

AUDIT & ASSURANCE

Nov-Dec 2022

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) Honest Sincere & Co. Chartered Accountants (HSC) is the auditor of High Standard Bank Ltd. (HSBL) for the year ending 31 December 2021. In the recent past, there were a number of news in the national level newspapers as regards some financial scandals where this HSBL was one of major affected banks. Being a listed company, the management has been putting substantial effort to defend the scandals issuing press notes and various advertisements. This bank has a small overseas branch in New York which in fact does not produce any remarkable (less than 1% of revenue) business for the bank. On the other hand, of the top five branches (4 in Dhaka and 1 in Khatunganj, Chottogram), the Khatunganj branch alone contributes 15% of gross revenue of the bank.

As part of the audit process the firm planned to visit and work in total seven branches. While sitting with the management for selecting branches, the DMD of the bank offered the Engagement Team of the firm to cover their New York branch. The DMD also offered to bear costs of business class tickets and accommodation in a five-star hotel for the audit team. Mr. Honest, the Engagement Partner accepted the offer and finalized 7 branches including the New York one. Surprisingly the highest revenue generating branch has not been kept into the list. During the course of the audit, Mr. Honest accompanied by one professional staff flew to NY and came back after 15 days with the audit results.

Requirement:

Comment on this audit with respect to code of ethics for the professional accountants in practice. 5

- b) It is often observed that a professional accountant in public practice is asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of an entity that is not an existing client. Very often regulators seek such a service from the professional accountants in public practice. Embedded self-interest threat in such an offer may create threats to compliance with the fundamental principles.

Requirement:

What actions would you prefer as safeguards to address such self-interest threat? 5

- c) Your firm is appointed as an external auditor of M&J Ltd. (MJL), a listed company and a PIE, for the year ended 30 June 2022. You started the field audit work, and you are leading the audit team. Your firm is a member firm of an International Audit and Assurance firm based in UK. As per the affiliation agreement, your firm must ensure 1:1 encrypted laptop with adequate controls and security protection. All students and staff must use email hosted through the parent firm's domain, which costs Tk. 4,000 per user per year. 31 percent of the students and staff does not use that e-mail because they shared laptop. Hence, you communicated data and client information to the g-mail of audit team. A team member kept MJL data in a portable USB pen drive, which was stolen last month from an audit team member. Sensitive data about the client was subsequently published on the internet by an activist group.

Requirement:

Outline the legal, professional and ethical issues arising from the above scenario and set out the safeguards that should be introduced by your firm to prevent such data breaches occurring in the future. 5

- d) ABC Chartered Accountants (ABC) has been carrying out the external audit of AMC Company Ltd. (AMCL) since 2015. The next audit will be for the year ending 31 December 2022. The audit manager on the audit of AMCL for the year ended 31 December 2021 left ABC and became the financial controller of AMCL on 1 November 2022. Mr. Rezaur Rahman, the Finance Director of AMCL became an audit partner at ABC on 1 October 2022. The Managing Partner of the firm allocated AMCL to Mr. Rezaur Rahman to act as an engagement partner of the audit of AMCL for the year ending 31 December 2022.

Requirement:

Identify the 'ethical threats' and 'conflict of interest' that arise from the above scenario, stating why each is a threat. State from which date the former finance director could become a member of the audit team of AMCL in accordance with the Ethical Standard issued by IFAC and ICAB. 5

2. a) Recently your firm XXX & Co., Chartered Accountants has been informed that the shareholders of Paradise Pharmaceuticals Ltd has appointed your firm as the auditor in the last AGM. In this regard, you being the audit director, met with the Managing Director of the company. The major discussion points were as follows:
- i) The MD informed that the previous auditor did not perform audit properly for which his company incurred Tk. 20 million loss. This was because the audit team could not identify the inventory fraud;
 - ii) Being aggrieved, the company management decided to change the auditor, but they did not serve notice under the Companies Act 1994 to the auditor before removal;
 - iii) The MD also informed that the income tax authority has recently issued assessment order where operating expenses Tk. 15 million have been disallowed for not deducting tax & vat at source. MD thinks this was also the audit failure for which his company is going to face another amount of loss.

