

AUDIT & ASSURANCE

March-April 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) Auditing profession and services have been changed magnificently in recent time through seamless implementation of International Standard on Quality Management (ISQM)-1, ISQM-2 and ISA 220 (Revised) Globally. Accordingly, stakeholders' expectations from the auditors and audit firm have been evolved beyond imagination in terms of quality at firm level and engagement level to protect fraudulent activities and other illicit actions by the beneficiaries. The ICAB has initiated training and refreshing knowledge of the auditors and others associated with the auditing processes. But adequate knowledge on ISQMs and other standards, the identification of the requirements and its execution is vital to achieve the desired objectives.

ABC & Co., Chartered Accountants is a member firm of globally top ten audit firm has 5 partners, 100 article students and 50 audit staff. The firm provides a range of audit, assurance, tax and advisory/consultancy services. The firm has two branch offices in the country and serves clients of all size.

The quality assurance partner of the firm has recently resigned, and he has not yet been replaced as the remaining partners of the firm has not been able to find a suitable replacement. Before his departure, the quality assurance partner was in the process of implementing a system of ethical compliance for assurance staff. Based on the foregoing, article students and audit staff would be required to confirm in writing their compliance with the Code of Ethics, hence, implementation of this system is incomplete.

Oxygen Limited is one of the firm's largest clients for which the firm provides audit, tax and other advisory services. A new engagement partner has been assigned to the audit, as the previous partner in charge was the one who resigned. The fee for the audit work and other services has been set at the same level as the previous year although additional work will need to be performed because Oxygen Limited has introduced a new computerized system. The starting date of the audit has been delayed due to problems with the new system. The management of Oxygen Limited was very insistent that the fee should not be increased because of implementation of new system in the company, which reduced processing time of all critical activities.

Requirement:

ISQM-1: International Standard on Quality Management envisages eight elements to ensure quality standards at the firm level. Discuss in brief the requirements of the following elements of ISQM-1 in terms of the above scenario to ensure overall quality:

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| i) Relevant ethical requirements. | 2 |
| ii) Resources. | 2 |
| iii) Monitoring and remediation process | 2 |
- b) You are an audit manager at T Hassan & Co, Chartered Accountants. You have recently been assigned to the audit of ABC Limited for the year ending 31 March 2022. ABC Limited is an unlisted foreign operation in Bangladesh. Its shares are owned by a company, listed with London Stock Exchange and New York Stock Exchange and the company has been an audit client of your firm for a number of years.

ABC Limited is a national distributor of cleaning products. The company buys the cleaning products from wholesalers and employs a team of approximately 750 sales staff around the country who sell the company's products to both domestic households and small to medium- sized businesses. Around 75% of ABC Limited's sales transactions are cash-based and each of the company's sales staff prepares a cash sales report monthly. According to the Chief Executive Officer of ABC Limited, Mr. SB Chowdhury, in order to foster 'an entrepreneurial spirit' amongst his staff, each staff member (including the senior management team) is encouraged to make cash sales and is paid on a commission basis to sell the company's products to friends and family. Mr. Chowdhury leads the way with this scheme and recently sold cleaning products with a value of Tk.33,000 to a business associate of his. He has transferred these funds directly into an offshore bank account in the company's name on which he is the sole signatory.

You reviewed the audit working papers independently as part of ISQM-1, and have identified the following potential issues:

Following your review of the audit engagement letter and the working papers of the taxation section of the audit file, you have established that T Hassan & Co performed the taxation computation for ABC Limited and completed the tax returns for both the company and Mr. Chowdhury. All of the taxation services have been invoiced to ABC Limited as part of the total fee for the audit and professional services. Mr. Chowdhury's personal tax return includes a significant number of transactions involving the purchase and sale of properties in various international locations. The taxation working papers include a detailed review of several offshore bank accounts in Mr. Chowdhury's name which identified the property transactions.

During your initial meeting with Mr. Chowdhury, he informed you that ABC Limited is planning to develop a new website in order to offer online sales to its customers. He has asked T Hassan & Co to provide assistance with the design and implementation of the website and online sales system.

Requirements:

- i) Discuss the policies and procedures which T Hassan & Co should have in place in relation to an anti-money laundering programme, and 2
- ii) Evaluate whether there are any indicators of money laundering activities by either ABC Limited or its staff. 2
- iii) Comment on the ethical and professional issues arising from your review of the audit working papers and recommend any actions which should now be taken by T Hassan & Co. 2

- c) Freshfield & Co., Chartered Accountants have been invited to tender for the audit of STQ Ltd. Freshfield & Co., has not previously acted in any capacity for this company but does act for QTS Ltd, which is the STQ Ltd.'s major competitor.

