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| **Client name** | : | Cosmopolitan Industries (Pvt.) Limited | | | |
| **Accounting Period** | : | 01 July 2021 to 30 June 2022 | | | |
| **Subject** | : | Memo on Management Override of Control (MOC) | | | |
| **Prepared by** | : | Imtiaz Rashid | **Date** | : | 10 Nov 2022 |
| **Reviewed by** | : | Salauddin Morshed | **Date** | : | 15 Nov 2022 |
| **Further Reviewed by** | : | Faruk Uddin Ahammed, FCA, CISA | **Date** | : | 20 Nov 2022 |
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**Background:**

The MEMO aims to document our conclusion regarding the audit procedures performed for testing management override of controls in accordance with *International Standard on Auditing (ISA) 240* *The Auditor`s Responsibilities Relating to Fraud in an Audit of Financial Statements*, *Consideration of Fraud in a Financial Statement Audit*, for Statutory Audit of Cosmopolitan Industries (Pvt.) Limited for the year ended 30 June 2022. In preparing this memo, we have reviewed and considered the Deloitte Guide to Journal Entry Testing to Address the Risk of Management Override of Controls (“Deloitte JE Guide”).

**Scope of Audit:**

Local Statutory Audit – Year Ended 30 June 2022.

**Accounting Information System:**

CIPL uses SAP for recording all of its financial transactions. From recording day-to-day transactions to preparing the trial balance is carried out by SAP which is maintained by the Parent Company. They maintain all their books of accounts for all their subsidiaries including Cosmopolitan Industries (Pvt.) Limited through their Web Portal of SAP. Each and every computer needs to be user configuration and then the authorized person can get access to the system through user ID and password.

**Reference to International Standards on Auditing (ISA):**

ISA 240, effectively we need to cover 3 aspects for MOC:

Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

**(a)** **Test the appropriateness of journal entries** recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:

(i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

(ii) Select journal entries and other adjustments made at the end of the reporting period; and

(iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41–A44)

**(b)** **Review accounting estimates for biases** and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:

(i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity’s management that may represent a risk of material misstatement due to fraud. If so, the auditor shall reevaluate the accounting estimates taken as a whole; and

(ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A45– A47)

**(c)** **Significant transactions that are outside the normal course of business** for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A48)

**Existing Management process for maintaining and review of JE (Journal Entry):**

Each and every journal entry is approved by respective authority as per financial hierarchy and posted by different persons in SAP. There are two types of entries, and these are - automated and manual. are manual entries which are posted in the system by respective persons of the departments. Depreciation expense which is automated is calculated based on the parameters inputted in the system automatically. Apart from depreciation expense, all other entries (including Revenue, cost of sales, payroll, operating expenses, tax expense, etc.) are posted manually. Usually, majority of manual entries are passed by Finance Controllership Unit.

**Refer** **Levvia: 12200.02 Financial statement closing process** for ET understanding of the journal entry process as part of the Financial Closing and Reporting Process (FCRP).

**Approach followed by the ET:**

1. **Process of Journal Entries and Test of Control Surrounding JE**:
2. Obtained detailed understanding of business process of posting and review of Journal Entries and documented the same as part of FCRP. **Refer WP-12200.02 Financial statement closing process.**
3. Tested D&I and OE of the control surrounding the review and approval of JEs. Samples [Total number as per the methodology - 60] selected - performing random sampling on the data dump. There are almost 118,936-line items in Data Dump.

**Refer WP No: 15610.01 Manual journal entry approval (FSL.C01)** (Levvia)

1. **Test of MOC through Journal Entries:**
2. Based on understanding of the JE process, it is noted by ET that most of the entries passed from Finance Controllership Team are standard entries through SAP. Hence, ET obtained Data Dump for the year and performed integrity test.

**Refer WP 21000.01 Journal entries testing (FSL.P01) – Final**

1. ET has performed the OE testing on the journal entries to confirm whether management control performed throughout the period.

**Refer WP No: 15610.01 Manual journal entry approval (FSL.C01)**

1. **Test for Unusual Transactions:**

1. ET has performed JE testing for finding unusual and exceptional items that may indicate potential MOC. ET has used Spotlight to perform JE testing. The profiling was performed based on 14 criteria and all the flagged exceptions are combined into one single file. Upon reviewing the entries flagged and management explanation for those entries, ET scoped in some unusual journal entries for test of details.

**Refer WP 21000.01Journal entries testing (FSL.P01) – Final**

1. ET has performed Test of Details on the scoped-in items which were scoped in as unusual journal entries.

**Refer WP 21000.01Journal entries testing (FSL.P01) – Final**

1. **Test for Accounting Estimate:**

Provision for tax, depreciation expense, and lease liability, RoU, and Security Deposit - FA are the estimate subject to detailed testing. **Refer WP: 29700.01 Review of estimates for indicators of management bias** (Levvia).

1. **GITC and Automated Control:**

In respect to the GITC tested and test of Automated Controls, it was noted that there was no major issue observed/noted regarding Privilege access to any business users who can pass any unauthorized transactions or pass any unauthorized entries in accounting system. This gives an additional comfort in addressing the Risk of MOC as Significant Risk.

**Refer WP: 15700.01 General IT controls testing** (Levvia).

**Overall Conclusion:**

Based on the results of the testing performed for point # 1 to 5 as above, it may be concluded that ET has been able to address the Risk of Management Override of Control as Significant Risk.

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