ADVANCED AUDIT & ASSURANCE

Time allowed - 3 hours
Total marks - 100

[N.B – *The figures in margin indicate full marks. Questions must be answered in English. Examiner will take account of the quality of language and 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) You are the Auditor of JMI Manufacturing Company Limited. As an auditor you have discovered and encountered with the following:

- The company manufactured 2.0 ml syringes specifically used by veterinary doctors. Those 2.0 ml syringes are used on human beings due to the shortage of syringes for human use. The Company has decided to phase out the 2.0 ml syringe in the next three years.
- In order to diversify into production of carbonated water, the Finance Director suggested that the company approach a bank for a complementary Tk.1.26 billion required to finance the diversification program. In spite of their proposal and cash flow to Bank of SCB Plc, which was described as being fantastic, their loan application was not granted. As a result, the company is likely to go into liquidation with its numerous staff disengaged, if viable alternative is not provided to raise the required fund.
- In carrying out the analysis of the sources of funds at the end of the year under review, you found that the company made much money from human trafficking to enable it accomplish the proposed plan of diversification. At the next meeting with management of the company, you brought your findings to their knowledge and threatened to disclose it as an extraordinary item in the income statement. Management frowned at it and were considering reviewing your appointment including fee which is currently 52% of your annual income.

Requirements:

(i) Identify the ethical issues involved as they relate to the auditor. 2

(ii) What are the three elements of fraudulent practices presented in this case? 2

(iii) What are the safeguards for the ethical issues identified? 4

(iv) List the issues that should be brought to the attention of the company by the auditors as regards the disclosure of the illegal act. 2

(b) In recent time, we observed that globally cyber hacking has been increased significantly. It starts from sharing password, easy access to the system, allowed unauthorized system access, using company e-mails to transfer data to personal e-mails, g-mails of others, unpublished news releases and using that non-public information in illegal trading to generate more illicit profits, etc and ended with serious fraud loss along with reputational risk to the organization. The Central Bank of Bangladesh lost USD 1 billion from its foreign reserves after a brazen cyber-attack. The hackers issued 35 fake SWIFT payment advice from Bangladesh of which 7-8 were executed. Moreover, ATM fraud in the country has also been increased where foreign nationals live in the country. In some cases, foreigners are directly involved. In this circumstances Banks, Financial Institutions which are operating in the digitalized platform and maintained banking relationship with other banks both inside and outside the country, do financial transactions through different real time on line systems. Now it is required for every company particularly who are providing on line services to the customers protects their systems from fraudsters, hackers to avoid reputational risk and fraud loss.

Requirements:

(i) You are advised to suggest the measures bank and financial institutions should take to strengthen the financial and information security controls to minimize the loss from hacking. 7

(ii) Assume that you are the auditor of XYZ bank for the year ended December 31, 2016. The hackers already withdrew Tk. 3 million in an hour from the bank's ATM and it lost Tk. 103 crore due to an internal fraud arising out of sharing passwords with colleagues. What would be your suggestion to the bank management? Will you include those things in the management letter after completion of audit for the year 2016? How can you mitigate those kinds of issues? 8

2. You are an audit manager at Rashed & Co, a firm of Chartered Accountants. You have been assigned to conduct the audit of the Himel Limited, a listed company which supplies food ingredients in North America.

The audit work for the year ended 31st December 2015 is almost over, and you are reviewing the draft audit report which has been submitted by the audit supervisor working in your team. During the year Himel Limited purchased a new subsidiary company, Mishti Sweeteners Co, which has expertise in the research and design of sugar alternatives. The draft financial statement of Himel Limited for the year ended 31st December 2015 recognize profit before tax of Tk. 495 million (2014 – Tk.462 million) and total assets of Tk.4,617 million (2014: Tk.4,751 million). An extract from the draft audit report is shown below:

Basis of modified opinion (extract)

In their calculation of goodwill on the acquisition of the new subsidiary, the directors have failed to recognize consideration which is contingent upon meeting certain development targets. The directors believe it is unlikely that these targets will be met by the subsidiary company and, therefore, have not recorded the contingent consideration in the cost of the acquisition. They have disclosed this contingent liability fully in the notes to the financial statements. We do not feel that the directors' treatment of the contingent consideration is correct and, therefore, do not believe that the criteria of the relevant standard have been met. If this is the case, it would be appropriate to adjust the goodwill balance in the statement of financial position.

