AUDIT & ASSURANCE

July-August 2023

Time allowed- 3:30 hours
Total marks- 100

[N.B. - The figures in the margin indicate full marks. Questions must be answered in English. Examiner will take account of the quality of language and of the manner in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order of sequence.]

Marks

1. a) During the course of the audit of MNO Ltd ('MNO') you came to know that a substantial cash deposit was paid into the company's bank account and immediately after deposit, the same amount was transferred into a bank account in the name of EFG, an overseas entity, related with MNO. You have also been informed that the managing director of MNO had instructed to employee of accounts department not to record the transaction in the accounting records as it had nothing to do with MNO's business.

Requirement:
As auditor of MNO, state with reasons, what are the actions to be taken in relation to this matter? 2

b) Your firm has got an invitation to submit expression of interest (EOI) for the audit of Alpha Ltd. Previously your firm had no experience to act in any capacity for this company but does act for Beta Ltd, which is one of the major competitors of Alpha Ltd.

Requirement:
Explain the ethical issues involved in relation to the situation as regards to EOI as mentioned above, and state how you would address those issues. 4

c) Mr. Sattar is going to start an audit assignment. As a senior qualified assistant, you are responsible to review the work of Mr Sattar before the working file is passed on to the engagement partner. What aspects will you be considering when you are reviewing Mr. Sattar's work? 2

d) The following points have arisen during the audit for the year ended 30 June 2023 of Car House Ltd., a nationwide dealer in used cars.
1. During the year, five of Car House Ltd.'s properties were revalued by an independent surveyor.
2. One property was sold during the year to the marketing director.
3. The directors have refused to make provision against a bad debt.

Requirement:
Explain whether or not each of the above would be referred to in the letter of representation for the year ended 30 June 2023. 3

e) A client company has recently prepared draft financial statements for the year to 31 December Year 2. During the year, the company closed a factory that made a loss-making product which contributed 14% to total sales revenue in the previous year and 10% in the current year.

The closure is permanent. It is mentioned in the directors' report and in the annual business review, but not in the financial statements themselves.

Requirement:
What should be the auditor's view of this situation? 4

f) A client company has prepared draft financial statements for the year to 31 December Year 3. In February Year 4 a legal claim was made against the company, claiming substantial damages. The company's lawyers have advised that the claim has less than 50% chance of success. If it did succeed, the company would have sufficient cash resources to meet the claim in full.

The matter is disclosed in the draft financial statements in a note, as a material contingent liability.

Requirement:
Should the audit opinion be unmodified, and if so, should the report contain a 'Material Uncertainty Related to Going Concern' paragraph? 5

2. a) You have been approached by the directors of Bix ltd. (Bix) with a view to appoint your firm as its auditor for the year ending 30 June 2023. Bix manufactures jute goods which it supplies to many of the major factories.

Bix has a wholly-owned subsidiary entity located overseas which manufactures packing materials for locally based fertilizer manufactures. The subsidiary, which is of a similar size to Bix, is located in a country where there is no audit requirement for companies whose shares are not publicly held. Bix prepares consolidated financial statements.

The shareholders of Bix are actively involved in the day to day running of the business and that of the wholly-owned subsidiary.

As auditor of the previous year's audit at 30 June 2022 Bix was carrying inventory totaling BDT 4,25,000 in respect of a cancelled order from a cement manufacturer that had gone into liquidation.

During August 2022, modifications were made to the inventory, at a cost of BDT 1,25,000, to enable them to be sold to another customer for BDT 2,45,000 that same month. The directors of Bix were concerned at the effect that any provision against the inventory in the financial statements would have on their distributable profits for the year. The directors accordingly insisted on including the inventory in the financial statements at BDT 4,25,000, which gave rise to a modified audit report. In this connection the directors of Bix have informed their existing auditors that they will not be re-appointed at the company's ensuing annual general meeting. They have not shown any reason for this, but the existing auditors suspect that it is due to the reason that a dispute arose during the audit of last year's financial statements as mentioned above.

In addition to your appointment as auditor, the directors of Bix have also requested:

(i) That you, as the proposed engagement partner, attend the company's monthly board meetings; and
(ii) That your firm be appointed to provide internal audit services to Bix.

Your firm has seven partners in total and has an office in three cities of Bangladesh.