Requirement:

Your firm has not submitted Form 23B to RJSC yet. Being the audit director, you are requested to articulate your proposal with justification to the engagement partner for the above audit acceptance. 5

- b) It is 1 July 2022. You are an audit supervisor of Zubaer & Co. Chartered Accountants, planning the final audit of a new client, CCC Construction Co, for the year ending 30 September 2022. The company specializes in property construction and providing ongoing annual maintenance services for properties previously constructed. Forecast profit before tax is BDT 13.8m and total assets are expected to be BDT 22.3m, both of which are higher than for the year ended 30 September 2021.

CCC Construction Co's finance director has provided you with the following "Meeting Notes" and "Information from Management Accounts".

Meeting Notes

The prior year financial statement recognized work in progress of BDT 1.8m, which comprised property construction in progress as well as ongoing maintenance services for finished properties. The latest management accounts recognize BDT 2.1m inventory of completed properties compared to a balance of BDT 1.4m in September 2021. A full year-end inventory count will be undertaken on 30 September at all of the 11 building sites where construction is in progress. There is not sufficient audit team resource to attend all inventory counts.

In line with industry practice, CCC construction Co offers its customers a five-year building warranty, which covers any construction defects. Customers are not required to pay any additional fees to obtain the warranty. The finance director anticipates this provision will be lower than last year as the company has improved its building practices and therefore the quality of the finished properties.

Customers who wish to purchase a property are required to place an order and pay a 5% non-refundable deposit prior to the completion of the building. When the building is complete, customers pay a further 92.5% with the final 2.5% due to be paid six months later. The finance director has informed you that although an allowance for credit losses/receivables has historically been maintained, it is anticipated that this can be significantly reduced.

Information from Management Accounts

CCC Construction Co's prior year financial statements and latest management accounts contain a material overdraft balance. The finance director has confirmed that there are minimum profit and net asset covenant attached to the overdraft.

A review of the management accounts shows the payables period was 56 days for June 2022, compared to 87 days for September 2021. The finance director anticipates that the September 2022 payables days will be even lower than those in June 2022.

Requirement:

You are required to describe the process that the Zubaer & Co should have undertaken to assess, in the context of ISA10, whether the preconditions for an audit were present when accepting the audit of CCC Construction Co. 5

- c) International Standard on Auditing (ISA) 315, Identifying and Assessing the Risks of Material Misstatement requires an auditor to identify risks at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures.

Medicare Ltd. is a newly incorporated pharmaceuticals company in Bangladesh, and it manufactures and supplies eye care and cardiovascular products, which must meet strict quality criteria. The market

has become very competitive and new legislation introduced a price cap for these goods. The finance director departed due to a disagreement with the managing director over failures in the implementation of IFRS based financial reporting. Besides, relax supervision of credit control resulted in material amounts owed by credit customers not being followed up for last six months.

Requirement:

Identify key risks of material misstatement at the financial statement level for Medicare.

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3. Zafran GROUP OF INDUSTRIES is a renowned group recently established WEST Apparels Ltd considering the potentiality of Blazer business. The group has the presence in the Real Estate Sector, Agro Sector, Power Sector, Engineering Sector and recently in the readymade garments sector. Being appointed, the auditor of WEST Apparels Ltd, a private company, discussed with the company management and noted the following issues during the entrance meeting:

Property, plant & equipment	The purchase need is reviewed by the MD and Chairman of the Board. In maximum cases, very limited suppliers are available to meet the required supply of the company. The price is negotiated by the MD and Chairman and decisions of import are taken by them. Factory related assets are delivered to the Factory of the Company directly. The accounts department maintains assets ledger but does not maintain complete fixed assets register.
Inventories	The company has huge inventories but they are not maintaining any software in this regard to have daily updated inventory position. The company has bond facility, so the custom maintains bond register to reflect the movement of inventory on a daily basis. On the other hand, the company store person maintains separate inventory register. The daily store register balance is normally reconciled with the balance of custom register. The huge number of inventories are kept in a limited space which makes impossible to physically verify all the inventories. The inventories are maintained buyer wise. After completing the shipment against any order, the remaining inventory items are sold out maintaining legal procedure. The internal audit of factory reviews the whole process.
Advance, Deposit and Pre-payments	Most of the advances are paid at factory level. The management considers advance request at factory level leniently for ensuring labour satisfaction. Moreover, such practice will help to protect labour movement.
Accounts Receivables	The receivables are the export sales against L/C which have maturity period of maximum 180 days. So, the receivables are realizable within the L/C period through banking channel. The company management collects proceed realization sheet from bank and adjust the receivables amount. The management does not feel the necessity to have a bad debt policy for the company.
Cash & Cash Equivalents	The company discourages the cash payment as well as the use of cash cheque. Most of the wages payments are also having done through bank transfer. Upto Tk. 5 lac, account payee cheque signature limit has been given upon the CFO and Manager Accounts. Above Tk. 5 lac, each cheque is signed by any of 2 signatories who are the directors of the company including the MD. Any cash payment is authorized by the MD. The accounts department does weekly checking of bank record and company's bank book and they do not feel the requirement of maintaining monthly reconciliation. To maintain cash money requirements, the accounts department has cash officer who maintains the daily cash. There is no limit for maintaining cash but the requirement of cash is approved by the MD considering the business need.
Long term loan	For the project expansion or for establishing new projects the company usually takes loans from bank. Re-payment of these loans are made following sanction letters. The accounts department collects bank statements per month and checks the interest calculation charged by the bank;
Short-term loan	The company is a 100% export- oriented concern. To do the export, the company has to import raw materials and other accessories through back-to-back L/C. In this process, the company has to engage itself with funded and non-funded liabilities. The accounts department collects bank statements monthly and checks the interest calculation charged by the bank;

Sales Revenue	The company recognizes revenue following the requirements of IFRS-15. The export sales are recognized when goods are dispatched and based on shipping documents.
Expenses	Cash expenses are approved by the MD. For incurring expenses, requisition is provided by the concerned person. After approval, the transaction posted in the books of accounts. Based on the journal posted in the books of accounts, payments are made after getting necessary approval.

The audit team prepared the initial analytical review based on the initial draft financial statements of the company which reflected the following scenario:

STATEMENT OF FINANCIAL POSITION				
Particulars	30.06.2022	30.06.2021	Changes in 2022 (%)	Mode of Change
ASSETS				
Non current assets				
Property, plant and equipment	628,208,745	505,952,643	24.16%	Increase
Intangible assets	2,501,023	2,438,909	2.55%	Increase
Deferred tax assets	22,311,190	-	100.00%	Increase
Total non-current assets	653,020,958	508,391,552		Increase
Current assets				
Inventory	904,622,862	749,316,321	20.73%	Increase
Advances, deposits and prepayments	100,242,752	206,243,679	-51.40%	Decrease
Accounts receivable	415,078,490	612,158,224	-32.19%	Decrease
Cash and cash equivalent	212,201,796	740,859,749	-71.36%	Decrease
Total current assets	1,632,145,900	2,308,577,973		
Total assets	2,285,166,858	2,816,969,525		
EQUITY AND LIABILITY				
Equity and reserve				
Share capital	30,000,000	30,000,000	0.00%	
Retained earnings	186,726,984	142,784,493	30.78%	Increase
Total equity and reserve	216,726,984	172,784,493		
Non current liability				
Long term loan	1,210,909,540	1,319,985,986	-8.26%	Decrease
Total non-current liability	1,210,909,540	1,319,985,986		
Current liability				
Accrued and accounts payable	31,511,514	12,345,660	155.24%	Increase
Bills payable	211,232,977	610,281,138	-65.39%	Decrease
Short term loan	614,080,938	701,246,372	-12.43%	Decrease
Income tax provision	704,906	325,876	116.31%	Increase
Total current liability	857,530,335	1,324,199,046		
Total equity and liabilities	2,285,166,859	2,816,969,525		