We believe that any required adjustment may materially affect the goodwill balance in the statement of financial position. Therefore, in our opinion, the financial statements do not give a true and fair view of the financial position of the Himel Limited and of the Himel Limited's financial performance and cash flows for the year then ended in accordance with Bangladesh Financial Reporting Standards.

Emphasis of Matter Paragraph

We draw attention to the note to the financial statements which describe the uncertainty relating to the contingent consideration described above. The note provides further information necessary to understand the potential implications of the contingency.

Requirements:

(a) Critically appraise the draft audit report of the Himel Limited for the year ended 31st December 2015, prepared by the audit senior. 10

(b) The audit of the new subsidiary, Mishti Sweeteners Co, was performed by a different firm of auditors, Fuad & Co. Chartered Accountants. During your review of the communication from Fuad & Co. Chartered Accountants, you note that they were unable to obtain sufficient appropriate evidence with regard to the breakdown of research expenses. The total of research costs expensed by Mishti Sweeteners Co. during the year was Tk.1·2 million. Fuad & Co. Chartered Accountants has issued a qualified audit opinion on the financial statements of Mishti Sweeteners Co. due to his inability to obtain sufficient appropriate evidence.

Requirement:

Comment on the actions which Rashed & Co should take as the auditor of Himel Ltd, and the implications for the auditor's report on Himel Ltd's financial statements. 5

(c) Discuss the quality control procedures which should be carried out by Rashed & Co. prior to the audit report on the Himel Ltd. being issued. 10

3. You are an audit manager in Sareeta & Co, responsible for the audit of Shanin Ltd, a listed company operating in the pharmaceutical industry. You are planning the audit of the financial statements for the year ending 31 December 2015, and the audit partner, Alamgir Chowdhury, has sent you the following email:

To: Audit manager
From: Alamgir Chowdhury, Audit partner
Subject: Audit planning – Shanin Ltd.

This is to inform you that I would like you to start planning the audit of Shanin Ltd.

The company's finance director, Shababa Rashid, has sent to me this morning the following information discussed at the latest board meeting:

Extract of the Minutes from Alamgir Chowdhury's meeting with Shababa Rashid

Shanin Ltd has approached its bank to extend its borrowing facilities. An extension of Tk.10 million is being sought to its existing loan to support the on-going development of new drugs. Our firm has been asked by the bank to provide a guarantee in respect of this loan extension. In addition, the company has asked the bank to make cash of Tk.3 million available in the event that an existing court case against the company is successful. The court case is being brought by an individual who suffered severe side effects when participating in a clinical trial in 2014. In January 2015, Shanin Ltd began to sell into a new market – that of animal health. This has been very successful, and the sales of veterinary pharmaceuticals and grooming products for livestock and pets amount to approximately 15% of total revenue for 2015. Another success in 2015 was the acquisition of the 'Cold Comforts' brand from a rival company. Products to alleviate the symptoms of coughs and colds are sold under this brand. The brand cost Tk.5 million and is being amortised over an estimated useful life of 15 years.

Shanin Ltd's accounting and management information systems are out of date. This is not considered to create any significant control deficiencies, but the company would like to develop and implement new systems next year. Management has asked our firm to give advise on the new systems as they have little specialist in-house knowledge in this area.