Requirements:

i) Set out the key issues specific to Bix that may prevent you from accepting the appointment solely as its external auditor, and state what action you could take to resolve these issues. 4

ii) Discuss the potential threats to objectivity caused by the provision of the additional services requested by Bix and describe what safeguards could be put in place to mitigate those threats. 4

b) You are the manager responsible for the audit of Abir Jewelers Ltd., a jewelry manufacturer and retailer. The final audit for the year ended 30 June 2023 is nearing completion and you are reviewing the audit working papers. The draft financial statements recognise total assets of Tk.1,919 million (2022 - Tk.1,889 million), revenue of Tk.1,052 million (2022 - Tk.997 million) and profit before tax of Tk.107 million (2022 - Tk.110 million).

The following information is available as part of the audit completion review:

Cost of inventory

Inventory costs include all purchase costs and the costs of conversion of raw materials into finished goods. Conversion costs include direct labour costs and an allocation of production overheads. Direct labour costs are calculated based on the average production time per unit of inventory, which is estimated by the production manager, multiplied by the estimated labour cost per hour, which is calculated using the forecast annual wages of production staff divided by the annual scheduled hours of production. Production overheads are all fixed and are allocated based upon the forecast annual units of production. At the year-end inventory was valued at Tk.21 million (2022 - Tk.20 million).

Impairment

At the year-end management performed an impairment review on its retail outlets, which are a cash-generating unit for the purpose of conducting an impairment review. While internet sales grew rapidly during the year, sales from retail outlets declined, prompting the review. On 30 June 2023 the carrying amount of the assets directly attributable to the retail outlets totaled Tk.137 million, this includes both tangible assets and goodwill.

During the year management received a number of offers from parties interested in purchasing the retail outlets for an average of Tk.125 million. They also estimated the disposal costs to be Tk.1.5 million, based on their experience with corporate acquisitions and disposals. Management estimated the value in use to be Tk.128 million. This was based on the historic cash flows attributable to retail outlets inflated at a general rate of 1% per annum.

Consequently, the retail outlets were impaired by Tk.9 million to restate them to their estimated recoverable amount of Tk.128 million. The impairment was allocated against the tangible assets of the outlets on a pro-rata basis, based upon the original carrying amount of each asset in the unit.

Requirement:

Using the information, comment on the matters to be considered and explain the audit evidence you would expect to find during your review of the audit working papers on 1 July 2023, in relation to the issues identified. 7

3. Your firm is the auditor of Extensions Ltd which operates 10 Mobile set Sales Centre (MSC) in and around Dhaka. You are the senior in charge of the audit of Extensions Ltd. for the year ending 30 June 2023 and are engaged on the audit planning.

Most of the company's sites are long-established and, as well as supplying mobile charger, mobile battery, facility of flexi load, have a mobile repairing and a shop.

Over the last few years, due to the intense price competition in mobile business, the shops have been expanded into mini-markets with a wide range of mobile accessories, food, drinks and household products. They also now sell National Lottery tickets.

Point-of-sale PCs are installed in all the MSCs, linked on-line via a network to the computer at head office. Sales and inventory data are input direct from the PCs.

The company has an internal auditor, whose principal function is to monitor continuously and test the operation of internal controls throughout the company. The internal auditor is also responsible for coordinating the year-end inventory count.

Requirements:

Prepare notes for a planning meeting with the audit engagement partner which:

a) Identify, from the circumstances particular to Extensions Ltd. as described above that should be taken into consideration when planning the audit with necessary explanation. 8

b) Describe the extent to which the work performed by the internal auditor may affect your planning, and the factors that could limit the use you may wish to make of his work. 7

4. a) You are the manager responsible for the quality of the audits of new clients of Syngenta & Co, Chartered Accountants. You are visiting the audit team working at the client's head office, ABC Ltd., a limited liability company. The audit team comprises Ameer Ahmed (audit supervisor), Chanchal Chowdhury (audit senior) and Enam Khan and Gazi Salahuddin (trainees). The company provides food hygiene services which include the evaluation of risks of contamination, carrying out bacteriological tests and providing advice on health regulations and waste disposal.

ABC Ltd.'s principal customers include food processing companies, wholesale fresh food markets (meat, fish and dairy products) and bottling plants. The draft accounts for the year ended 31 December 2022 show revenue Tk.19.8 million (2021: Tk.13.8 million) and total assets Tk.6.1 million (2021: Tk.4.2 million).

