

AUDIT & ASSURANCE

Time allowed- 3:30 hours

Total marks- 100

March-April 2022

[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) ICAB recently restructured its Quality Assurance Department (QAD) for ensuring high quality engagement and auditing services by its member firms through seamless implementation of ethical guidelines and IFAC Code of Ethics. You are a Senior Manager at QAD, responsible for reviewing quality control and ethical matters which arise with regards to the clients of its member firms. You visited the following firms during the year 2021-22 and identified below matters:

i) D & Co., Chartered Accountants

D & Co., Chartered Accountants audits Newborn Limited. The Chairman of the Board of Directors of the company has asked whether one of the D's audit partners can be appointed as a non-executive director and serve on the audit committee. At present, the audit committee lacks a financial reporting expert, and the appointment of an audit partner would bring much needed knowledge and experience to ensure corporate governance codes. On the other hand, the company has changed cost approach to revaluation approach in reporting of tangible assets in 2019, which they have turned back to cost approach for the year ended December 31, 2021.

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ii) XYZ & Co., Chartered Accountants

Kate Limited is currently a non-audit client of XYZ & Co., Chartered Accountants who has provided a range of non-audit services to the company including bookkeeping, payroll and tax computation, and advice. The company recently applied for additional financing from its bankers, the amount requested is significant and the purpose of the loan is to finance the growth aspirations of the company. The management of Kate Limited has ambitious plans for growth which they believe will result in revenue tripling within one year and then continuing to grow at a 50% growth rate for at least the next five years. As a pre-requisite for approving the additional financing request, the bankers have asked the directors of Kate Limited to audit the financial statements by a big accounting firm. Hence, Kate Limited has asked if your firm will become the company's auditors, as well as continuing to provide the existing services. This will include auditing the financial statements for the year ended December 31, 2022, at the request of the new financiers.

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iii) M&J and Company, Chartered Accountants

Baraka Group is an audit client of M&J and Co., Chartered Accountants. An investigation into the group's tax affairs started in December 2020. The tax authorities are investigating the possible underpayment of taxes by each of the companies in the group, claiming that tax laws have been breached. The group's tax planning was performed by another firm of chartered accountants, ABC & Co, but the group's audit committee has asked if your firm will support the group by looking into its tax position and liaising with the tax authorities in respect of the tax investigation on its behalf. ABC & Co. has resigned from their engagement to provide tax advice to the Group. The matter is to be resolved by a tribunal which is scheduled to sit in March 2022.

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iv) MK & Co., Chartered Accountants

Dunhill Limited is an audit client of MK & Co., Chartered Accountants. The management team of the company has asked you to perform a valuation of the shares of another, MABS Limited, with a view to buying the entire shareholding from its 3 shareholders. MK audited also MABS Limited for the last 3 years. Dunhill increased 75% of audit fees for the year ended 31 December 2021.

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Requirements:

Discuss the ethical and other professional issues raised for each of the above cases, and recommend actions which should be taken by the companies concerned and Chartered Accountants firms above.

- b) The core principle of IFRS-8 is ‘An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates’. To meet the objective of this principle, an operating segment is to match with determining criteria to be a reportable segment. Sometimes, number of operating segments together may form reportable segments following aggregation criteria.

The operating segments of a transport and logistics group are:

Operating segment	% Of consolidated revenue
Logistics/Distribution services	55
Parcel	8
Van hire	7
Home moving	9
Commercial moving	8
Document storage	6
Refuse collection services	7

Requirement: Identify reportable segments as per IFRS-8.

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- c) ISA 701 deals with the auditor’s responsibility to communicate key audit matters (KAM) in the auditor’s report. The ISA applies to audits of complete sets of general purpose financial statements of listed entities. It also applies when the auditor is required by law or regulation to communicate KAM for other entities or when the auditor decides to communicate KAM on a voluntary basis.

Requirement:

You, being the engagement manager for the audit of Peu Pharmaceuticals Limited for the year ended 31 December 2021, are required to describe how the auditor would determine factors to be considered as KAM.

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2. a) ABC digital communications ltd., a unit of a big conglomerate has been dealing with various types of telecommunications services including selling and distributions of mobile phone sets. The company board consists of 5 members with one being highly acclaimed and influential personality both at home and abroad. They appointed Smart Wise & Co. Chartered Accountants, a partnership firm as statutory auditor for the year ended 31 December 2021. This was new appointment while the company had been audited by other big firms in the past. Having some good perception, the firm did little study before accepting the engagement.