STATEMENT OF COMPREHENSIVE INCOME				
Particulars	2021-2022	2019-2020	Changes in 2022 (%)	Mode of Change
Sales	3,232,642,339	4,010,908,467	-19%	Decrease
Cost of goods sold	(2,876,593,859)	(3,599,680,871)	-20%	Decrease
Gross profit	356,048,480	411,227,596	-13%	Decrease
Administrative and selling expenses	(91,012,231)	(138,798,718)	-34%	Decrease
Operating profit before tax	265,036,249	272,428,877	-3%	Decrease
Finance cost	(172,337,358)	(226,578,731)	-24%	Decrease
Profit before tax	92,698,891	45,850,147	102%	Increase
Income tax expenses	(8,981,023)	(21,124,274)	-57%	Decrease
Profit after tax	83,717,868	24,725,873		Increase

The audit team identified the following guideline from ICAB Audit Practice Manual to calculate materiality level:

Materiality Range

Range of turnover or gross assets	% of turnover or gross assets	% of Gross Profit	Materiality ranges
Tk. 0 – Tk5 Crores	3.00%	10%	Tk1 -Tk15 lacs
Tk5Crores 1 - Tk 10 Crores	2.50%	10%	Tk15 lacs 1 -Tk25 lacs
Tk10 Crores 1 – 20 Crores	2.00%	10%	Tk25 Lacs 1 – Tk40 Lacs
Tk20 Crores 1 - 56 Crores	1.50%	10%	Tk40 Lacs 1 – Tk84 Lacs
over Tk56 Crores	1.00%	10%	over Tk84 Lacs

Requirements:

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

- a) Identify the audit risks associated with the audit of WEST Apparels Ltd set out in the above scenario. 8
 - b) For each of the risks identified set out the audit work that would need to be completed before reliance could be placed on the controls in place. 8
 - c) The company management has prepared the financial statements on going concern basis. You are requested to set out your comments on the acceptability of the company management's assumption. 4
4. a) Amid facing the brunt of Covid 19, the global economy has been on the verge of being struck by another unprecedented situation brought in by the war between Russia and Ukraine. The impact of Covid was general by nature across economies while Russia and Ukraine war has been impacting more critically on the fuel intensive business and industries. Russia, the accused of war crime, being one of the highest oil and gas exporting nations in the world, under multifarious sanctions imposed by the western nations is not being able to export fuels to its usual markets. As a result of that the fuel price has soared up by an unprecedented higher rate. The foreign exchange market has been very volatile pushing the US Dollar prices up exponentially. The power generation and transportation industries have naturally been found to be the worst affected industries in the country specific economies including ours. As a result of this abrupt exchange rate fluctuations in the US Dollars, the companies having transactions in this currency are bound to think about their business differently.

Smart Efficient & Co. Chartered Accountants is the statutory auditor of Quick Power Generation Company Ltd., a 100% foreign owned company. The extract of the financial statements for the year ending 30 June 22 reflected following information:

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Particulars	30 June 2022 BDT	30 June 2021 BDT
Revenue	600,000	480,000
Receivables	360,000	120,000
Cash and Cash Equivalents	120,000	300,000
Capital Assets	300,000	300,000
Borrowing from Dubai Bank (Payable in USD)	300,000	300,000
Borrowing from local banks	240,000	150,000

Note: The entire power of the company is sold to the national power supply corporation.

Briefly discuss critical points you would like to ask your team members to pay attention while carrying out respective audit. 6

- b) Trust Sincere & Co. Chartered Accountants has recently been appointed auditor of Fun Electronics Ltd., a wholesaler of Cell Phone sets and related accessories for the middleclass market in the

country. Being engagement manager having responsibility for planning the audit, you have obtained the following background information.

The company imports most of its goods from the manufacturers in China and South Korea. The suppliers issue invoices in US Dollars, payable within 30 days. The finance director uses a mixture of forward exchange contracts and spot purchases of dollars to pay these suppliers.

Most of the company's customers are small retailers. However, the company has increased its sales by 50% in the last quarter due to a new contract to supply a large retailer, having chain stores across major cities in the country. In order to secure this new business, credit terms had to be relaxed from the standard 30 days to 60 days for this customer.

As a result of this expansion the company is finding it difficult to stay within its overdraft limit and is currently negotiating with the bank to increase the facility.

The company recently upgraded its PC based modular purchases, sales, and nominal ledger systems to an integrated system. The accounting package was supplied by a software company which had recently commenced trading.

The software supplier assisted the company with the changeover from the old system to the new. As a result management decided that there was no need to involve the previous auditor or to have a parallel run.

