**AUDIT & ASSURANCE**

**July-August 2024**

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) Recently news scam in financial and nonfinancial organization has been published in the print and electronic media of the country. Most of them are occurring due to related party transactions. In the partners meeting of your firm, it has been decided to perform a training session for the professional staff of the firm and you are given the responsibility.

**Requirements:**
You are required to prepare notes for the training session on how to identify related party transactions. Your notes should include:

i) A list of possible features which would lead you to investigate a particular transaction to determine whether it is, in fact, a related party transaction. 6

ii) A summary of general audit procedures you would perform to ensure that all material related part of transactions have been identified. 6

b) Members of the Institute of Chartered Accountants of Bangladesh (ICAB) are expected to well grasp the ethical codes promulgated by the IESBA as adopted by the ICAB as well as those embedded in the Schedule-C of ICAB Bye Laws.

There has been a perennial debate about whether professional accountants can advertise their services and activities! On the other hand, advertisement is believed to be one of the key drivers to the business growth. Professional accountants in practice are usually guided by two sets of ethical codes underlying their services provided to the clients. Alongside local codes, respective jurisdiction might be guided by the IESBA codes of ethics.

**Requirement:**
Being an accountant in practice, describe if accountants in practice are allowed to advertise their practices. 4

c) You are the Partner in Charge of client acceptance in your firm of Chartered Accountants. Below are two prospective clients for your final review.

- Reed Ltd. is a fast-growing company in the trading industry and deals in hardware. Your firm has been nominated to be the auditor of Reed Ltd. and formal communication has been received by your firm. Your firm of chartered accountants has significant shares in the largest distributor of hardware in the country.
- Fast Communication Ltd. advertised for audit services and your firm submitted a bid in response to the advertisement and was nominated as auditors. Your firm has audit experience in this industry because it is the current auditor of Link Ltd. a company in the same industry. The year-end of Fast Communication Ltd. is different from that of Link Ltd. and so the same engagement team will audit both Companies.

**Requirement:**
Describe the response that you will give in view of the nominations for your firm to be auditor of the two companies above. 4

2. a) Most of the business entities are small in size in our country. The management of the company does not want to go to different professionals for professional service. Most of the companies want to get services from one professional firm. Under these circumstances, your Chartered Accountancy firm, having seven partners, has been invited by Mr. Hilton, the Managing Director and majority shareholders of Paltan Ltd. to accept appointment as the auditor of the company and provide assistance with the preparation of the financial statements as well as the company tax matters.

The principal activity of Paltan Ltd. is to process and pack tea bags and tea cups which are sold to customers operating in fast foods and retail shops. The main purpose of this audited financial statements is to obtain loan from bank. As per country leading policy, debt equity ratio is required for such small business is 1:1.

The accounting records are computerized and the company uses the software which was developed by Proton Software Ltd. a company owned by Mr. Hilton's brother. The software has been customized to integrate inventory control with receivables and payables. Proton Software Ltd. also provides support for the company's computer systems. The accounting records are maintained by Mr. XYZ, assisted by Mr. PQR who is a part time employee of the company and responsible for payroll processing.

**Requirement:**

State, with reasons, what matters are to be considered at procedures to be performed prior to your firm accepting and commencing the audit of Palton Ltd. 5

b) ABC Limited, a company dealing with the production and distribution of electrical equipment, has been in the market since January 2015. About 80% of their production is sold in the local market so far while the remaining 20% is exported to the Sub-Saharan countries in Africa. Given the growth in the business coupled with the reputation gained by the company, there has been a possibility of attracting new investors to their business. So, with a view to adding more credibility to their financial reporting status and underlying acceptability, they have started thinking of engaging a better audit firm to do their audits.

**Requirement:**

Being a potential auditor of this company, you are asked to delineate the minimum conditions you would take into consideration before accepting such an engagement. 5

c) ISA 210 prescribes the terms of an audit engagement. So, a careful read and grasp of the contents of the respective ISA is critical to accepting an audit engagement.

**Requirement:**

Elucidate the term as prescribed in ISA 210 for an audit engagement. 5

3. a) Gamston Ltd. is a private limited company engaged in manufacturing and exporting garment items. Raw materials (yarn) import and finished products export are taken place on Back-to-Back L/C. Due to Covid-19 and Russia-Ukraine war, the exports, have been hampered severely. Several export orders have been cancelled by the buyer. Lending bank has created demand loan by substantial amount and in the sanction of demand loan, bank has given condition that Gamston Ltd. can be allowed to open further L/C up to the limit of 75% repayment of demand loan. Under this situation, your firm has been appointed auditor of Gamston Ltd. In a partners' meeting the managing partner of the firm informed the engagement parties of the audit assignment of Gamston Ltd. that there is a risk of going concern issue in the Gamston Ltd. and we have responsibility to obtain sufficient appropriate audit evidence about the appropriateness of management's use of going concern assumption.

