AUDIT & ASSURANCE

Time allowed – 3 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) MQR is the external auditor of UBL Ltd, a FMCG company. The managing partner has been called to a meeting with the board of directors of UBL. At that meeting the firm has been asked if it can provide the following non-audit services.

UBL wish to implement a new sales system. They have asked MQR to take on a consultancy project whereby the firm will evaluate several possible systems, advise on which system should be selected, and oversee the installation of the new system. Being the senior manager of MQR you have to advise the managing partner on the following:

i. Should MQR accept the engagement? Why? 2
ii. What are the threats that would arise from the above scenario, if the engagement is accepted by MQR? 2

(b) PQR has been invited by CCL, a listed company, and SRC, a non-listed company, to provide audit and non-audit services. If accepted, the fees for CCL would represent 11% of the firm's gross fee income, and the fees for SRC would represent 12%. Paying due considerations to the ethical standards and international best practices should PQR accept both the clients? 4

(c) XYZ is a ten-partner CA firm which has been asked to accept the statutory audit of two separate companies. The following potential issues have been identified. For each of the following potential clients, state the basis on which the engagement could be accepted or state as to why the engagement should not be accepted, in accordance with Ethical Standards: 4

i. SCL Industries Ltd., a listed company, will also require XYZ to prepare the financial statements.
ii. MCL, whose finance director is the brother of one of the partners of XYZ.

(d) Recently you met one of your school friends after a very long time. You two had dinner at a fancy restaurant. During the conversation at dinner, you came to know that your friend is going to invest a significant amount in a company which you are currently auditing and ask for your advice, if any. Your friend is not aware of the fact that you are currently auditing the company. You know from your audit that the company is currently incurring significant loss. How will you respond to this conversation? 4

(e) What are the components of new format of auditors' report suggested in the new Standard ISA 700 (Revised) Forming an Opinion and Reporting on Financial Statements? 4

2. (a) LVL Ice Cream Ltd. is a company that is expanding rapidly and is regularly opening new ice-cream parlors, thus recruiting new employees. The payroll is processed in-house in the HR department using a Payroll software. The CEO is worried that fictitious employees could be included on the payroll by way of collusion between dishonest employees from the HR department and operations department.

Please advise the most likely internal controls to be established to prevent inclusion of fictitious employees and disbursement of salaries to them. 4

(b) Dhaka Ltd. (DL) has outsourced its payroll function to Safco, an accounting firm. Each month, DL provides Safco with relevant information for all employees including new joiner, employees retired/resigned, leave without pay, promotions, increments and bonuses etc. Safco calculates monthly payroll information by reference to employees' details held as standing data on Safco's Payroll system. Based on the information provided by Safco, DL disburses salary directly into its employees' bank accounts after deducting Income Taxes, employees' contribution to provident fund etc. Safco is responsible for filing of tax returns for DL.

Identify the business risks to which DL is exposed by outsourcing its payroll function to Safco and state the implications for the financial statements. 4

(c) Right Spinning Mills Limited (RSML),a public limited company since November 15, 2006, is located in Chittagong. The main activity of the company is to manufacture and sell high quality cotton yarn of all qualities and all other textile products. The company started commercial production of 100% cotton yarn like Knit (combed, carded) and Open-end yarn with an approved annual capacity of 5,680 MT at Ring Unit and 3,550 M. Ton at Rotor Unit. Currently the company is utilizing around 80% of its total capacity. The total number of employees of RSML is around 1200. The company intends to raise Tk. 2,000 million in the form of local currency corporate bond. RSML Management has approached your firm to carry-out an audit assignment before going to market. The engagement partner has asked you, being a senior manager, to prepare an audit plan based on analytical review procedure.

Requirement:
Identify what are the benefits of analytical procedure? What are the limitations of analytical procedure in planning of audit of Right Spinning Mills? 4

(d) Your firm has been appointed on 01 March 2017 to conduct audit of the financial statements of Jamal Apparels Limited (JAL) for the year ended 31 January 2017. The financial statements indicates significant amount of finished goods and goods in transit at the year end. No stock taking was done at the year end. What will be your audit approach and procedures for auditing inventory reported in JAL's financial statements? 4

3. (a) You have recently been appointed auditor to BBL Bangladesh Ltd. and are in the process of planning the audit for the year ending 31 December 2017.