Requirement:

Under this situation identify and explain the principal ethical issue and state the procedures Freshfield & Co., would implement to address this issue. 5

- d) Section 2 (8) of FRA 2015 has widely covered the jurisdictions of related other legislations to conclusively define the Public Interest Entity (PIE). However, to further clarify the definition of Public Interest Entity (PIE), the Financial Reporting Council (FRC), under the authority of the Financial Reporting Act 2015, has adopted some critical determinants fulfilling the requirements of two Sub-sections of Section 2 (8)(Ka). The FRC in its notification dated 11 March 2020 has made the definition public for use. Eventually, this definition has been mandatorily applicable to auditors to determine if the subject entity under audit is a PIE! As regulator, FRC often quotes PIE in its notification with a view to enforcing its directives to be complied with.

Requirement:

Write down the determinants of PIE as per latest FRC notifications. 3

- 2. a) You are a Senior Manager in Ahmed & Co., Chartered Accountants. You are responsible for evaluating proposed engagements and for recommending to the partners whether or not an engagement should be accepted by your firm.

General Express Ltd., a listed company, is an existing audit client and is an international mail services operator, with a global network including 220 countries. The company offers mail and freight services to individual and corporate customers, as well as storage and logistical services.

General Express Ltd. follows its corporate social responsibility meticulously and publishes sustainability key performance indicators (KPIs) in a Sustainability Report, which is published with the financial statements in the annual report. Partly in response to requests from shareholders and pressure groups, General Express Ltd.'s management has decided that in the forthcoming annual report, the KPIs should be accompanied by an independent assurance report. An approach has been made to your firm to provide this report in addition to the audit. Your firm has recently established a specialist social, environmental and sustainability assurance department, and if the engagement to report on the Sustainability Report is accepted, it would be performed by the partner and members of that team, who would not be involved with the audit.

You have also had a meeting with Ali Monsur, the manager responsible for the audit of General Express Ltd., and notes of the meeting are given below:

Ahmed & Co. has audited General Express Ltd. for three years, and it is a major audit client of our firm, due to its global presence and recent listing on two major stock exchanges. The audit is managed from our Dhaka office, which is also the location of the Country Head Office of General Express Ltd.

We have not done any work on the KPIs, other than reviewing them for consistency, as we would with any 'other information' issued with the financial statements. The KPIs are produced by General Express Ltd.'s Sustainability Department.

We have performed audit procedures on the charitable donations, as this is disclosed in a note to the financial statements, and our evidence indicates that there have been donations of Tk.9 million this year, which is the amount disclosed in the note. However, the draft KPI is a different figure of Tk.10.5 million, and this is the figure highlighted in the draft Chair's Statement as well as the draft Sustainability Report. Tk.9 million is material to the financial statements.

The audit work is nearly complete, and the annual report is to be published in about four weeks, in time for the company meeting, scheduled for April 2023.

Requirement:

Evaluate the matters which should be considered before your firm accepts the invitation to perform an assurance engagement on the Sustainability Report of General Express Ltd.

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- b) Strong Beverage Ltd. a listed company has been engaged in soft drink production and distribution business over decades. As usually the company is compelled to prepare their financial statement (FS) in accordance to conceptual framework as guided by the International Financial Reporting Standard (IFRS). In the respective AGM of the company Honest Man and Co. Chartered Accountants (HMCO) has been appointed auditor for the year ending 31 December 2022.

Notable that although the company is a listed one, a family being major investor has been passively engaged to influence the major decisions of the company. The one who represents the family is a highly influential personality being closely connected to national level politics.

HMCO having been influenced by the brand image of the company accepted the engagement without doing much of pre acceptance review. Having been engaged, the firm deputed the engagement manager to have a quick review of the draft FS as part of the risk assessment process. The engagement team revealed that the company has been reporting their annual maintenance costs (not overhauling) as part of the Property Plant and Equipment which naturally does qualify to be capital expenditure. Given the nature of the company this expenditure is substantially a large amount. The engagement team primarily doubted that the management had been overstating profit every year by capitalizing such big amount of annual maintenance cost.

The engagement team argued that this was wrong reporting leading to a gross misstatement and would require rectification in the financial statement under audit. This could never be accepted as capital expenditure which results in understatement of the operating expense and correspondingly overstatement of the capital expenditure. The management, without much deliberation, outrightly refused to put required rectification and they referred to their logic applied to their previous auditors. The company seemed to be worried about the implication, should they accept such rectification proposition. Such rectification proposition might require restatement and necessary adjustments in the previously published FS as well as in the draft handed over to the auditor. On the contrary, if not necessary adjustment accepted, carrying such substantial misstatement, the respective audit report would be a modified one. But the management too indicated that their board geared by the influential corner might not accept any modified opinion.