**Requirements:**

i) Identify the tasks that will have to be carried out to identify the genuineness of going concern assumptions of Gamston Ltd. 7

ii) Write down the possible indications of going concern problems as per ISA 570. 7

b) ISA 240, while talks about auditors' responsibility with regards to fraud in audit of financial statements, among others uses the term management override to refer to the unique ability of management to manipulate the accounting records and therefore produce misleading financial statements. Reasons for management override are many and varied, for example financial gain, tax avoidance, or the enhancement of personal or business performance. Auditors need to assess the risk of management override during the planning stage of the audit, and design appropriate audit procedures in response.

**Requirement:**

Indicate the minimum procedures that would give you reasonable confidence in arriving at the conclusion that frauds emanating from management override have not occurred in the financial statements under audit. 5

4. a) You are planning the audit of the financial statements of Frangos Ltd. for the year ended 31 December 2022. Frangos Ltd. imports its raw materials through Chottogram port where port staff generally calls for strike to achieve their salary increment movement. During the current year the company experienced serious delays in the arrival of raw materials due to delays arising from the strike. This is the first time you will be auditing a company in the chemical industry.

You are leading a team of newly recruited Audit Assistants, who completed their studies recently, on the audit of the financial statements of Frangos Ltd.

Frangos Ltd. manufactures fertilizers and company was awarded a contract by the Ministry of Agriculture to supply fertilizer to the Govt. Depots. In the last two years, Frangos Ltd. could not meet the demand for its products due to the company failing to meet its production targets. This was attributed to old equipment which constantly breaks down. As a result of this, the Technical Manager of Frangos Ltd. resigned this year citing frustrations in failing to meet production levels. It is not easy to find technical staff in this industry. In view of the award of the contract to supply fertilizers for the next farming season, the company undertook extensive repairs of its ageing equipment during the year and in some cases, complete refurbishment of the equipment. The Managing Director is concerned that if the company fails to meet its contractual obligations the contract would be cancelled, and the company would face difficulties repaying the bank loan which it secured for the repairs and refurbishment of the equipment. The loan is secured on the equipment purchased using the facility.

You establish that a farmer based in Bogra sued Frangos Ltd. in the year under review claiming that the company supplied him with expired fertilizer resulting in his losing TK1.5m. The farmer is claiming damages and interest as the courts may determine.

There has been increased monitoring of the disposal of hazardous substances by the concerned ministry and agency for managing environment and climate.

**Requirements:**

i) State four matters that should be documented in the working papers with regards to materiality in the audit of the financial statements of Frangos Ltd. 4

ii) Identify and explain four audit risks in the audit of the financial statements of Frangos Ltd. and suggest suitable responses for each risk. 4

iii) Identify and explain four business risks in Frangos Ltd. 4

b) Chowdhury & Associates are auditors of Cyba Limited and the audit of the financial statements of Cyba Limited for the year ended 31 December 2023 is nearing completion.

The company has not paid out any dividends for the last five years on account of re-investing most of the profits in order to improve the liquidity of the company. In the year under review, the company failed to satisfy customer requirements resulting in some customers switching suppliers. In an effort to retain customers the company offered 30 days extended credit to some of its customers who were on cash basis. This significantly affected the liquidity of the company. Major suppliers withdrew credit to Cyba Limited on account of delayed payments.

Because of poor liquidity, the company experienced a number of labor disputes during the year resulting in workers withdrawing labor. The Audit Manager performed analytical procedures of the financial statements and the result shows a net current liability position. The directors of Cyba Limited evaluated the ability of the company as a going concern and concluded that it was a going concern and that it would be recapitalized and the liquidity position would improve in the next twelve months.

You are the Engagement Partner for the audit of the financial statements of Cyba Limited and four other clients of your firm.

You are reviewing the working papers of the four other audit clients and the following information has been extracted from the working papers:

**Client one**

The audit team on this audit obtained sufficient appropriate evidence on which to base the opinion. There is a matter that you are concerned about and you would like to include it in the audit report. This relates to a provision for a pending legal case involving a spillage of hazardous substances by the company. You are concerned that environmentalists may express concern if this matter is not mentioned in the audit report. The penalty for the spillage according to the act is small and is considered immaterial to this client.

You are pleased that management correctly accounted for this and adequately disclosed it in note 2 of the financial statements.

**Client two**

An evaluation of the schedule of uncorrected material misstatements in the audit of the financial statements shows that the uncorrected misstatements are above the materiality figures set at the planning stage. The request to management to pass an adjustment in the financial statements was declined.

The total amount of uncorrected misstatements is material but not pervasive to the financial statements.

**Client three**
A few days before the inventory count at the year end, fire gutted part of the warehouse destroying the entire inventory. The book value of the inventory was used to determine the inventory value. It was not possible to obtain sufficient appropriate evidence of the value of inventory at the year end and you concluded that inventory is material figures in the financial statements and considered pervasive to the financial statements.

