Audit & Assurance

Time allowed – 2½ 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 way in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order to sequence.]

Marks

1. Your firm XYZ, Chartered Accountants was appointed as the statutory audit of ABC Company Limited a construction company, for the year ending 31st December, 2010. Upon completion of audit, your firm have issued the following audit report:

Auditor’s report to the shareholders of ABC Company Limited
We have audited the accompanying balance sheet of the ABC Company Limited as of December 31, 2010 and the related profit and loss account and statement of cash flows for the year then ended. These financial statements are the responsibility of the company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope:
We conducted our audit in accordance with Bangladesh Standards on Auditing (BSA). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion:
In our opinion, the financial statements prepared in accordance with Bangladesh Financial Reporting Standards (BFRS), give a true and fair view of the state of the company’s affairs as of December 31, 2010 and of the results of its operations and its cash flows for the year then ended and comply with the applicable sections of the Companies Act 1994, the Securities and Exchange Rules 1987 and other applicable laws and regulations.

We also report that:
(a) we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit and made due verification thereof.
(b) In our opinion, proper books of account as required by law have been kept by the company so far as it appeared from our examination of those books and (where applicable) proper returns adequate for the purposes of our audit have been received from branches not visited by us.
(c) The company’s balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.
(d) The expenditure incurred was for the purposes of the company’s business.

XYZ
Chartered Accountants

Requirements:

In the context of the above report, you are to answer the following:

(a) In your report, your firm have affirmed that the audit have been conducted in accordance with Bangladesh Standards on Auditing. Describe the procedures you have adopted in support of the above affirmation. 8
(b) Explain the phrases: ‘material’ and ‘reasonable’ and their implication in Audit and Assurance. 5
(c) In your report, your firm have also stated that the financial statements have been prepared in accordance with Bangladesh Financial Reporting Standards. What are the procedures that you have carried out to affirm your statement and which of the standards are relevant for your client company. 8

[Please turn over]
(d) In the opinion paragraph, your firm have asserted that the financial statements give a `true and fair' view of the state of affairs of the company. Explain what you have meant by the phrase 'true and fair'. Also explain when and under what circumstances, the financial statements give a true and fair view of the state of affairs of the company.

2. Consider the following independent situations, which all relate to the year ended 30 June 2010:

   (i) Karim is the sole proprietor of Karim’s Gift Shop (KGS). KGS leases premises in a large shopping complex in Dhaka. Karim received a preliminary notice in May 2010 that the complex owners were planning a major redevelopment commencing later in the year. Karim’s lease would be terminated around October 2010 and at this stage it appears that no alternative premises will be offered. All necessary approvals have been obtained for the redevelopment project.

   (ii) Ms Sulekha runs a beauty parlour in a shopping arcade in the suburbs of Dhaka. The lease runs out on 31 December 2010. Ms Sulekha informed you at the planning stage of the audit that she does not intend to renew her lease. She will simply close the shop, sell what equipment she can, pay her outstanding accounts and retire.

   (iii) ZX Limited is a subsidiary of an overseas electronic giant, ZY Limited. ZX has always made a loss and has always been financially supported by ZY. Each year, ZY signs a letter of support stating they will provide financial support for ZX in the next twelve months. You have such a letter on file this year. However, recent articles in the financial press suggest that ZY is in financial difficulties and may be subject to a hostile takeover bid.

Requirements:

   (a) Discuss whether there is a potential going-concern issue in each situation.

   (b) Describe the additional procedures that you would perform (if any) in each situation.

3. You have completed your audit of Bangla Limited, a listed company for the year ended 30 June 2010. As at this date, Bangla reported net assets of Tk.35 crore and sales revenue of Tk.42 crore. Materiality for the audit was set at Tk.3 crore.

   During the audit you made note of the following potential management letter points:

   (i) Invoice number 697, issued on 1 May 2010, contained incorrect prices. This resulted in the invoice being understated by Tk.1,75,000.

   (ii) Inventory held at a third-party warehouse was found to be damaged and unsaleable; however, it was not written off. It is currently shown in the accounting records at its original cost of Tk.17,50,000.

   (iii) High turnover in the head office accounts department resulted in the bank account remaining unreconciled for three months. The problem was only resolved several weeks after the year end.

   (iv) A fraud was perpetrated by warehouse staff, who acted in collusion with the stock controller to steal approximately Tk.700,000 of stock during a six-month period. All employees involved in the fraud have since left the company. Additional controls have been put in place to prevent recurrence of the problem.

   (v) Unrecorded liabilities amounting to Tk.392,000 were discovered during the examination of cash payments made post balance date.

   (vi) Two laser printers purchased by the marketing department were mistakenly posted to repairs and maintenance expense rather than fixed assets. The printers cost Tk.5,60,000 and depreciation of Tk.1,40,000 should have been charged in the year ending 30 June 2010.