Receiving the draft financial statements, the engagement team started assessing the risk underlying potential misstatements. The company had the largest income item being dividend received from a listed company which constituted about 70% of the reported revenue of the company. The team naturally wished to relate such income with their investment portfolio, but no major such investment could be found out. An in-depth review revealed that this was a part of dividend income shared by one of their sister concerns to whom this company had lent a large amount of money against agreed term that earned revenue against this money would be shared at agreed ratio.

The engagement team argued that this was wrong reporting leading to a gross misstatement and would require rectification in the financial statements under audit. This could never be dividend of this company. The management, without much deliberation, outrightly refused to put required rectification and they referred to the acceptance of their previous auditors. The company seemed to be worried about the impact of income tax should they accept such rectification proposition. On the contrary, carrying such critical misstatement, the respective audit report would be critically a modified one.

Under the given circumstance and having felt the influential stature of the board, the audit firm wished to discontinue the engagement and withdraw their team without further progress in the audit work.

Requirements:

- i) As engagement manager what steps would you suggest that your firm should take to discontinue the engagement?
- ii) Being a new engagement, what actions as guided by the ethical codes should your firm have taken prior to formally accepting such engagement?

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- b) Obscure Limited provides an on-line trading platform which connects buyers and sellers in the country, and around the world. The platform provides an avenue for the sale and purchase of physical goods and professional services. On receipt of sales orders, sellers are responsible for processing and transporting the orders to the customers. In addition to the platform, it assists sellers in invoicing and collating data on transactions done on the platform. Customers also pay directly to the sellers but through the Obscure Payment Gateway. Obscure collects a service fee @20% from the sellers for the use of the platform and for the invoicing services. The Board of Obscure has decided to change its auditors, and it has approached your firm to be appointed as the new auditors. Your firm is reviewing the engagement offer. You are the Audit Manager responsible for the engagement. You have met with your team members and noted that there are some trainees in the team who are not conversant with controls in on-line businesses.

Requirement:

Evaluate the risks associated with the engagement and application of electronic data interchange in an on-line business and identify the effective controls that may be put in place to minimise the risks.

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3. a) Smart sports Ltd. a popular sports accessories manufacturing company has been in the business for over last two decades. Before setting up the current manufacturing industry, Rahin Chowdhury, the Chairman of the company used to procure various types of sport accessories from both local and foreign sources under his proprietorship business license and sell through his own outlets in the Dhaka city. Alongside building trading skill, the enterprising personality Mr. Chowdhury started gaining knowledge on various technical aspects of his goods and accessories on the shelves.

Geared by the increased demand, Mr. Chowdhury set up his mind as regards expanding his business to a bigger size to be able to manage supplying goods to his existing customer as well as potential new ones. Then about two decades ago, he planned to form a new company inviting few new investors and finally built this manufacturing set up. The company has been doing formidably good business since the inception of the company. However, with the increase in the demand, over last half decades, alongside regular entry of new traders in this field a number of global brands have also opened their business in the cities, resulting in a decreasing trend in the growth of the business of Smart.

Some key financial numbers picked up from the books of Smart are:

Amount in '000			
Particulars	Ref.	2021 (Taka)	2020 (Taka)
Revenue		920,000	910,000
Cost of goods sold		500,000	480,000
Gross profit		420,000	430,000
Administrative expense		42,000	39,000
Selling expenses		200,000	180,000
Distribution expenses		23,000	22,000
Property, Plant and Equipment		2,300,000	2,430,000
Receivable		280,000	220,000
Cash and cash equivalents		12,000	20,000
Creditors		230,000	190,000

Given the regulation of the auditors' rotation, the company has appointed Efficient Sincere & Co. Chartered Accountants to be their statutory auditor for the year ended 31 December 2021.

Requirements:

With a view to ensuring successful completion of the audit, you, being the engagement manager of the firm, are asked to:

- Describe the critical requirements underlying planning an audit as per ISA 300 5
- Write in brief about the way you would understand the business with a view to ensuring good planning 4
- Given the facts above, narrate few areas of potential risks to be covered in the planning memo 4
- By exercising analytical procedures, based on the financial information, make indicative note for the audit team 4

- b) Safe Life Pharmaceuticals Ltd., a major pharmaceutical company, has appointed Trust & Co. Chartered Accountants statutory auditor for the year ended 31 December 2022.

You, being engagement manager for this engagement, have been assigned to deal with the planning of the audit. As you know that, the audit is to be carried out on a risk-based planning, having reasonable understanding of the entity and its internal control practices, you have started focusing on the specific areas as part of the planning activities.

While talking to the payroll supervisor, you have been given brief of the strength of the company's payroll internal control system. He has assumed that this internal control system guarantees the completeness, accuracy and validity of the payroll accounting records.