BBL caters to the fast food market in Bangladesh and owns and operates a chain of 50 outlets located in most of the key areas of Dhaka, as well as beyond Dhaka. They have a commitment to provide hygienic food in a decent simple clean environment. The principal ingredient, the juicy fresh chicken is bred by the owners at their farm facility in Rangpur, under strict supervision of their own trained staff. The signature blend of spices with which the chicken is coated in unique in taste and aroma, manufactured carefully under the creative supervision of master blender.

BBL's key costs include premise costs, costs of breeding chicken, costs of leasing equipment like grills and fryers, and training and staffing costs. BBL meets these costs centrally, with all permanent staff salaries paid monthly by direct bank transfer. Each outlet is run on a day-to-day basis by an outlet manager, who is responsible for sourcing planning and procurement of other consumable goods locally and taking on any casual staff needed to cover peak periods. Both these expenses are generally met using cash from the till. Outlet managers have bonus incentives limited to the annual profit of their outlet.

BBL has recently set up its own internal audit department, having previously outsourced this function to their previous auditors. Several of the senior posts within the department were created by transferring established long-serving staff members from BBL's main finance department.

Requirements:
(i) Outline the factors that need to be taken into account by an external auditor when evaluating an internal audit function and its work. 5
(ii) Identify, with reasons from the situation outlined above, circumstances that should be taken into account when planning the external audit of BBL. 9

(b) BTL Ltd. was incorporated in Bangladesh in 1995. The company has one of the most modern composite mills in the region, with an installed capacity of 288 high-speed air-jet looms in its weaving section and a high-tech dyeing and finishing section with a capacity of 100,000 yards of finished fabric per day. This company is located at the BTL Industrial Park.

BTL Ltd. has a state of the art composite knit fabric production mill, which serves the growing needs of high-quality knit garments exporters in Bangladesh. The project was set up as a state of the art knit fabric knitting, dyeing and finishing facility. BTL Ltd. also has a cotton and polyester blended yarn-spinning mill, with 122,000 spindles, which is one of the largest spinning mills of the country. The mill was set up to feed the country's export oriented industries. BTL Ltd. produces specialized finished denim cloth for export in finished product as well as intermediate cloth form.

The company ventured into the retail arena initially through wholesaling of fashion clothing to retailers on credit basis. However, in 2004, the company diversified in to retailing with the opening of its retail outlets under the name of “Green”, a new chain of exclusive fashion shops in Bangladesh and abroad for the general public. No credit facilities are granted to customers of the retail outlets.

You have been entrusted with planning the audit of Green retail operations. During your planning meeting with the finance director, the following matters were highlighted as the major changes since the last audit.

Expansion of retailing operations
As a result of the success of the retailing business, the company expanded its operations and opened ten additional retail outlets during the year ending 31 December 2017. The management accounts indicate that the retail operations will amount to at least 20% of the company's revenue for the year ending 31 December 2017.

Increase in overdraft facility
The overdraft facility was increased to help fund the expansion. The company is currently trading at its overdraft limit as a result of the increased volume of business. The directors are seeking to increase the facility and are negotiating with the company's bankers.

New computer system
During the year, the company replaced its computer system to accommodate the retailing activities. It installed a central computer at head office linked to terminals at its warehouses and retail outlets. The software is an integrated standard package, which includes an inventory control system, modified by the supplier to the company's requirements.

Requirements:
Identify, from the circumstances described above, the audit risks, and for each risk Outline the audit work you would perform in that risk area. 9

(c) Monsoon rains have caused water levels to rise in various rivers in northern Bangladesh that triggered flooding across 32 districts in the northern, north eastern and central parts of the country, affecting at least 7 million people during May-June 2017. 72,131 households of 272 chars/ villages have been affected by flooding, leaving 1092 cattle dead and 20,376 acres of crops damaged. With 7,117 tube wells and 10,434 latrines damaged, thousands of families have faced a severe shortage of drinking water and sanitation which resulted in the outbreak of serious waterborne diseases. In such devastating circumstances, Fellowship Bangladesh, a not-for-profit NGO, stood by the flood victims by providing emergency health care and humanitarian assistance obtaining license from the Directorate General of Drug Administration (DGDA). This was only made possible due to generous donations.

The NGO is required to undergo an external audit in accordance with the constitution in its governing document and you are the audit senior responsible for the audit for the year ended 30 June 2017. During the audit, your team raised following observations:

(1) Collection boxes used during street collections were not sealed or numbered and collectors were responsible for counting and recording proceeds from their own collection boxes.
(2) Certain life saving drugs and veterinary drugs were not stored in a secure lockable and temperature controlled container, in contravention of the requirements of DGDA.

