

AUDIT & ASSURANCE

Nov-Dec 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) Being manager in an audit engagement in Attires Ltd., a readymade garments manufacturer, you discovered that the payroll officer had been defrauding the client through not deleting leavers from the payroll records until two months after departure. By doing it, he was pocketing the money for himself.
Requirement:
What should you do with regard to:
i) Informing the client?
ii) The audit report? | 2
2 |
| b) IAS-37 deals with recognition, measurement and disclosure requirements of provisions, contingent liabilities, and contingent assets. As an audit professional, it often puts you in difficulty separately evaluating the appropriateness in the treatment provisions and contingent items.
Requirements:
i) You are required to define following items in the light of IAS-37: <ul style="list-style-type: none">• Trade payables & Accruals• Provisions ii) Distinguish between legal obligation and constructive obligation | 2
2 |
| c) The auditors' independence may be impaired include for providing:
i) taxation services to the company and its directors;
ii) accountancy services, including preparing periodic management accounts and annual financial statements;
iii) management consultancy, including advice on new computer systems and systems of internal control.
Requirement:
Narrate how each of the situations mentioned above may compromise auditors' independence, and the ways in which an audit firm can minimise the effect which the provision of other services has on independence. | 6 |
| d) You are the Audit Manager at Rahman & Associates whose client portfolio includes ABC Credit Ltd. which is a listed financial institution offering loans and credit facilities to both commercial and retail customers. You have received an email from the Audit Supervisor who is currently supervising interim testing on systems and controls in relation to the audit of ABC Credit Ltd. for the year ending 31 October 2022. The email gives the following details for your consideration:
i) One of the audit team members, Adeeba Sultana, has provisionally agreed to apply for a loan from ABC Credit Ltd. to finance the purchase of a domestic residence. The loan will be secured on a property and the client's business manager has promised Adeeba Sultana that he will ensure that she gets 'the very best deal which the bank can offer.'
ii) The payroll manager at ABC Credit Ltd. has asked the audit supervisor if it would be possible for Rahman & Associates to provide a member of staff on secondment to work in the payroll department. The payroll manager has struggled to recruit a new supervisor for the organisation's main payroll system and wants to assign a qualified member of the audit firm's staff for an initial period of six months.
Requirement:
Assess the ethical and professional implications of the issues raised with respect to the audit of ABC Credit Ltd. and recommend actions to be taken in each case by the audit firm. | 6 |
| 2. a) Your firm, which has seven partners, has been invited by Mr PQR, the managing director and majority shareholder of WXY Ltd, (The company) to accept appointment as auditor of the company and also provide assistance with the preparation of the financial statements and the tax computation. | |

The company was incorporated on 1 October 2021 and the financial statements will cover the 15 month period to 31 December 2022. Although the company's revenue and assets are below the thresholds for statutory audit purposes, the company's bankers require the annual accounts to be subjected to a full audit.

The accounting records are computerised and the company uses software which was developed by ITS Ltd, a company owned by Mr PQR's brother. The software has been customised to integrate inventory control with receivables and payables. ITS Ltd also provides support for the company's computer systems. The accounting records are maintained by Mrs CDE, assisted by Mrs B who works one day a week and is responsible for payroll processing.

Requirements:

- i) State, with reasons, the matters to be considered and procedures to be performed prior to your firm accepting and commencing the audit of WXY Ltd for the period ending 31 December 2022. 5
- ii) Identify, from the information provided above, the factors which should be taken into account when assessing the risk of misstatement in the financial statements of WXY Ltd and explain why such factors should be taken into account when conducting the audit. 5
- b) Kazal Brothers Ltd is a retailer of academic textbooks which sells through its own network of book shops and online through its website. The revenue from the website includes both cash sales and sales on credit to educational institutions. The company has provided historical analysis from its trade receivables ledger indicating that for sales made on credit, 25% payment is received in the month of sale, 70% after 30 days and the remainder are irrecoverable debts.

You are a Manager in Mahin & Company, a firm of Chartered Accountants which offers a range of services from audit to non-audit for its clients. On 1 July 2023, your firm was asked by Kazal Brothers Ltd, a company which is not an audit client of your firm to consider a potential engagement to review and provide an assurance report on Prospective Financial Information. Mahin & Company has already conducted specific client identification procedures in line with money laundering regulations with satisfactory results.

Additionally, Kazal Brothers Ltd has approached your firm to obtain an independent assurance opinion on its cash flow forecast which is being prepared for its bankers in support of an application for an increase in its existing overdraft facility.

Requirement:

In line with the relevant ISA: The Examination of Prospective Financial Information, discuss five matters to be considered by Mahin & Company before accepting the engagement to review and report on Kazal Brothers Ltd's Prospective Financial Information. 5

- 3. 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. 4

- 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. 2

- c) The profession of assurance on the part of Professional Accountants in practice has been turning to be tougher day by day. Alongside all existing and emerging regulations, the business

environment across the industry supported all modern technologies has been posing more risk for the audit professionals to accomplish their audit managing their risk to an acceptable level.

