

AUDIT AND ASSURANCE

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 |
|---|-------|
| <p>1. a) An audit firm has a client company, Zoom Limited, which operates a motor racing circuit. The audit firm has discovered that the audit manager for the Zoom Limited audit keeps a racing car at Zoom Limited's circuit and uses the race track regularly. Because he is the audit manager, Zoom Limited allows him 50% off normal charges for garaging the car and for use of the race track.</p> <p>Requirement:</p> <p>What is the ethical position and what measures should the audit firm take to deal with this situation?</p> | 5 |
| <p>b) An audit firm has completed the annual audit for a client company and the audit team has identified a number of weaknesses in internal controls that have been notified to the client's management. As a result, the client has asked the firm to carry out a review of its financial IT systems.</p> <p>Requirement:</p> <p>What are the ethical issues to consider in this situation and how might the problems be dealt with?</p> | 5 |
| <p>c) Hasib Electronics Ltd., a renowned electronic household appliances producer in the country, sells their products through country-wide distributors and four of their own retail outlets located in two major cities. To keep track of critical information, they have a practice of receiving financial management information from their respective MIS department. In order to be satisfied that the information so provided are reliable and useful, the directors have engaged company's auditors to review the system and the information, and to provide a report with suitable conclusion.</p> <p>Requirement:</p> <p>In view of the about scenario, differentiate statutory audit of the financial statements with review work requested here with respect to the scope of the engagement and form of the report to be issued.</p> | 5 |
| <p>d) IESBA Codes of Ethics set out a set of fundamental principles which should be followed by professional accountants being members of IFAC. ICAB being member of the IFAC, such principles become mandate for its members to abide by too.</p> <p>Requirement:</p> <p>Briefly write about all these principles.</p> | 5 |
| <p>2. a) Brothers Limited is a 'One Person Company (OPC)'. It has asked your firm to become its auditors. The following information has been obtained about the company, mainly from the company's current auditors.</p> <p>(1) The current auditors have just resigned from the audit because they no longer have sufficient resources to carry out the audit work for Brothers Limited. They had taken on the audit two years earlier, after the previous auditors had resigned due to a dispute about fees. The current auditors commented that the company's management liked to keep a close control over costs, and they had agreed to do the audit for a lower fee.</p> <p>(2) The current auditors had discovered a number of internal control weaknesses in Brothers Limited and had reported them to management, but nothing appeared to have been done by management to improve the control system.</p> <p>(3) There were ongoing disputes with the tax authorities about the amount of tax payable by Brothers on profits for the previous three years.</p> <p>(4) Brothers Company has a poor public relations image. It is currently under investigation by both the police authorities and the regulatory authorities for alleged breaches of regulations, and some of these had been widely reported.</p> <p>(5) The company is ambitious and plans to expand its business in the next year or so. It expects to obtain bank loans to finance most of the expansion.</p> <p>Requirement:</p> <p>What issues should the audit firm consider when deciding whether or not to accept the new audit appointment?</p> | 6 |

- b) You have recently had a serious disagreement on a matter of financial reporting with the directors of one of your major audit clients. The directors, as a result of disagreement so mentioned, have threatened you of removing your firm by recommending another firm of auditors for appointment at the next AGM.

Requirement:

Under such circumstance, what rights do you have if they carry out their threat.

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- c) It is a common fallacy, even in the practitioners' fraternity, that engagement letter is necessary only when there is a matter of statutory audit. But, it appears, such a letter with agreed terms and conditions is more necessary in the case of a review engagement for financial statements and similar other assurance engagements as there is no detailed regulatory framework for other assurance engagements.

Requirement:

Write briefly about the purpose of an engagement letter for review of financial statements.

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- d) Your firm has been appointed on 01 February 2022 to conduct audit of the Financial Statements of Reliable Pharmaceuticals Ltd for the year ended 31 December 2021. The financial statements contain significant amount of finished goods and goods in transit at the year end. No stock taking was done at the year-end by the management.

Requirement:

Briefly narrate the audit approach and procedures that would satisfy the audit objective of the inventory reported in the financial statements.

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3. a) ABC Airlines, a limited liability company, was incorporated in Bangladesh on 1 June 2010. In July, the company exercised an exclusive right that it had been granted by the Government of Bangladesh to provide alternate day flights direct between Dhaka (the capital city of Bangladesh) and Heathrow, London, UK. The service has been widely advertised in the national newspapers of both countries as 'prompt, efficient and reliable'. As a result of these flights, it is expected that the travelling time between Dhaka and London will be reduced by about three to four hours. This shortened travelling time should increase the volume of commerce and trade between the two countries.