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 are the steps would you suggest that your firm should take to discontinue the engagement? 4
- ii) Being a new engagement, what actions as guided by the ethical codes should your firm have taken prior to formally accept such engagement? 4
3. a) Melvin & Co., Chartered Accountants offering audit and assurance services to a large portfolio of clients. You are a manager in the audit department responsible for the audit of KINGS Ltd.

KINGS Ltd is a manufacturer of luxury food items including chocolate and other confectionery which are often sold as gift items individually or in hampers containing a selection of expensive items from the range of products. The company has a financial year ended 30 June 2022, much of the planned audit work has been completed, and you are reviewing issues which have been raised by the audit senior. Due to an economic recession because of COVID 19 pandemic and other political turmoil, the sales of products have fallen sharply this year and measures have been implemented to support the company's cash flow. You are aware that the company only has Tk.150,000 in cash at the year end.

Extracts from the draft financial statements and other relevant information are given below.

	Jun-22 (Draft)	Jun-21 (Actual)
	<u>Tk.000</u>	<u>Tk.000</u>
Revenue	2,440	3,950
Operating expenses	-2,100	-2,800
Finance charge	-520	-500
(Loss)/profit before tax	-180	650
Total assets	10,400	13,500
Long-term liabilities - bank loan	3,500	3,000
Short-term liabilities - trade payables	900	650
Disclosed in notes to financial statements:		
Undrawn borrowing facilities	500	1,000
Contingent liability	120	

The following matters are noted for attention:

- The bank loan was extended in February 2022 by drawing on the borrowing facilities offered by the bank. The loan carries a fixed interest rate and is secured on the company's property including the head office and manufacturing site. The first repayment of loan capital is due on 30 June 2023 when Tk.350,000 is due to be paid.
- KINGS Ltd renegotiated its terms of trade with its main supplier of cocoa beans, and extended payment terms from 50 days to 80 days in order to improve working capital.
- The borrowing facilities are due to be reviewed by the bank in April 2023 and contain covenants including that interest cover is maintained at 2, and the ratio of bank loan to operating profit does not exceed 4:1.
- The contingent liability relates to a letter of support which KINGS Ltd has provided to its main supplier of cane sugar which is facing difficult trading conditions.

Requirements:

- Identify and explain the matters which may cast significant doubt on the KINGS Ltd.'s ability to continue as a going concern, and
 - Recommend the audit procedures to be performed in relation to the going concern matters identified.
- b) BMCL International Limited is a company with corporate registrations in both United Kingdom (UK) and Bangladesh. The Chairman of the company is based in Bangladesh and from time to time, travels to the UK to oversee the office there and order for the purchase some products for sale. To ensure steady supply of the products, some of the products are also ordered from China. The purchases from the UK are charged to the Bangladeshi entity in pound sterling, while the purchases from China are charged to the Bangladeshi company in American dollars.

In September, 2022 the Chairman embarked on a trip to Dubai for two weeks where he spent part of his annual holiday. During this period, he hosted a couple of friends with the costs that were paid for by the company as the costs were above his approved annual holiday expenses. He subsequently travelled to the UK and stayed in a resort for two weeks before moving to the usual business lodge that he uses. Despite using that period to oversee the UK company, all the costs incurred were borne by the Bangladeshi company.

The products bought in the UK and sent to Bangladesh were charged at cost plus 25%, while the Bangladeshi company was responsible for insurance and freight. The goods purchased from China were forwarded to Bangladesh at cost of landing in Bangladesh plus 30%. The China-made products are less expensive and therefore give better profits despite the cost of the long-distance freight.

Money was transferred to the Chairman's account for the company's purchases in the UK, the purchases made in China and the chairman's personal expenses. An agent in China bought the goods which were paid for by the Chairman.

The UK company staff handled the documentation of all the transactions of the Chairman while there and transferred them to Bangladesh subject to the approval of the Chairman.

Separate records were not maintained for the Chairman's expenses in the UK. However, his comparison of the results of the two units showed that for the immediate past accounting year, the Bangladeshi company had performed sub-optimally and way below the targeted profit in relation to the UK company. The Chairman is very unhappy about this as he expects that his personal visit to the UK would reduce the purchasing and associated costs. It is usual for the Chairman to account

for the cost of purchases based on his personal expenses attributable to each purchase together with the actual cost of purchases. The UK component is elated about this costing method which favours it and would wish that this arrangement continues. The two units prepare separate financial statements which are audited by separate accounting firms before the two financial statements are consolidated in Bangladesh for the Chairman's evaluation.

Requirement:

Evaluate, with appropriate justifications, from the scenario above, the areas of risk which the auditor needs to consider.