Key Financial Information:

Key financial information	2015 –Actual unaudited	2014 – Actual audited
Revenue	40,000	38,000
Operating profit	8,100	9,085
Operating margin	20%	24%
Earnings per share	0.25	0.29
Net cash flow	(1,200)	6,000
Research and development cash outflow in the year	(3,000)	(2,800)
Total development intangible asset recognized at the year end	50,000	48,000
Total assets	200,000	195,000
Gearing ratio (debt/equity)	0.8	0.9

I also provide you with following minutes of a meeting I had with Kamal Ahmed last week and some background information about the company:

Extract of the minutes from Alamgir Chowdhury's meeting with Kamal Ahmed

Shanin Ltd is a pharmaceutical company, developing drugs to be licensed for use around the world. Products include medicines such as tablets and medical gels and creams. Some drugs are sold over the counter at pharmacy stores, while others can only be prescribed for use by a doctor. Products are heavily advertised to support the company's brand names. In some countries television advertising is not allowed for prescription drugs. The market is very competitive, encouraging rapid product innovation. New products are continually being introduced and improvements are made to existing formulations. Four new drugs are in the research and development phase. Drugs have to meet very stringent regulatory requirements prior to being licensed for production and sale. Research and development involves human clinical trials, the results of which are scrutinized by the licensing authorities. It is common in the industry for patents to be acquired for new drugs and patent rights are rigorously defended, sometimes resulting in legal action against potential infringement.

Using this information I would like you to prepare briefing notes for my use in which you:

(a) Evaluate the business risks faced by Shanin Ltd; 10

(b) Identify and explain FOUR risks of material misstatement to be considered in planning the audit; 8

(c) Recommend the principal audit procedures to be performed in respect of the acquired 'Cold Comforts' brand name; and 5

(d) Discuss the ethical issues relevant to the audit firm, and recommend appropriate actions to be taken. 7

4. (a) You are carrying out the audit of Aftab Autos Ltd. (AAL) for the year ended 31 December 2015, a listed company, engaged in the business of manufacture of spare parts for trucks, buses and tractors. The following information has been obtained during the audit:

(i) Agreements with two local distributors contain clauses that offer a significantly higher percentage of discounts which are above normal market rates. Due to the tough competition in the local market, the management of the company is currently negotiating with certain foreign customers for export of company's products.

(ii) In February 2016, court notices from two major customers were published in the newspapers, alleging the company of supplying inferior quality spare parts in the month of April 2015 and claiming damages of Tk. 150 million. The management is of the view that the allegations are baseless.

(iii) A supplier of the company has become bankrupt. The company owes an amount of Tk. 138 million to the supplier. However, the liquidator has lodged a claim of Tk. 140 million.

(iv) AAL is a family owned company. Out of its seven directors, four are executive directors. The non-executive directors have been elected on the board for the 4th time.

(v) The Board has formed a three member Audit Committee, which is chaired by a non-executive director, who is also the maternal uncle of the chief executive.

(vi) The half yearly accounts were not finalised because of a legal dispute. The company had informed BSEC in respect of such non-compliance.

(vii) Internal audit department includes only one person who is a chartered accountant and is engaged on a part time basis.

(viii) The warehouse from where goods are dispatched is under the management of sales department.

Requirements:

(a) Suggest appropriate measures to improve compliance with the Code of Corporate Governance. 5

(b) Explain the impact of information contained in para (vi) on the reporting responsibilities of the auditor with respect to Code of Corporate Governance. 5

(b) Marwa is a sole trader who is currently enjoying the privilege of doing monopoly business in the cosmetic industry of Bangladesh. She manufactures matte lipsticks from vegetable oil cultivated in her own family's farm in Rangamati. Her company, Colourpop Ltd has its head office situated in Savar, which is in the suburb of Dhaka City. At this stage her business is still considered as a small and medium enterprise with a bright future.

Since Marwa has big plans for her company she wants to make sure that the company has a sound internal control system. Therefore Marwa, has decided to appoint an auditor to conduct a management audit for her company.

You are a manager working at LTR & Co. Chartered Accountants. You are currently working under one of the partners, Mr. Dip Kumar Saha who is the engagement partner of Colourpop's management audit.

Requirement:

Prepare summary sheets which covers the audit risks pertaining in such small and medium enterprise. 5

Marwa has informed Mr. Saha that the auditors shall have to travel to Rangamati to carry out some audit procedures to ensure the vegetable oils used are up to the standard.

Requirement:

Prepare briefing notes for Mr. Saha specifying the pros and cons of opting for a joint audit under the current scenario. 5