You have summarised the findings of your visit and review of the audit working papers relating to the audit of the financial statements for the year to 31 December 2022 as follows:

(i) Against the analytical procedures section of the audit planning checklist, Chanchal has written 'not applicable – new client'. The audit planning checklist has not been signed off as having been reviewed by Ameer.

(ii) Ameer is currently assigned to three other jobs and is working from Syngenta & Co's office. He last visited ABC Ltd.'s office when the final audit commenced two weeks ago. In the meantime, Chanchal has completed the audit of non-current assets (including property and service equipment) which amount to Tk.1.1 million as of 31 December 2022 (2021: Tk.1.1 million).

(iii) Enam has just finished sending out requests for confirmation of trade receivable balances as of 31 December 2022 when trade receivables amounted to Tk.3.5 million (2021: Tk.1.6 million).

(iv) ABC Ltd.'s purchase office supplies and keeps Tk.2,500 cash to meet sundry expenses. The audit program shows that in counting it is 'outstanding'. Chanchal explained that when Salahuddin was sent to count it he reported back, two hours later, that he had not done it because it had not been convenient for counting. Salahuddin had, instead, been explaining to Enam how to extract samples using value-weighted selection. Although Jules had later announced that he was ready to have his cash counted, Chanchal decided to postpone it until later in the audit. This is not documented in the audit working papers.

(v) Enam has been assigned to the audit of inventory (comprising consumable supplies) which amounts to Tk.150,000 (2021: Tk.90,000). Syngenta & Co was not appointed as auditor until after the year-end physical count. Enam has therefore carried out tests of controls over purchases and issues to confirm the 'roll-back' of a sample of current quantities to quantities as at the year-end count.

(vi) ABC Ltd. has drafted its first report which contains health, safety, and environmental performance data for the year to 31 December 2022. Chanchal has filed it with the comment that it is 'to be dealt with when all other information for inclusion in the company's annual report is available'.

Requirement:

Identify and comment on the implications of these findings for Syngenta & Co's quality management policies and procedures. 15

b) You are a senior manager with Fazle Elahee and Co and are a member of the team conducting post-issuance reviews. You are currently reviewing the audit file of Camelia Ltd., a subsidiary of a listed overseas parent, which imports and distributes office furniture, usually manufactured by other group companies.

During your review you notice the following:

- Minutes of the planning meeting are on file but were not signed by the partner.
- The company's year-end is 31 December. Fieldwork was completed by 15 February and the financial statements together with the auditor's report were signed on 15 April. The subsequent

events checklist was completed on 15 February.

- The company has very little headroom in its overdraft and apparently no other borrowing facilities.
- There is a letter of support on file from the holding company dated 15 April.
- Materiality is calculated at Tk.60,000, which is in line with the firm's recommended procedures.
- Non-current assets consist of office furniture, office equipment and racking and forklifts for the rented warehouse. The carrying value is Tk.250,000 and additions in the year were Tk.40,000. Copy invoices for all the additions are on file but you find it difficult to see precisely what work was done. The working papers, other than the pre-printed audit programme and lead schedule, have not been initialed or dated.
- The receivables circularisation was successful except for one nonreply for Tk.40,000.

Requirement:

Comment on the quality of the audit of Camelia Ltd. and describe the recommendations would you make to the firm's audit quality committee. 10

5. a) You are the manager responsible for the audit of Alpha Ltd, a listed company specialising in the manufacture and installation of sound-proof partitions for domestic and industrial buildings. You are currently reviewing the draft auditor's report on the company's financial statements for the year ended 31 March 2022. Extracts from the draft auditor's report are shown below:

Independent auditor's report to the shareholders and directors of Alpha Ltd

Basis for opinion

We conducted our audit of Alpha Ltd (the Company) in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements which are relevant to our audit of the financial statements in the jurisdiction in which the Company operates, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

We have audited the financial statements of Alpha Ltd, which comprises of the statement of financial position as at 31 March 2022, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 March 2022, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Material uncertainty regarding going concern

The Company is financed by a long-term loan from its bankers which is due for redemption in August 2022. At the date of this auditor's report, the Company is in the process of renegotiating the loan but has not yet reached a final agreement with its bankers. It is our view that the loan finance is essential to the continued survival of the Company and that at the time of reporting, therefore, the absence of a finalised agreement represents a material uncertainty regarding going concern. The financial statements have been prepared on a going concern basis but do not make any reference to the loan redemption or the ongoing negotiations with the bank. As the external auditor therefore, we are fulfilling our duty by bringing the matter to the attention of users of the financial statements.