Requirement:

State whether you agree with the payroll supervisor's assumption that an internal control system can guarantee the completeness, accuracy and validity of the records, supporting your answer by using examples from a payroll system.

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4. a) Healthy Foods limited, a renowned food producing company has been running its business mainly through its country wide distributors and a very small portion through its own brand shops at Dhaka and Chattogram. The credit term with distributors is 30 days, but in special cases such term gets extended to 45 days. As the company has been growing every year at a formidable rate, its receivable balance is also standing in big figure in the Financial Statements at the reporting dates. It is natural, when receivable stands higher, the risk of related bad debt goes higher too. So, in order to present the operating results credibly, it is imperative and too required by the reporting framework to keep appropriate allowances against receivables.

Requirement:

You, being a senior audit staff, are required to explain how the auditor would approach the audit of an allowance for the receivables.

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- b) You are the audit senior of OPC Limited, a newly formed one-person company and doing restaurants business in Dhaka, for the year ended 31.12.2021. The company operates a current bank account with Amex Bank. The account has been credited with the following transactions during the period from 01 January 2021 to 31 December 2021.

Cash deposit at counter	Tk. 28,860
Cheque deposit	Tk. 43,750
EFTN local transfer from few corporate	Tk. 28,900
Special rate Loan (6%)	Tk. 50,000
Interest	Tk. 375
Food Panda	Tk. 16,260

Food Panda realized commission on sales order received @20%. Food Panada settled the dues and paid to OPC bank account after deducting their commission.

OPC Ltd. does not keep proper accounting record in accounting software but provided the following for your review:

Sales	Tk. 50,000
Purchase	Tk. 40,000

OPC runs two restaurants in Banani and Dhanmondi, Dhaka. It is widely accepted that the food costs in restaurant business in Dhaka is around 30% to 35%. OPC provided you the sales and purchase invoices for the amounts mentioned above. The OPC estimated closing stock Tk. 3,500 as on 31.12.2021.

Requirement:

You are required to draft your queries to the management to complete field work of audit of OPC Ltd.

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5. a) GB Multihub, a leading business house, starting business about 5 decades ago, has been transformed into formidably a major conglomerate in the country predominantly in the consumer products markets.

GB Consumer Healthcare Ltd., being one of the leading companies in the conglomerate, deals with Health Milk and Safe Milk powder. These two brands ('Health Milk' and 'Safe Milk') have been very popular and thus have grabbed a wide range of market across the country by virtue of their consistent quality commitment as well as other related commitments applicable to health care field. The company has closed their financial year ended 31 December 2021 with about BDT6 billion ensuring growth as high as they expected while planning for the year.

The financial statements for the year ended 31 December 2020 reflected inventories BDT2 billion whose cost was BDT3.5 billion as per books. Not having performed proper procedures of obsolescence testing, the company accountants applied prudence and written down the inventory values by about 43%. The directors argued that inventory obsolescence had never exceeded even 15%. But, here in this case no satisfactory audit procedures were left that could be adopted to confirm the true figure at the reporting date.

Requirement:

In respect of the issue over inventory, reach a conclusion on whether you would modify your audit opinion for the year ended 31 December 2021, on the basis that no other matters arose which might affect the opinion. You should offer reasons supporting your conclusion and describe any additional statements that would be required to be made in the audit report.

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- b) Kafee & Co. Chartered Accountants (KafeeCo) has been appointed auditor for the Shahab Group of companies for the year ended 31 December 2021. The scope of the work of KafeeCo includes auditing and expressing opinion on the financial statements of Shahab Holdings Limited and 5 others out of 7 companies of the group. Under the engagement term, KafeeCo would remain responsible for issuing opinion on the consolidated financial statements of the group. 2 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, KafeeCo finds that they do not have adequate staff to run all audits in the engaged entities simultaneously. KafeeCo, under this unavoidable circumstance, has decided to sub-contract audit engagements for 2 companies and take loan of 8 staffs from other firms. KafeeCo has issued audit instructions to component teams where 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 loan? 4
 - ii) As principal auditor, what are the procedures that KafeeCo should perform in respect of the components that are not being audited by KafeeCo? 5
 - iii) What evidence should KafeeCo obtain in order to express opinion on the consolidated financial statements? 4
 - iv) Say, one of the component auditors has expressed qualified audit opinion in its audit report. How will this opinion affect the opinion of KafeeCo on the financial statements of Shahab Holdings Ltd. and the consolidated financial statements of the group. 4
- c) 'Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the forecast.'

From the given extract, describe the level of assurance provided by this statement and explain how and why it differs from the level of assurance provided by an audit report on annual historical financial statements.

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