ABC Airlines operates a refurbished 30-year-old aircraft. This is leased from an international airline and registered with the Civil Aviation Authority (CAA) of Bangladesh. The CAA has a strict requirement that the engines of all aircraft on its register should be overhauled every two years. The overhaul of an aircraft engine usually puts the aircraft out of operational activity for up to five weeks.

The aircraft can carry 20 First Class, 50 Business Class and 80 Economy Class passengers. It also has a large hold for transporting cargo, in addition to passenger luggage.

On-board meals for the eight-hour journey are prepared in Dhaka under a contract with an airport catering company. Market research by ABC Airlines has shown that passengers are in general dissatisfied with the quality of in-flight food, especially on the Heathrow, London to Dhaka flight. ABC Airlines employs 12 full-time cabin crew attendants whose training in air-stewardship includes first aid training and medical procedures in the event that passengers are taken ill or injured during a flight. The captain and co-pilots for the aircraft are provided under contract by the international airline that leases the aircraft to ABC Airlines.

Flight tickets are sold by ABC Airlines (by telephone and at its offices and airport reception desks) and by travel agents in Bangladesh and the destination country. On several occasions, there has been over-booking of Economy Class seats. When this happens, customers are upgraded to Business Class. Now there is spare capacity in First Class and Business Class on all flights. Ticket prices for each class depend on several factors, such as whether the tickets are refundable (so that customers get their money back if they cancel their trip), exchangeable (so that customers can exchange tickets on one flight for tickets on an earlier or later flight). Ticket prices also vary with the day of the week and time of year.

ABC Airlines has extensive insurance cover, including employer's liability insurance (against the risk of accidents to employees) and passenger liability insurance (against the risk of liability to passengers for death, injury, extensive flight delays, and other risks).

Requirement:

Identify and explain the business risks facing ABC Airlines.

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- b) Ahmed & Ahmed, a firm of Chartered Accountants has accepted a statutory Audit engagement from KGSL Ltd., a model pharmacy with many sales points across the country. In 2021, the company implemented a computerised system that has been networked to all sales points to the Corporate Head Office in Dhaka. In the middle of 2021, the company started accepting mobile money through bKash as a means of payment in addition to cash and cheque payment. Mobile money payments are confirmed with an accounts staff before medicines and other healthcare products are supplied.

In planning the audit of KGSL Ltd., the Audit Manager, Shimul Siddiki, identified risks associated with electronic processing systems which provides additional challenges for auditors.

Requirements:

- i) Discuss four challenges Ahmed & Ahmed would encounter in performing an assurance engagement on the electronic processing system. 4
- ii) Discuss four audit approaches Ahmed & Ahmed should adopt in performing an assurance engagement on electronic processing system. 4

4. a) Wilko HiTech, a limited liability company, manufactures 'high-tech' computer-controlled equipment for use in other production industries. Its Directors and Senior Managers are also the company's shareholders. On 1 July 2021 they accepted an offer from a US corporation to buy Wilko HiTech's own manufacturing equipment and technology, which is protected by patent rights.

Management notified the employees, suppliers and customers that Wilko HiTech would cease all manufacturing activities on 31 August 2021. All the factory workers and most of the employees in the accounts and administration departments were made redundant, and the same was duly completed on 31 August 2021.

Most of the employees who remained in employment with the company after 31 August were made redundant from 31 October 2021. However, the company retained a small head office operation, consisting of the Chief Executive Officer, Director- Marketing, Director-Sales, Director- Finance and a small accounting and administrative support team. This head office unit will continue to operate for a few more years until the company's operations are wound down completely.

Before the sale, Wilko HiTech operated from twelve premises. Eight of these were put on the market on 1 August. Three of the other premises are held on leases that will expire in the next three to five years. Under the terms of the lease agreements, none of these premises can be sub-let and the leases cannot be sold. A small head office building will continue to be occupied and used until the lease expires in three years' time. Wilko HiTech accounts for all its tangible non-current assets at depreciated cost.

All the products sold by Wilko HiTech carry a one-year warranty. Until 31 August, the company sold extended two-year and five-year warranties, but extended warranties were not offered on any products sold from 1 September.

Wilko HiTech sold its products through national and international distributors, under three-year agreements. Wilko HiTech also had annual contracts with its major suppliers for the purchase of components. So far, none of the distributors or suppliers has initiated legal proceedings against Wilko HiTech for breach of contract. However, some distributors are withholding payments from Wilko HiTech on their account balances, awaiting settlement of the large penalty payments that they claim are now due to them from Wilko HiTech.

Requirement:

Using the information provided, identify and explain the financial statements risks to be taken into account in planning the final audit of Wilko HiTech in respect of the year ended 31 December 2021.

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- b) The draft statement of financial position of ABC Company includes an amount of Tk. 30,000 owed by ABODE Ltd. The total assets of ABC Company are Tk. 20 million.