Other information

The Company's principal activity is the manufacture and installation of sound-proof partitions for domestic and industrial buildings. The Company therefore engages in long- term contracts which are incomplete at the reporting date and which are material to its revenue figure. The installation process is complex and significant judgement is applied in assessing the percentage of completeness which is applied to calculate the revenue for the year. The significance of this judgement requires us to disclose the issue as other information which is relevant to the users of the financial statements.

Requirement:

Comment on the issues raised in the extract from the draft auditor's report for the year ended 31 March 2022. (Note: You are NOT required to re-draft the extracts from the auditor's report.) 6

b) Your firm, Edward & Co., Chartered Accountants has asked you to perform an independent review of the working papers of ABC Limited which is a listed entity and has been an audit client of your firm for the last ten years. The audit fieldwork is almost complete and as part of your review, you have been asked to advise the audit team on the drafting of their report to those charged with governance. ABC Limited is a discount food retailer which operates 15 stores nationwide.

Below is an extract of the financial statements for the period:

	2022 (TK. Million)	2021 (TK. Million)
Revenue	247	242
Profit before tax	14.6	14.1
Total Assets	535	321

After a period of rapid expansion, 2022 has been a year in which ABC Limited has strengthened its existing position within the market and has not acquired any additional stores or businesses. The company's draft statement of financial position for 2022 includes a property portfolio of Tk.315 million all of which are legally owned by the entity. In the current year, the company has chosen to adopt a policy of revaluing its property portfolio for the first time and this is reflected in the draft figures for 2022. The audit work on property, plant and equipment included testing a sample of the revaluations. Edward & Co. requested at the planning stage that independent, external valuation reports should be made available to the audit team at the start of the final audit visit. A number of these documents was not available when requested and it took three weeks for them to be received by the audit team. The audit working papers also identified that on review of the non-current asset register, there were four properties with a total carrying amount of Tk.11.1 million which had not yet been revalued and were still recorded at depreciated historic cost.

The audit supervisor's reviewed board minutes of ABC Limited and identified that the company has renovated seventeen car parking facilities at its stores which has resulted in a significant increase in customer numbers and revenue at each of these locations. The total cost of the renovation work was Tk. 13.2 million and has been included in operating expenses for the current year. The audit file includes a working paper recording discussions with management which confirms that capital expenditure authorisation forms had not been completed for this expenditure.

You are aware that your firm had intended to replace the current engagement partner, Mr. Kamal Ahmed FCA, with Mr. Syed Bashir Ali FCA who is Edward & Co.'s other specialist in food retail. Unfortunately, Mr. Syed Bashir Ali FCA was ill earlier in the year and will not now be available until next year's audit engagement. As a result, 2022 is the eighth consecutive year in which Mr. Kamal Ahmed FCA has acted as an engagement partner.

Requirement:

From the information provided above, recommend the matters which should be included in Edward & Co.'s report to those charged with governance, and explain the reason for their inclusion. 10

6. Three situations which have arisen in three audits are described below. The year end in each case is 30 June 2022.

(1) PQR Ltd uses leased machine which have been accounted for as operating leases. However, during the course of audit it came to notice that these leases are finance leases and should have been capitalized at BDT 51,000. The current treatment does not comply with accounting standards which require finance leases, where the user takes on the risks and rewards of ownership, to be included within non-current assets and capitalized. Profit for the year would then have been reduced by BDT 4,000.

The pre-tax profits of PQR Ltd for the year ended 30 June 2022 were BDT 6,00,000, and total assets at 30 June 2022 were BDT 5.4 million.

(2) A fire in the warehouse of DEF Ltd in July 2022 destroyed the inventory sheets, which were the only record of the company's inventories at the year end. The company has included an estimated inventory figure of BDT 7,80,000.

(3) The pre-tax profits of DEF Ltd for the year ended 30 June 2022 were BDT 1 million and total assets at 30 June 2022 were BDT 6.5 million.

(4) GHI Ltd has included a note in the financial statements explaining that 90% of its revenue is derived from a national retailer with whom it has a three-year renewable contract. This contract is due for renewal in December 2022. However, the directors require the auditor's report on the financial statements to be signed on 31 August 2022.

Requirements:

a) Evaluate the use of standardized auditor's reports. 3

b) Taking into consideration the materiality, describe briefly each of the situations outlined above. Describe the effect on the auditor's report for each situation. 6

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