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| **Client Name:** Cosmopolitan Industries Pvt. Ltd. (CIPL) | | |
| **Accounting period:** 01 July 2021 to 30 June 2022 | | |
| **Prepared by:** Mizanur Rahman |  | **Date:** |
| **Reviewed by:** |  | **Date:** 19 July 2021 |
| **Further Reviewed by:** |  | **Date:** 20 July 2021 |
| **Subject:** Materiality Memo for the audit of CIPL (USD) | | |

**Objective:** The objective of this memo is to document rationale for closing raw material inventory rate

**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.

This memo has been prepared to document the rationale for using the benchmark and percentage to determine materiality level.

For audit of financial statements of this company, materiality level needs to be set and for this purpose, we have reviewed/analysed what area should be the most appropriate to consider as benchmark and how much percentage we can apply to set the most appropriate materiality level.

**Justification:**

To exercise this, we analysed the company’s financial statements. We noted that the company’s business is in garments sector and its main earning is export sales and again this export is made to the parent company, i.e. Epic Designers Limited, located in Hong Kong.

We have identified the company’s users of the financial statements and they are mainly: shareholders, regulators and the loan providers. We have also analysed their probable focus areas of the financial statements and these are given below:

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| --- | --- | --- |
| **SL.** | **Stakeholders’ Names** | **Focus Points** |
| 01. | Shareholders | Profit after Tax (PAT), Revenue from export |
| 02. | National Board of Revenue (NBR) | Profit before Tax (PBT), Revenue from export |
| 03. | EPZ Authority | Revenue from export |
| 04. | Loan provider/Creditor | Financial position |

From our analysis, we noted that 99.99% shares of the company is owned by its Parent (EPIC Designer Limited) and the parent company there is the only customer of the products since it is 100% export oriented company. Shareholders’ main focus point is Profit After Tax amount, out of which, the company can declare dividend. So, dividend is the main income of the shareholders. Again, this net profit after tax is fully dependent on company’s total revenue.

From the regulators’ perspective (NBR and EPZ Authority), the main focus point is Profit Before Tax (PBT), on which, the company needs to pay its corporate income tax. Here also profit before tax depends on company’s total revenue.

We have analysed the company’s profit position before considering this as Benchmark. Our analysis of the Company’s Profit/(Loss) before tax for the previous years are given below:

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| --- | --- | --- | --- | --- |
| **Particulars** | **30 June 2018** | **30 June 2019** | **30 June 2020** | **30 June 2021** |
| **USD** | **USD** | **USD** | **USD** |
| Profit/(Loss) before Tax | 1,125,072 | 616,685 | -655,961 | -2,875,527 |
| Percentage of change |  | -45.2% | -206.4% | -338.3% |

From our above analysis over the profit position, it is clearly understood that the company’s profit position is not stable and hence, we should not consider this amount as Benchmark for determining audit materiality.

Now, we can also analyse the company’s revenues for the last few years, and these are shown as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Particulars** | **30 June 2018** | **30 June 2019** | **30 June 2020** | **30 June 2021** |
| **USD** | **USD** | **USD** | **USD** |
| Revenue from export | 76,109,646 | 81,038,655 | 71,628,270 | 63,313,374 |
| Percentage of change |  | 6.5% | -11.6% | -11.6% |

From the above tables and graph, we can see that the company’s revenues are comparatively stable and it is more rational to be considered as Benchmark compared to the company’s unstable profit situation. Hence, we have considered revenue should be the most relevant benchmark to determine the materiality level.

From the Loan provider/Creditor’s perspective, company’s financial position is the main focus area. Since the company’s loan position/ creditors’ balances are not so significant, we have not considered financial position of the company should be the Benchmark.

Now, the second consideration is that how much percentage will be considered. Per Section 2.3: Determination of Percentages Applied to Benchmarks for materiality, it is recommended to set the range from 0.8% to 2%. Although this is our second year of audit for the company, we have selected materiality percentage at the lower level considering the inherent risk of the Garments industry as well as the company is still relatively new to us in terms of years of audit. Based on this, a percentage towards the lower level, i.e. @ 0.8% has been applied to determine the materiality. However, Deloitte Audit Manual recognises that other percentages may be used based on the professional judgment of the engagement partner.

The engagement team has determined to calculate the materiality by applying 0.8% on export sales and performance materiality @75% of materiality. The following materiality has been calculated based on draft financial statements for the year ended 30 June 2021:

|  |  |  |
| --- | --- | --- |
| **Sl. No.** | **Particulars** | **USD** |
| **For Statutory Audit** | | |
| 1 | Revenue from export sales | 63,313,374 |
| 2 | Materiality (0.8% on export sales) | 500,000 |
| 3 | Performance materiality (75% of materiality) | 375,000 |
| 4 | Clearly trivial threshold (5% of materiality) | 25,000 |

**Performance materiality:**

We have considered performance materiality to be 75% of the materiality based on the factors like other manufacturing concerns and the risk of uncorrected and undetected misstatements may remain in the financial statements.

**Clearly trivial threshold:**

Per DAM 13100 para 40, up to 5 percent of materiality is often considered as clearly trivial. 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 for the company.

**Conclusion:**

Based on the above analysis, we have determined that materiality @0.8% on export sales is appropriate and also concluded that the use of a lower percentage of materiality calculation did not carry significant risk of undetected or uncorrected misstatements of the financial statements.