   (vii) During testing of controls performed on payroll, it was noted that staff at one branch were verbally advising management of their annual leave requirements rather than completing the appropriate form.

   (viii) During the review of prepayments, it was noted that Bangla’s lease for its office premises expired in March 2010 and has not yet been renewed.

At the end of the audit the chairman of the board approached you and said: ‘And another thing, don’t waste the board’s time by including all those trivial issues in the management letter. We only want to know about important things that may have a real impact on our operations, not irrelevant matters.’
4. Your firm has recently been appointed external audit of Hatil Ltd (Hatil) for the year ending 30 June 2010. The previous auditor did not seek reappointment. Your firm has also been invited to provide tax planning and compliance work for the company.

All of the shares in Hatil are owned by the Patwari brothers, Martin and Maruf. They are the only directors and spend on average three days a week managing Hatil as they have other business interests. The company employs a full-time qualified accountant but does not have a finance director. Matin and Maruf have plans to grow the business and wish to recruit a finance director. They have asked your firm to assist with the recruitment of a suitable candidate and advise on the remuneration package.

Hatil’s principal activity is the manufacture and sale of high quality leather sofas, chairs and other forms of seating which are sold to the public, clubs, hotels and restaurants. Items are produced by hand in the company’s workshop which is located in the North of Dhaka. Customers place their orders by telephone or over the internet and pay by cheque or credit or debit card. All sales are transacted in BDT.

The company’s terms of trade require a 50% deposit with the order. Once the order is completed, the balance must be paid five days prior to delivery. Typical production time is three to four weeks. Customers are required to check the items on delivery and have seven working days to return the items if not completely satisfied. All items are sold with a one-year guarantee. At peak times the company uses sub-contractors to assist with the manufacture of the seating. These sub-contractors are required to invoice Hatil at the end of each month.

The company does not supply goods from inventory as all items are made to customer order. Finished goods in the workshop relate to items awaiting dispatch to customers. The company does not have continuous records for raw materials inventory and undertakes a full count of raw materials at each month end including at the year end. The quantities are recorded on inventory sheets and are subsequently costed by the company accountant. Matin Patwary estimates the value of work in progress and finished goods awaiting dispatch.

Raw materials are sourced from number of suppliers based in Bangladesh and overseas. All of the timber used in the frames for the seating is purchased from Timber Ltd. which is owned by Matin and Maruf’s mother, Selina Patwary.

There has been steady growth in sales in recent years and, in May 2010, Hatil acquired the premises adjacent to its existing workshop to allow expansion of its manufacturing capacity. The new premises are not yet in use as they are currently undergoing extensive refurbishment in order to make them fit for purpose.

The acquisition was funded by a bank loan repayable in quarterly installments over ten years. The existing workshop, which is owned by the company and included in the financial statements at cost less accumulated depreciation, was revalued by an external valuer in April 2010. The directors wish to incorporate the revalued amount in the financial statements for the year ending 30 June 2010.

Requirements:

(a) Outline the procedures your firm should have undertaken, prior to accepting appointment, in order to assess the integrity of Matin and Maruf Patwary. For each procedure describe how it would have assisted with your firm’s assessment of the integrity of Matin and Maruf.

(b) Explain what is meant by a self-review threat in the context of the provision of taxation services to Hatil and state the safeguards available to your firm in order to reduce this threat.

(c) In respect of the recruitment and remuneration package, explain the threats to independence which may arise from the provision of each of these services and discuss how your firm might respond to these threats.
(d) Identify, from the information provided in the scenario, the principal areas of audit risk in respect of the financial statements of Hatil for the year ending 30 June 2010. For each risk:
   (i) list the factors which have led you to identify that risk; and
   (ii) outline the procedures that should be included in the audit plan in order to address the risk.

You should present your answer in a **two-columnar** format using the headings (i) audit risk and factors; and (ii) procedures to address the risk.

5. Described below are situations which have arisen at two unrelated external audit clients of your firm. The year-end in each case is 30 June 2010

**Dhaka Ltd. (Dhaka)**
The management of Dhaka has refused to provide written representations that:
- it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework;
- it has provided the auditor with all relevant information and access as agreed in the terms of engagement; and
- all transactions have been recorded and are reflected in the financial statements.

**Eastern Ltd. (Eastern)**
Eastern maintains continuous inventory records and consequently the company does not perform a physical count at the year end. On 5 May 2010, a fire in the office at Eastern’s warehouse destroyed the company’s inventory records and dispatch records. The physical inventory was not damaged. There were no satisfactory alternative audit procedures which could be performed. The company has included an estimated closing inventory figure of Tk.7,00,00,000 in the financial statements. This estimate represents 5% of Eastern’s total assets and 20% of profit before tax.

In each of the two situations outlined above, state whether you would modify the audit report. Give reasons for your conclusions and outline the modifications, if any, to each audit report.

– The End –