also be other threats to objectivity including self-review and advocacy.

A self-interest threat is created as the value of the services provided is substantial compared to the audit fee. The fact the non-audit fees are so high would create a proportionately bigger intimidation threat because they would form a larger part of the firm's income and the audit firm may not be objective for fear of losing the client.

ZC should ensure that its policies and documentation on engagement acceptance, especially in relation to additional services for existing audit clients, are reviewed and made more robust if necessary.

Engagement Quality Control Review *(Maximum 2 Marks)*
As this is a listed audit client, an Engagement Quality Control Review should have been performed. It is not clear whether this took place or not, but no time has been recorded for this review. If a pre-issuance review was carried out then it should have picked up these problems prior to the audit opinion being issued.

(ii) ***(Total Allocated Marks – 6)***
(Maximum 4 Marks)
The audit work on going concern has been inappropriately delegated to an audit assistant who would not have the necessary skill or experience. This is especially concerning given that going concern was identified as a significant audit risk, and that the work involves using judgement to evaluate information relating to contract performance. The work should have been performed by a more senior member of the team, probably one of the audit managers, who is more able to exercise professional scepticism and to challenge management where necessary on the assumptions underpinning the forecasts.

It is concerning that the audit work appears to have been based on a review of contracts which were selected by management. First, only five contracts were reviewed but the company is typically working on 20 contracts at one time. So it is likely that the coverage of the audit work was insufficient, and more contracts should have been subject to review. Given the risk attached to going concern perhaps all the contracts currently being carried out should have been reviewed, or the sample selected based on the auditor's evaluation of the risk associated with each contract and their materiality.

Second, management may have selected the better performing contracts for Maira to review. This would create a false impression of the performance of the company as a whole, leading to an inappropriate conclusion on going concern being reached.

Finally, the work performed by Maira on this small selection of contracts appears insufficient and inappropriate. Assumptions should not just be agreed as consistent with the previous year, especially in a situation of increasing economic uncertainty as applies in this case. Assumptions should be challenged and other work performed as required by ISA 570 Going Concern. Theclack of further audit procedures means that the audit evidence is not likely to be sufficiently robust in this significant area.

Audit Committee *(Maximum 1 Marks)*
It is concerning that the audit committee of ZL does not appear to have raised concerns about the issues discussed, especially the provision of the non-audit service and the length of time which Zamad has been associated with ZL. One of the roles of the audit committee is to oversee ethical issues relating to the external auditor and to be involved with the engagement of external providers. ZC should ensure that these matters are discussed with the audit committee so that further ethical issues do not arise in the future.

Conclusion *(Maximum 1 Marks)*
From the discussion above it can be seen that there are many problems with the audit of ZL. Zamad appears to have ignored his responsibilities as audit engagement partner, and the audit firm needs to discuss this with him, consider further training or possibly taking disciplinary action against him. ZC need to implement procedures to ensure all work is carried out at the appropriate level of personnel with the appropriate experience and that training is given to staff to ensure they understand the client does not pick or specify the audit work to be carried out in any area, it is to be selected by the audit team in accordance with the audit firms methodology and sampling tools.

Answer. 4 ***(Total Allocated Marks – 10)***
Competence, capabilities and resources *(Maximum 3 Marks)*
SC should only accept FG as a client if the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so. There are two issues to consider here. First, FG is a large, multinational organisation with listed status and with many subsidiaries. Although the majority of the subsidiaries would be audited by other firms, this is still a sizeable audit spanning many countries and requiring extensive liaison with component auditors, all of which will be demanding on the audit firm's resources. It is worth mentioning at this point that FG audit committee wants the audit fee 'as low as possible' indicating that there may be pressure on the audit firm to use a smaller audit team.

Second, the activities of FG are quite specialised, with its operations including the production of various agricultural goods and their processing. Audit staff will need to be familiar with this industry, or SC can consider bringing in staff with the necessary experience, though this will have implications for the profitability of the audit engagement. FG is also listed, so audit staff would need to be familiar with the reporting requirements of the listing rules in Pakistan. SC could bring in experts to perform this work, if necessary, but this would have cost implications and there already appears to be fee pressure on the assignment.

The financial reporting standards applied by the foreign subsidiaries many also be a problem for FG audit team if SC have no experience in reconciling subsidiaries financial statements prepared under local accounting rules to that under which FG reports. This lack of competence could be a significant barrier to accepting the audit.

Client integrity *(Maximum 1 Marks)*
ISQC 1 requires consideration of client integrity when assessing whether to take on a new audit client. The environmental damage allegedly caused by ML could cause SC to question the business ethics of FG, though it is not certain that the accusations are based in fact. Even so, the audit firm may not wish to be associated with a client with a poor reputation.