Your team also gathered information that due to a reduction in government spending, Fellowship has experienced a decline in the level of government grants available for its activities. It has also found it increasingly difficult to obtain financial donations through its traditional fundraising activities of street collections and telephone campaigns. In December

2016, the trustees decided to meet a shortfall in Fellowship's funding using crowd funding which is the practice of obtaining funding by raising monetary contributions via the internet. Fellowship chose to raise funds through its website and launched a campaign on the website in January 2017. However, the trustees had no experience of this type of fundraising activity and failed to put in place any promotional or marketing support for the campaign. The lack of public awareness meant the campaign failed and no funds were received by Fellowship.

In March 2017, the trustees negotiated an increase in Fellowship's overdraft facility and obtained a bank loan, secured on Fellowship's only premises, to meet the shortfall in funds and enable Fellowship to continue its activities. However, the draft statement of financial activities for the year ended 30 June 2017 shows that expenditure exceeded income for the year and the draft balance sheet at 30 June 2017 shows a net liability position. As a result of the financial issues arising in the year, three of Fellowship's five trustees and its fund raising manager resigned from their positions.

Requirements:

(i) Write down in a tabular format the two observations raised by your team, their implications and auditor's recommendations for inclusion in your firm's report to those charged with governance and management at Fellowship. 6

(ii) Identify and explain the factors which give rise to an uncertainty about the going concern status of Fellowship. 4

(iii) Assuming your firm concludes there is an uncertainty about the going concern status of Fellowship, explain the potential implications for the audit opinion on the financial statements of Fellowship for the year ended 30 June 2017 if the trustees: 5

  i. make appropriate disclosures; or
  ii. do not make any disclosures.

Your answer should describe the effects, if any, on your firm's audit report in each situation.

4. (a) AK Group is one of the leading conglomerates of Bangladesh and started its journey as a tobacco marketing company back in 1953. With headquarters based in the commercial capital Chittagong, the group flourished into a multi-business portfolio of fast moving consumer goods, steel, cement, ceramics, marble, shipping and trading business.

The group opened a separate company under the banner of AK Consumer Goods Limited (AKCGL) in 1994 to spearhead fast moving consumer products business. With its flagship brands of Starship and later Marks milk powders, the company gradually became the major player in the market. Over the years, both the brands have successfully acquired an iconic stature through providing superior quality as well as making significant social contributions.

AKCGL has grown during the year ending 31December 2017 and its profit before tax for the year will be around Tk. 700 crores.

The financial statements for the year ended 31 December 2016 showed inventories of Tk. 250 crores. Inventories at cost were Tk. 500 crores. A review of obsolescence was not performed but, on the recommendation of the company's accountants, the cost was written down by 50% on the grounds of prudence. The directors admit that obsolete inventories rarely exceed 10%. but there are no satisfactory audit procedures that could be adopted to confirm the true figure at that date.

Requirements:

In respect of the issue over inventory, reach a conclusion on whether you would modify your audit report on AKCGL for the year ending 31 December 2017, on the basis that no other matters arise which affect the opinion. You should give reasons for your conclusion and describe any additional statements which would need to be made in the audit report. 6

(b) You are Engagement Manager responsible for audit of the financial statements of Siddique Dairy Farms Ltd. for the year ended 31 March 2017. This is the first year of your audit and the team senior of your audit team has raised following issues during audit execution stage:

(i) Some balances in the opening financial statements, prepared from the ledger, do not match with those account balances in the previous year's audited financial statements.

Management has informed us that the difference is because of the audit adjustments proposed by the previous auditor. Those adjustments were incorporated in the previous year's audited financial statements, but have been posted in the ledger in the current financial year. Difference amount is material for the current financial statements.

(ii) Management records the transactions when cash is received or cash is paid. However, they prepares the financial statements on accrual basis. The entity does not prepare bank reconciliations.

(iii) Client management has refused to provide us documents related to management Salary sheets and Annual bonus on the ground of confidentiality.

(iv) Receivables constitutes significant number of small local customers. We were not able to obtain receivables confirmation from these customers as they are not familiar with the confirmation process and ignored the balance confirmation requests.

Requirements:

1. Help your team to design appropriate audit procedures to mitigate the risks. 9
2. What audit evidences should be collected in relation to the audit approach you have designed. 4
3. What will be the audit opinion in respect of each of the items after completing your audit procedures? 4

(c) During concluding an audit engagement, where management has disclosed related party information & transaction following the disclosure requirements of BAS-24, what steps you will take to conclude on the related party disclosure? 3