**Client four**
The client uses a manual accounting system and the audit team observed that the filing of documents is very poor. The audit team was not able to obtain the necessary evidence regarding 70% of the samples on sales revenue. It was not possible to obtain the required evidence through other means and this was brought to the attention of management.

A misstatement of the revenue figures in the audit of this client will result in a misstatement of the profit for the year.

**Requirements:**

i) Explain the reasons why auditors are concerned with the ability of client companies operating as going concerns. 3

ii) Identify and explain four conditions that suggest that Cyba Limited has going concern problems. 3

iii) Suggest, giving reasons, a suitable opinion for each of your firm's audit clients one to four above. 3

5. a) Edward & Co. Chartered Accountants (EdCo) has been appointed auditor for the Mittal Group of companies for the year ended 31 December 2023. The scope of the work of EdCo includes auditing and expressing opinions on the financial statements of Mittal Holdings Limited and 5 others out of 7 companies of the group. Under the engagement term, EdCo would remain responsible for issuing opinions on the consolidated financial statements of the group. Two other companies are also very important and material to the reporting of the group but are being audited by other firms.

Under strict deadlines to finalise the audits, EdCo finds that they do not have adequate staff to run all audits in the engaged entities simultaneously. EdCo, under this unavoidable circumstance, has decided to sub-contract audit engagements for 2 companies and take loan of 8 staffs from other firms. EdCo has issued audit instructions to component teams where a list of deliverables and timetable has been mentioned. Component teams are required to determine their own materiality level.

**Requirements:**

i) What are the ethical or professional issues arising from sub-contracting audit engagements and taking staff loans? 3

ii) As principal auditor, what are the procedures that EdCo should perform in respect of the components that are not being audited by EdCo? 3

iii) What evidence should EdCo obtain in order to express its opinion on the consolidated financial statements? 3

iv) Say, one of the component auditors has expressed qualified audit opinion in its audit report. How will this opinion affect the opinion of EdCo on the financial statements of Mittal Holdings Ltd. and the consolidated financial statements of the group. 3

b) Mittal Holdings Ltd. is a listed company that manufactures and sells various types of household electrical equipment. To sell their products, the company uses both their own selling outlets in a few major cities as well as countrywide retailers and distributors. The latest annual general meeting of the company was held on 28 March 2023, where shareholders appointed Edward & Co. Chartered Accountants (EdCo) as auditor for the year ending 31 December 2023.

Being a listed company, the statutory auditors must issue their reports with mandatory paragraph of Key Audit Matters (KAM). Though the term itself offers an indication of what those matters should be, the auditors remain confused of selecting Key Matters to be mentioned.

**Requirements:**
Being Engagement Manager nominated by your firm to deal with the proposed audit, you are asked to narrate the determining criteria of KAM as indicated in ISA 701. 3

6. a) Described below are three situations which have been arisen in three audits. The year end in each case is 30 June 2023.

(i) Alpha Ltd. sold goods to Beta & Co. valued Tk. 5,000. The goods were delivered to the store of Beta at 7:00 pm when there was no responsible person to acknowledge the receipt of goods. At the same night at 10:00 pm fire had taken place and the delivered goods were burnt. The management of the Beta has refused to pay the value of delivered goods with a logic that they did not acknowledge the receipt of the goods. However, Alpha Ltd. has accounted for the delivered goods as "sales" and "receivable from Beta". The issue has remained with the arbitrator.

The pre-tax profits of Alpha Ltd. for the year ended 30 June 2023 was Tk. 3,000,000 and total assets at 30 June 2023 was Tk. 6,000,000.

(ii) Due to the devastating flood inventory sheet kept at the warehouse of TP Ltd. was destroyed. The destroyed inventory sheet was only the record of the Company's inventories at the year end. The company has included an estimated inventory figure of Tk. 8,50,000.

The pre-tax profits of TP Ltd. for the year ended 30th June 2023 was Tk. 1,200,000 and total assets at 30 June was Tk. 1,750,000.

(iii) During the course of audit of PQR ltd, it has been noted by the auditor that 80% of its revenue is derived from a single retailer customer with whom it has a three-year renewable contract. This contract is due for renewal in November 2023. However, the directors require the auditor's report on the financial statements to be signed on 31 August 2023.

**Requirement:**
For each situation describe the effect on the auditor's report. 6

b) As a partner of MNO & Co. Chartered Accountants and engagement partners of providing audit service to Petersons Ltd. in one hand you have issued audit report with "unmodified opinion" on the other hand as the second point under the "Report on other Legal and Regulatory Requirements" you have mentioned.

"In our opinion, proper books of accounts were required by law have not been kept by the company as far as it appeared from our examination of this books"

Reviewing the report, The Financial Reporting Council wanted clarification as you have issued contradictory auditor's report.

**Requirement:**
You are required to clarify your position in support of issued auditor's report. 4

---The End---