The 'incentive payment' also brings FG's integrity into question, as it could be a bribe paid to ensure that the land acquisition could go ahead. As this situation has been reported in the media it is another reason why the audit firm may conclude that FG's business ethics are in doubt.

Ethical and other requirements *(Maximum 4 Marks)*
The only ethical issue apparent which may impact on whether the firm can comply with ethical requirements relates to the request from FG audit committee to keep the audit fee as a low as possible. This could be seen as an intimidation threat to auditor objectivity. A low audit fee puts pressure on the audit firm to keep costs as low as possible which compromise quality.

Further, ISA 600 requires an audit firm to evaluate before accepting a new engagement relates to component auditors. Specifically, where component auditors will perform work on components of FG, the audit firm should evaluate whether FG engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. Therefore, before making their acceptance decision, SC should find out more about the component auditors and whether there may be any restriction on obtaining evidence from them, or any potential difficulty in dealing with them.

In addition, ISA 600 suggests that FG auditor should understand group management's rationale for appointing more than one auditor. This is a significant issue for this audit, as FG audit committee has requested that component auditors are used for all foreign subsidiaries, which account for 60% of FG's assets. In particular, SC should discuss with group management their reason for appointing a new Group auditor but keeping the incumbent component auditors for the audits of the subsidiaries.

In addition, given the specialised nature of FG's activities, SC should evaluate the competence of the component auditors as this will have a significant impact on the quality of the audit work, on which FG auditors will be placing some reliance.

One specific risk attaches to the new business in Togo which seems very unusual in that it is not incorporated as a company and is not required to prepare accounts or have a local audit. This means that FG audit team would have to audit this business, creating logistical issues due to its remote location and having cost implications.

Logistical issues *(Maximum 2 Marks)*
The global positioning of this potential client makes it logistically difficult. Members of FG audit team must be willing to travel to conduct at least some of their work, as it would be difficult to perform the engagement without visiting the component auditors to review their work. There are also cost implications of the travel, which will need to be built into the proposed fee for the engagement.

Answer. 5
(a) ***(Total Allocated Marks – 13)***
Revenue from recipe box subscriptions *(Maximum 3 Marks, 0.5 Mark for each point)*

- **i.** The number of meals/people in each subscription is based on market research.
- **ii.** The rate of growth is consistent with the rate of growth/trends in Pakistan market at its launch.
- **iii.** Prices are in line with any recipe box services already in the Qatari market.
- **iv.** The 20% discount is reflected and for customers' first month only.
- **v.** The proportion of customers using discount is based on past campaigns.
- **vi.** Prudent assumption about cancellation/retention rates, ie cancellations are likely to be higher after the end of the promotional period.

Purchases from local farmers and food distributors *(Maximum 3 Marks, 0.5 Mark for each point)*

- **i.** The cost of ingredients should be consistent with:
  - local market prices
  - any correspondence/negotiations with suppliers.
- **ii.** Purchase volumes should be consistent with sales volumes.
- **iii.** Rebate terms should be in line with those typically available in the Qatari market.
- **iv.** Rebates should be earned one year after the start of contract / Sept 2022.

Delivery costs *(Maximum 3 Marks, 0.5 Mark for each point)*

- **i.** The rates paid for local delivery companies should be consistent with market rates.
- **ii.** Costs should be consistent with sales volumes.
- **iii.** Delivery company costs should stop when the volume of sales reaches 10,000 boxes.
- **iv.** At which point running costs of FEL's own delivery vehicles should be included.
- **v.** The costs should reflect the geographic area to be covered.

Depreciation *(Maximum 3 Marks, 0.5 Mark for each point)*

Depreciation commences when assets are ready for use.

Leasehold

- **i.** The cost of the leasehold property should be realistic compared to similar properties in locale.
- **ii.** Depreciation should reflect the likely term of leasehold.

Specialist storage facilities and equipment

- **i.** The cost of storage and equipment should reflect the tenders submitted.
- **ii.** An appropriate policy should be applied in respect of the capitalisation of assets.
- **iii.** Prudent estimates of residual value should be made for specialised facilities.
- **iv.** Depreciation policies should reflect the assets' useful lives.

Vehicles

- **i.** Vehicle costs should be consistent with market rates.
- **ii.** The rate of depreciation should be appropriate for likely mileage.
- **iii.** Depreciation starts when sales volume reaches 10,000.

General *(Maximum 1 Mark, 0.5 Mark for each point)*

- **i.** Rate of inflation.
- **ii.** Sensitivity analysis.
- **iii.** Revenue and costs commence 1 September 2021.
- **iv.** Seasonality considered.

(b) ***(Total Allocated Marks – 6)***
(Maximum 2 Marks)
There is a material misstatement as the assumptions are significant. The report/conclusion should be modified. An adverse conclusion is required by ISAE 3400 The Examination of Prospective Financial Information (PFI). The report should state that the assumptions do not provide a reasonable basis for the PFI. A paragraph headed 'Basis for adverse conclusion' should be included which describes the matter giving rise to the modification. The firm may still be able to give an unmodified opinion that the PFI is properly prepared on the basis of the assumptions.