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4. a) Mr. Shahed is planning the audit of Jonson Ltd (The company) for the year ending 30 June 2022. The principal activities of the company are the manufacture and distribution of a range of toys and of the component parts for toys. Approximately 50% of revenue is generated from overseas customers.

During preparation for the planning meeting with the Chief Financial Officer, the following matters have been highlighted as significant.

- (i) Operating results the company has had a successful year to date with revenue, gross and operating margins up on the previous year.

	10 months to 30 April 2021 Tk. '000	10 months to 30 April 2020 Tk. '000	10 months to 30 June 2020 Tk. '000
Revenue	27,120	23,950	26,840
Cost of sales	16,272	15,568	17,178
Gross profit	10,848	8382	9,662
Operating expenses	5,424	5,029	5,636
Operating profit	5,424	3,353	4,026
Gross profit margin	40%	35%	36%
Operating profit margin	20%	14%	15%

- (ii) During the year the company replaced its accounting software with a fully integrated standard package modified by the supplier to the company's requirements.

- (iii) During the year the company introduced an incentive scheme under which the executive directors are entitled to a bonus based on pre-tax profits. The bonus will be paid thirty days after the audited accounts are available.

Requirement:

Based on the above, you are required to identify and explain the potential audit risks and indicate the matters Mr. Shahed should discuss with the Chief Financial Officer at his planning meeting.

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- b) Your firm is the auditor of Midget Ltd which operates 10 CNG stations in and around the country. You are the senior in charge of the audit for the year ending 30 June 2022 and are engaged on the audit planning.

Most of the company's sites are long-established and, as well as supplying CNG, oil, air and water, have a car wash and a shop.

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

Point-of-sale PCs are installed in all the CNG stations, 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 organisation. The internal auditor is also responsible for co-ordinating the year end inventory count.

Requirements:

You are required to prepare notes for a planning meeting with the audit partner which:

- i) From the situation described above, identify the circumstances particular to Midget Ltd that should be taken into account when planning the audit and explain clearly why these matters should be taken into account.
- ii) 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.

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5. a) IAASB has been relentlessly promulgating standards and pronouncements with a view to ensuring effective audit that communicates meaningful results to the users of the audit reports and underlying audited financial statements. Like many countries in the globe our markets have also accepted International Standards on Auditing (ISA) and made mandatory for the auditors to follow in performing their audits. Every often there comes a new standard in the existing list and too come revised ones with additional requirements or some modified requirements. So, it is encouraged that auditors remain updated about latest promulgations as well any changes being brought by a revised ISA.
ISA 260 (revised) deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. This standard prescribes for the auditors to communicate certain matters and underlying process with those charged with governance.
- Requirements:**
- i) Briefly discuss about the matters those are necessary to be communicated with those charged with governance. 4
 - ii) Also discuss the process through which matters could be appropriately communicated. 3
- b) An audit is an examine of the financial statements with a view to forming an opinion on the overall accuracy. The auditor thus has to make a suitable plan that enables him to properly evaluate all findings in their merits and magnitude of impact on the expected accuracy.
ISA 450 Evaluation of Misstatements requires the auditor to accumulate misstatements identified during the audit unless those misstatements are trivial.
- Requirement:**
Describe in detail the requirements as stated that serves the purpose of this standard towards effective completion of an audit. 5
- c) Visual Electronics Ltd. has been in the business of trading various electronic goods for over last two decades. Given the market stake and underlying reputation, this company often remains on the press. The company on critical misunderstanding, had terminated their CFO last year. Being delicate, this event sparked out faster and naturally turned into hot talks into the whispering community including some of the leading newspapers.
The CFO being aggrieved has filed a claim with the court describing facts constituting his financial claim. He also claimed additional compensation indicating that his career has been on the stake due to this termination. While preparing annual financial statements for the year ending 31 December 2021, though there is indication of contingent liability, the finance team is in a fix as to how to treat this claim.
- Requirement:**
Define contingent liability and describe necessary disclosure requirements underlying contingent liability. 4
6. a) 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. 3
- b) In the expansionary business environment, it is evident that some companies are naturally group companies and thus related audit engagements necessitate use of guidelines prescribed by ISA 600. ISA 600 precisely requires group management to objectively understand the component auditor.
- Requirement:**
As manager of a group auditor, you are required to describe the guidelines for the group management to understand related component auditor. 3
- c) On the emergence of ISA-700 (revised), it became mandatory for the auditors of listed company to determine Key Audit Matters (KAM) and mention on the face of the audit report.
- Requirement:**
As Engagement Manager of your firm on the audit of Household Commodity Ltd. a listed company, you are asked to describe as to how you would determine KAM for the respective audit report. 3