Mr. Farid is solely responsible for the input of data, but due to the changeover he is several weeks behind with his work. He hopes to be up-to-date by the time of the audit as he intends to work overtime to clear the backlog.

The company has introduced an incentive scheme under which the directors are entitled to a bonus on achieving a certain level of profit. The bonus will be paid 30 days after the audited accounts are available.

Identify the factors that impact on audit risk in respect of the above matters, and state what effect these would have on audit procedures. 6

- c) A perennial challenge in financial reporting is that an influential part of the management retains unique ability to manipulate accounting records leading to the production of a misleading set of financial statements which is technically known as 'management override'. While planning an audit, the auditor is expected to assess the risk of management override.

As engagement manager of the audit of a major entity, please list down the procedures you should consider unearthing potential override. 4

- d) By recognizing revenue incorrectly due to inappropriate knowledge or an evil intention, the financial statements under audit may be materially misstated. Please spell out suitable audit procedure in response to risk pertaining to revenue recognition. 4

5. a) JB Partners & Co., Chartered Accountants are the auditors of Holborn Ltd. You are an Audit Manager and reviewing the audit working files of Holborn Limited for the financial year ended June 30, 2021. However, the audit is nearing completion. Holborn Limited is a producer of canned pickle, canned tomatoes and pepper, selling its products to wholesalers and supermarkets. From your review of the audit working papers, you have noted that the level of materiality was determined to be Tk. 340 million at the planning stage, and this materiality threshold has been used throughout the audit. There was no evidence in the audit file that this threshold has been reviewed during the audit. From your review of the audit planning, you noted that a building was acquired in March 2021 by Holborn at a cost of Tk 410 million and was recognised in the draft statement of financial position at a carrying amount of Tk. 420 million as of June 30, 2021. The building is in Gazipur and was acquired for the purpose of staff dormitory working for the company's factory in Gazipur. The building has not been physically verified by any member of the audit team. Based on the audit working papers, it was concluded that we have obtained the sales agreement in relation to the building, and therefore can conclude that the asset is appropriately valued and that it exists. In addition, the Factory Manager has confirmed in

writing that the building is located within their premises, and it is in good condition. No further work is required in respect of this item. Inventory was recognised at Tk.580 million in the draft statement of financial position. You have reviewed the results of audit procedures performed at the inventory count, where the test counts carried out by the audit team indicated that the count of some items performed by the company's staff was not correctly done, but the team did not consider the discrepancies to be material. The audit senior spoke to you yesterday about his concern regarding the review of the audit working papers. Apparently, the audit manager's review and the partner's review occurred concurrently. The partner only asked the audit senior if there were any residual issues on the audit, scanned through the audit documentation and signed off in the working papers.

Requirement:

Comment on the quality of the audit performed, discussing the quality control issues raised. 10

- b) There are matters in the auditor's reports that do not modify the opinion per ISA-706 (revised) while some matters per ISA-705 (revised) require auditors to modify their opinion.

Requirement:

As an audit professional, you are asked to spell out the circumstances (i) where modification is necessitated as per appropriate guidance of the ISA-705 (revised), and (ii) where an emphasis of matter is necessary as per ISA-706 (revised). 10

- c) While dealing with the audit of Fair Cement Ltd. for the year ended 31 December 2019, you came across that Accounts Receivable presented in Statement of Financial Position included a substantial amount of doubtful receivable against which there has been no provision made in the accounts. Detailed review revealed that the entire receivable is connected to one major customer which has gone into litigation allegedly due to a major quality issue. The customer is unwilling to pay the respective debt on the ground that a major portion of the cement under complain could not be used. On the other hand, whatever portion the customer has used/sold has been a case of major reputation threat. Seeing no way-out Fair Cement ltd has filed a case against the customer for collecting the dues.

As part of the audit of this item, you strongly argued that the entire amount should have been provided for in the accounts. But the client management did not agree to make provision and kept their presentation unchanged. Given the magnitude of the misstatement and comparing with your audit materiality, you decided to suitably qualify your opinion.

Requirement:

Write up only necessary paragraphs as extracts to the complete audit report where signs/indications of qualifications remain visible (you may keep other paragraph titles blank). 5

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