IAASB has always been active to promulgate appropriate standards and guidelines for the auditors to be able to effectively accomplish respective engagements retaining their independence uncompromised. IAASB has accordingly revised ISA-315: Identifying and Assessing the Risk of Material Misstatements introducing some special features enabling audit professionals to more effectively assess their risk to accomplish respective audits.

Requirements:

As an audit manager, you are required to:

- i) Briefly discuss the business model as mentioned in ISA-315 (revised) being necessary for better understanding of the entity under audit. 5
- ii) Discuss newly inserted features to better understand about Inherent Risk while assessing risk as part of Planning an audit. 5

4. a) The audit of Nabil Ltd's financial statements for the year ended 30 June 2022 is nearing completion and the auditor's report is due to be signed next week. Nabil Ltd manufactures parts and components for the aviation industry. You are conducting an engagement quality control review on the audit of Nabil Ltd which is a listed entity and a significant new client of your firm. The draft financial statements recognise revenue of BDT 8.7 million, assets of BDT15.2 million and profit before tax of BDT1.8 million.

You have identified the following issues during your review:

- i) The planned audit approach to trade payables was to place reliance on purchasing controls and keep substantive tests to a minimum. During control testing on trade payables, from a random statistical sample, the audit team identified three purchase orders which had not been authorised by the procurement manager. On review of the supporting documentation, the audit team concluded that the items were legitimate business purchases and therefore concluded that no additional procedures were required.
- ii) Following a review of petty cash transactions, the audit assistant identified that the petty cashier paid for taxi fares for personal, non-business journeys with a total value of BDT175. Following discussions with the Audit Assistant, you have ascertained that he did not report the matter as the amount is immaterial. The audit assistant also commented that the petty cashier is his brother and that he did not want to get him into trouble.
- iii) Cut-off testing on revenue has identified two goods despatch notes, dated 2 December 2022, for items sent to Chinn Co., with a combined sales value of BDT17,880 which had been included in revenue for the year ended 30 June 2022. The client's financial controller, Hamidur Rahman, has explained that Chinn Co. does not order on a regular basis from Nabil Ltd. In the absence of a regular payment history with Chinn Co. therefore, and in order to minimise the receivables collection period from this particular customer, the sales invoice was raised and sent to the customer on the same day that the sales order was received. The average time period between the receipt of an order and dispatching the goods to the customer is approximately one to two weeks. The audit working papers have concluded that no further investigation is necessary.
- iv) The Finance Director, Lutful Huq, has not completed the tax computation for the year ended 30 June 2022. He has recently asked the audit assistant to compute the company's tax payable for the year on the basis that as a newly qualified chartered accountant, the audit assistant was more up to date with recent changes in tax legislation.

Requirement:

Evaluate the quality control issues and the implications for the completion of the audit including any further actions which should be taken by your audit firm. Your answer should include the matters to be communicated to management and those charged with governance in relation to the audit of Nabil Ltd.

- b) Reasonable assurance is the highest level of assurance auditors may provide. However, due to the limitations of auditing, it is impossible to guarantee 'absolute' assurance. Some users of financial statements however, have the misconception that an audit provides absolute assurance; that the

audit opinion guarantees that the financial statements are 'accurate.' The 'Expectations Gap' refers to these and other misunderstandings regarding the work of an auditor.

Requirements:

- i) State the inherent limitations of an audit that makes it impossible to provide 'absolute' assurance. 2
- ii) State the misconceptions about the role an auditor plays. 2
- c) Modern approach to Internal Auditing has been broadened the scope of the functions of the Internal Audit. The focus has shifted from pure financial audit to covering other important areas of operations. These include Value for Money audit and Best value audit.

Requirement:

What you know about 'Value for money audit' and 'Best value audit'? 4

- d) You have been appointed the auditor of Shades which has a year end of 31 May. Shades is a small registered NGO based in a small town in Khulna. The organisation provides shelter for abandoned pet animals.

The NGO is managed by a voluntary committee, including a Chairman (Mr X), a Treasurer (Mr Y) and a Secretary (Mr Z). Appointment is by annual election by the committee each year however X, Y and Z have held their posts for a number of years as other committee members feel unable to give the required time commitment.

Shades also employs a number of paid employees. In addition a number of unpaid volunteers help out at the shelter as and when they are needed depending on the number of animals at the centre at a particular point in time.

The main sources of income are as follows:

NGO shop

This is run by a full-time manager, assisted by a team of volunteers. Members of the public make donations (primarily clothes and toys) which are then sold in the shop. All transactions are in cash. The shop does not accept cheques or credit cards. The transactions are recorded by the till, with completed till rolls being passed on to the bookkeeper.

Collections

Volunteers make house to house calls on a regular basis. In addition, on Saturday mornings volunteers make collections in three local town centres. All cash is counted by the volunteers, and returned to the bookkeeper with a receipt confirming the amount.

Show on pet animal

Each year on 1st June, a Festival is held in the town. As part of this event Shades organise a show on pet animal. Any member of the public can enter their pet animal by completing an entry form which can be obtained from the shop.

