Doc. Ref: Mat. Annex 13120

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| **Client name** **:** Cosmopolitan Industries Pvt. Ltd. (CIPL) | | | | |
| **Accounting period :** 01 July 2021 to 30 June 2022 | | | | |
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| **Prepared by** | **:** Salauddin Morshed | | **Date:** 08 July 2022 |
| **Reviewed by** | **:** Faruk Uddin Ahammed | | **Date:** 10 July2022 |
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| **Subject:** Materiality Memo for Statutory Audit. |  |

**Objective:** The objective of this memo is to document rationale for materiality benchmark and the percentage to be applied in determining Audit Materiality.

**Background:** Cosmopolitan Industries Private Limited ("the Company” or "CIPL") was incorporated in Bangladesh on 26 June 2005 as a private limited company under the Companies Act, 1994. Cosmopolitan Industries Private Limited, the Company is engaged in the production and export of readymade garments. The Company is in operation with two units namely Washing and Garments unit. The Washing unit commenced its commercial operations from 31 August 2006 for automatic washing of all kinds of garments and the Garments unit commenced its commercial operation from 1 November 2006 for the production of ready-made garments. The Company is a subsidiary of Epic Designers Ltd., Hong Kong.

**Users and their primary focus:** Users of financial statements include foreign shareholders, local management, creditors, and tax authority. Based on our discussion with management and our knowledge of the business major areas of focus of the users of the financial statements identified as revenue, profit before tax, profit after tax/net income, cash flow from operations, and total assets.

1. **Shareholders**: Generally primary focus of shareholders is on total assets, revenue, and net income.
2. **Management**: Primary focus of the management is on revenue and operating income.
3. **Creditors**: Generally primary focus of creditors is on cash flow from operating activities.
4. **Tax authority**: Generally primary focus of tax authority is on profit before tax.

Among the existing users, shareholders are the primary stakeholders and user of financial statements of the company. The shareholders of the company have interest on total assets, revenue, and net profit.

**Benchmark for materiality:** According to Deloitte Audit Manual 13100, for the audit of non-listed entities’ revenue, profit before tax for continuing operation, total assets, total equity/net assets, expense, or cash flows from operations may be used as a benchmark. Key stakeholder has primary focus on total assets, revenue, and net income.

As the portion of current assets of the company is larger than non-current assets, real assets of the company is not expected to be a key concern of the management. Moreover, the company’s profitability over the year is not stable and hence we should not consider this amount as benchmark for determining audit materiality.

At the current stage of operations, the management of the company is expected to be more concerned with revenue base. Besides, the company’s revenue figures over the years have been fluctuating in a close range.

Therefore, revenue can be considered as a rational and logical benchmark for calculating materiality of the company. In the group referral instructions, revenue has also been considered to determine the group audit materiality. Accordingly, the engagement team has considered revenue as reasonable and justifiable benchmark for materiality determination.

**Percentage to be applied to the benchmark:** Based on DAAM 13100 Para 22A, materiality using revenue as the relevant benchmark may be determined by applying a percentage within a range of 0.80% to 5% of revenue. Professional judgement is used to determine what percentage is appropriate for the audit of the Company. The engagement team considered the size and maturity of the Company. As the Company is a private limited company, with 17 years history of operations, having no fraud/corruption history, the engagement team calculated materiality based on 1.5% of revenue to keep the materiality at the lower part. The engagement team is still on the lower side of the prescribed range per DAAM. The percentages are reasonable because of the following as well:

1. The company is a private limited company
2. No history of modification in audit report in prior year
3. Engagement risk of the company is assessed as normal

**Determination of performance materiality:** As per DAM 13100 Para 29, the determination of performance materiality involves the exercise of professional judgment. It is affected by the understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and thereby the auditor’s expectations in relation to misstatements in the current period. The engagement team has not identified uncorrected misstatement and do not estimate any uncorrected misstatement.

As Per DAM 13100 Para 32 & 33, even though the engagement team does not anticipate that no misstatements will be detected or that management will correct all misstatements, performance materiality shall be set at a lower level than materiality to reduce the risk of reaching an inappropriate audit conclusion.

The engagement team has determined performance materiality @ 75% of materiality, i.e. USD976,500 which is lower than the materiality. Rules of Thumb suggests using percentages range from 60% to 85% depending on the risk of material misstatements. Considering the third-year audit and low nature of implied risk of material misstatements, performance materiality has been considered as 75% for all classes of accounts.

**Clearly trivial threshold (CTT):** According to DAM 13100 Para 40, upto 5% of materiality is often considered as CTT. The engagement partner may determine, based on the facts and circumstances of the entity and the audit engagement, that a lower level is appropriate. Factors such as the nature of the entity, history of misstatements, and number of locations may affect the actual threshold of what we consider clearly trivial. As such, we have considered the maximum percentage allowed by DAM.

The following table summarizes materiality, performance materiality, and clearly trivial threshold determined by the engagement team.

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| **Benchmark** | **Amount (USD)** | **Percentage applied** | **Materiality** |
| A. Revenue | 86,826,344 | 1.50% | 1,302,395 |
| B. Materiality rounded to the nearest amount | - | - | 1,302,000 |
| C. Performance Materiality (B x 75%) | - | - | 976,500 |
| D. Clearly Trivial Threshold (B x 5%) | - | - | 65,000 |

**Conclusion:** Based on the above analysis, we have determined materiality and concluded that the use of lower side percentage of materiality calculation did not carry significant risk of undetected or uncorrected misstatements of the financial statements.

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