The auditor has obtained the following audit evidence:

- ABODE Ltd. is controlled by the chairman of ABC Company, who is its majority shareholder.
- The draft financial statements of ABC Company do not provide any disclosures about the Tk. 30,000 transaction, on the grounds that it is immaterial.
- There is no information about the nature of the transaction, but the Tk. 30,000 had been included in receivables at the end of the previous financial year.

Requirement:

What further measures should the auditor take?

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5. a) Independent Auditor's Report per ISA-700 (Revised) has brought about substantial changes reflecting a lot of additional information for the users to better understand the message the report is intended to convey. Earlier one was pretty simple with not so much of information which could let users know of the pertinent risk factors as well as critical judgement the management used to take in preparing the financial statements to be published. But the current one has reformatted the reportable texts and paragraphs in a systematic order. As a result, users find reports in this new format more informative and useful in helping them taking appropriate decisions.

Requirements:

- i) You are required to write down paragraphs in orderly manner being in line with ISA-700 (revised)
 - ii) Mention about four other ISAs that require you to study to be able to provide necessary information in the new format of the auditor's report.
- b) Auditors report per ISA-700 (revised) requires critical focus on the matter of going concern while performing an audit. Although some financial reporting frameworks do not contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, IAS-1 requires management to make an assessment of an entity's ability to continue as a going concern. In our market, various regulators have mandated companies to prepare their financial statements in accordance with International Financial Reporting Standards. Hence, the auditors are left with responsibilities to obtain sufficient appropriate audit evidence on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern as per International Standards on auditing-570.

Requirement:

Describe the reporting responsibilities of auditors at different situations as per International Standard on Auditing (ISA) 570 (Revised): Going Concern.

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- c) Masda Manufacturer Ltd (Masda) is one of the established businesses in the manufacturing sector. The company has received different awards over the past decade. Masda's year-end was 30 September 2021. The audit of Masda is nearly complete and the financial statements and the audit report are due to be signed in a few days. However, the following additional information on two material events has just been presented to the auditor on 3 December 2021.

- (1) **This event occurred on 10 November, 2021.** Production at the Aluta factory was halted for one day when a truck carrying dye used in colouring the fabric on mattresses reversed into a metal pylon, crashing the vehicle and causing a dye to spread across the factory premises and into a local river. The Environmental Protection Association of Bangladesh is currently considering whether the release of the dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.
- (2) **This event occurred on 19 October, 2021.** The springs in a new type of mattress have been found to be defective making the mattress unsafe for use. There have been no sales of this mattress as it was due to be marketed in the next few weeks. The company's insurers estimate that inventory worth Tk.600,000 has been affected. The insurers also estimate that the mattresses are now only worth TK.100,000. No claim can be made against the

supplier of springs as this company is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay Masda for the fall in value of the inventory as the company was underinsured. All of this inventory was in the finished goods at the end of the year and no movements of inventory have been recorded post year-end.

Requirements:

- i) Explain the reporting implication of the issues in accordance with IAS 10: Events after the Reporting Period. 3
- ii) Explain the auditors' responsibility and the audit procedures that should be carried out in accordance with ISA 560: Subsequent Events. 3
- iii) Assume that the date is now 10 December 2021, the financial statements and the audit report have just been signed, and the Annual General Meeting is to take place on 10 January 2022. The Environmental Agency has issued a report on 28 December 2021 stating that Masda is in breach of environmental legislation and a fine of Tk.800,000 will now be levied on the company. The amount is material to the financial statements.
Explain the additional audit work the auditor should carry out in respect of this fine. 3
- d) You are the manager in charge of the audit of Edward Consultants, a limited liability company. Your auditor's report for the previous financial year to 31 December 2020 was signed, without modification, in February 2021.

The scope of the audit for the year to 31 December 2021 has been limited. This is because the company's Chief Executive Officer fled the country in April 2021, taking the accounting records with him.

You have identified a valuable training opportunity for Robin, one of your audit team members. As a training exercise, you have asked Robin to draft the extracts for the basis of opinion and opinion paragraphs that would not be standard wording in an unmodified auditor's report.

Robin's draft extracts were produced as follows:

Basis of opinion (extract)

However, the evidence available to us was limited because accounting records were missing at the beginning of the year and it was not possible to reconstruct them completely.

Opinion (extract)

Because of the possible effect of the limitations in the information available to us, we do not express an opinion on the financial statements.

Requirements:

- i) Identify and comment on the principal matters relevant to forming an appropriate opinion on the financial statements of Edward Consultants for the year ended 31 December 2021. 3
- ii) Discuss the suitability of Robin's draft extracts. 3

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