Tickets to see the show can be purchased up to two weeks in advance from the shop or can be purchased on the day at the Festival. In recent years the show has been a great success although two years ago it had to be cancelled due to COVID.

T-shirts can also be purchased from a stall manned by volunteers.

Sponsorship

Shades is sponsored by a local pet supplies company. The company makes an annual donation and provides prizes for the winners of the show. In return for this their services are advertised in the event programme and their logo is printed on the T shirts.

The main expenses are as follows:

Rent, rates, heat and light

Both the shelter and the shop are rented properties. These expenses are all paid by monthly direct debit.

Employee remuneration

Two employees are paid directly into their bank accounts on a monthly basis. Two employees are paid by the hour. They are paid by cheque on a weekly basis.

Medicine bill

The local vet provides his time free but any medicines etc do need to be paid for. Payments are made by cheque on receipt of the invoice.

Printing costs

Leaflets are produced to support fund raising campaigns. The most significant element of this cost is the show on Pet animal programme which outlines the timetable of events. The programmes are printed and delivered to Shades in May. The printer invoices at the time of delivery.

The accounts are maintained by the bookkeeper on a computerised spreadsheet. Occasionally, the treasurer may also assist with the preparation of accounting information at particularly busy times in the year, for example, immediately after the show.

Requirements:

- i) As the auditor of Shades discuss the key planning issues based on the above scenario. 6
- ii) Outline the audit work you would plan to perform in respect of the following expenses: 4
 - Rent, rates, light and heat
 - Employee remuneration
 - Medicine bills
 - Printing costs.

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

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 healthcare field. The company has closed their financial year ended 31 December 2022 with about BDT7.5 billion turnover ensuring growth as high as they expected while planning for the year.

The financial statements for the year ended 31 December 2021 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 2022, 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. 3

- b) Gentle & Co. Chartered Accountants (GentCo) has been appointed auditor for the Shahab Group of companies for the year ended 31 December 2022. The scope of the work of GentCo includes auditing and expressing an opinion on the financial statements of Shahab Holdings Limited and 5 others out of 7 companies of the group. Under the engagement term, GentCo would remain responsible for issuing opinions on the consolidated financial statements of the group. Two (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, GentCo finds that they do not have adequate staff to run all audits in the engaged entities simultaneously. GentCo, under this unavoidable circumstance, has decided to sub-contract audit engagements for 2 companies and take loan of 8 staffs from other firms. GentCo 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 evidence should GentCo obtain in order to express opinion on the consolidated financial statements? 3
- ii) Say, one of the component auditors has expressed qualified audit opinion in its audit report. How will this opinion affect the opinion of GentCo on the financial statements of Shahab Holdings Ltd. and the consolidated financial statements of the group. 3

- 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.'

Requirement:

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.

3

- d) You are an Audit Assistant of Ahmed & Partners and your firm is planning the audit of a client. You have been provided with draft financial statement extracts and the following information is about your client, TFL International Ltd, who is a kitchen equipment manufacturer. The company's year-end is 30 June 2022.

TFL International Ltd has recently been experiencing trading difficulties, as its major customer who owes BDT0.6 million to TFL International Ltd has ceased trading, and it is unlikely any of this will be received. However, the balance is included in the financial statements extracts below. The sales director has recently left TFL International Ltd and is yet to be replaced.

The monthly cash flow has shown a net cash outflow for the last two months of the financial year and is forecast as negative for the forthcoming financial year. As a result of this, the company is unable to settle suppliers whose payment are due and some are threatening legal action to recover the sums owing.

Due to its financial difficulties, TFL International Ltd defaulted a loan repayment and as a result of this breach in the loan contract, the bank has asked that the loan of BDT4.8 million be repaid in full within six months. In view of this, the directors have decided not to pay dividend for the period. Below is the Financial Statement extracts for TFL International Ltd for the year ended 30 April:

	Draft 2022 Million BDT	Actual 2021 Million BDT
Current assets		
Inventory	3.4	1.6
Receivables	1.4	2.2
Cash	-	1.2
Current liabilities		
Trade payables	1.9	0.9
Overdraft	0.8	-
Loans	4.8	0.2

Requirement:

Explain the factors that indicate that TFL International Ltd may not be operating as a going concern entity.

6

- e) Social and environmental issues have become important for the statutory auditor in recent years because these issues are important to the company as they can potentially impact on the financial statements. In Bangladesh, these issues have become even more important due to exploration for discovery and exploitation of Gas and ternary waste in our territorial waters. Social and environmental issues are also required to be considered under the International Standards of Auditing – ISA 250. Consideration of laws and regulations in the audit of financial statements and social and environmental issues impact all the stages of audit in terms of:

- Knowledge of the business (ISA 315)
- Inherent risk assessment (ISA 315 and 330)

Requirement:

Discuss six situations where social and environmental issues can potentially impact the financial statements.

3

6. a) Distinguish between Auditors' report and Audit opinion. 2
- b) The chairman of Fitness Ltd wanted to know to the CFO of the company about the type of Auditor's report for the year-ended on 30th June 2023. The CFO informed that the Auditor's report is modified but opinion is not modified. – Clarify the response of CFO. 2

---The End---