Conclusion/Opinion Paragraph: *(Maximum 4 Marks)*
We have examined the forecast in accordance with the International Standard on Assurance Engagements applicable to the examination of prospective financial information. Management is responsible for the forecast including the assumptions set out in Note X on which it is based.

Based on our examination of the evidence supporting the assumptions, due to the significance of the matter discussed in the Basis for Adverse Conclusion paragraph, we believe that these assumptions do not provide a reasonable basis for the forecast. Further, in our opinion the forecast is properly prepared on the basis of the assumptions and is presented in accordance with IFRS / applicable financial reporting framework.

Actual results are likely to be different from the forecast since anticipated events frequently do not occur as expected and the variation may be material.

Answer. 6
(a) ***(Total Allocated Marks – 5) (1 marks for each brief para)***
If the full extent of the fraud is Rs. 400,000, then the audit team is correct to determine that the fraud is immaterial to the financial statements. However, without performing further procedures it is not possible to reach that

conclusion. There is no auditor-generated evidence to support the assertion that Rs. 400,000 is the total amount of stolen funds. Relying solely on a conversation between the finance director and the manager who carried out the fraud and a list of invoices provided by the finance director is not acceptable as this evidence is not sufficiently reliable.

Indeed, finance director could be involved with the fraud, and is attempting to deceive the auditor and minimize the suspected scale of the fraud in order to deter further procedures being carried out, or investigation or actions being taken. The auditor should approach the comments made by finance director with an attitude of professional scepticism, especially given that he has asked the audit team not to investigate further, which raises suspicion that he may be covering up the fact that the fraud was on a larger scale than has been made known to the auditor.

There are two courses of action for the auditor. First, further independent investigations should be carried out in order for the auditor to obtain sufficient and appropriate evidence relating to the amount of the fraud. If the fraud is actually more financially significant, the financial statements could be materially misstated, but without further audit evidence, the auditor cannot determine whether this is the case.

Second, the auditor should consider whether reporting is necessary. ISA 240 requires that when fraud has taken place, auditors shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

In addition to reporting to management and those charged with governance, ISA 240 requires that the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. The auditor's duty to maintain the confidentiality of client information makes such reporting potentially difficult, and the auditor may wish to take legal advice before reporting externally.

(b) ***(Total Allocated Marks – 5)***
(Maximum 3 Marks for discussion)
Given that the development costs are material to the financial statements, more audit work should have been carried out to determine whether it is acceptable that all, or some, of the Rs. 6 million should have been capitalised. There is a risk that research costs, which must be expensed, have not been distinguished from development costs. Currently, there is not sufficient, appropriate audit evidence to conclude that the accounting treatment is appropriate, and intangible assets could be materially misstated.

Agreement of amounts to invoice provides evidence of the value of expenditure, but does not provide sufficient, appropriate evidence as to the nature of the expenditure, i.e. the procedure is not necessarily an evaluation of whether it is capital or revenue expenditure.

Performing an arithmetic check on a spreadsheet does provide some evidence over the accuracy of the calculations but does not provide sufficient, appropriate evidence on the validity of the projections, and in particular, there is no evidence that the assumptions are sound. Given that finance director has not allowed the audit team access to information supporting the spreadsheet and has refused to answer questions, he may have something to hide, and the audit of the projection should be approached with a high degree of professional scepticism. The assumptions may not be sound and may contradict other audit evidence.

Finally, there appears to be over-reliance on a written representation from management which should only be used to support audit evidence. In this situation, it appears that the representation is the only evidence which has been sought in regard to the likely success of the new product development which is inappropriate.

Further evidence should be obtained to distinguish between research costs and development costs, and to support whether the development costs meet the recognition criteria in IAS 38 Intangible Assets, and to confirm whether all of the Rs. 6 million should be capitalised. Further evidence should be obtained, including: *(Maximum 3 Marks for further evidence)*

- A discussion with the project manager to obtain their view on the likely launch date for the new product, anticipated level of demand, any problems foreseen with completion of the project.
- A further review of a sample of the costs included in the Rs. 6 million, including evaluation of whether the costs are capital or revenue in nature.
- For the sample of costs, review purchase invoices and ensure they are in the name of the company to confirm the rights and obligations assertion of the capitalised costs.
- Results of any market research to support the assertion that the new product will generate future economic benefit.
- A discussion with management to identify how they have incurred development costs without carrying out any research first.
- Assuming that finance director makes the supporting documentation, including assumptions, available to the audit team, the assumptions should be reviewed for reasonableness, with the auditor considering whether they are in line with business understanding and with other audit evidence obtained.

(The End)

PAC