

**a). What are the business activities of Kathmandu that you will need to understand to carry out a successful audit? Using information you obtained about Kathmandu, and the industry they are in, come to an informed view as to the 'business' and 'industry' risk for this prospective client that you think is important for deciding to accept this client. Be sure to set out the basis (reasons) for your decision.**

According to ASA 315; ISA 315, gaining an understanding of the client is necessary to assess the risk that the financial report contains a material misstatement due to:

**- The nature of the client's business.**

- >KMD is an established global multi-channel business which is the parent company to brands Kathmandu, Oboz and Rip Curl.

- >For-profit

- >Recognised as global outdoor, lifestyle and sports company.

- >The Kathmandu brand was born in 1987. Kathmandu Holdings formed in 2009 as a publicly listed company.

- > Net profit after tax of \$63.4 million, an increase from \$8.9 million in the 2020 financial year (which included transaction costs from the Rip Curl acquisition);

- >Going-concern: operational in the foreseeable future - strong financial position

- >Consistent Audit result historically

-Generally moderate risk of material misstatement given the size of the company, its operations (global) and need to produce favourable financial reports due to its public listing this is partially mitigated given as they are held to a higher regulatory standard and its consistent audit results.

-Important to understand so auditor can establish where reporting misstatements may occur within the company and internal pressures governance may be under.

**- The industry in which the client operates.**

- >Apparel is generally a competitive industry with large number of brands operating in the market.

- >Covid has negatively impacted foot traffic, supplier cost and ability of debtors to repay accounts owing to KMD brands.

- >Demand is dependent on trends and may fluctuate - operates in a dynamic environment.

- >Creditors and the government have provided support to retailers due to unpredictable 'lock-down' regulations.

-Generally High risk of material misstatement given the highly competitive nature of the industry and the unpredictable environment it operates in due to the pandemic.

-Important to understand so auditor can establish where reporting misstatements may occur within the company due to the industry it operates in and external pressures governance may be under.

**b. Evaluate issues to do with**

**(i) Self-review and**

**(ii) Familiarity threats to independence that could potentially arise from performing a statutory audit on the financial statements of Kathmandu. Explain why these issues could be a threat to the credibility of the financial statements and how those issues should be addressed before accepting the audit engagement?**

**i)**

- >The self-review problem arises when the auditor, as part of the audit, has to test transactions or systems that were recorded or provided by another part of the audit firm or by a previous employee of the audit firm, or the testing is performed by a previous employee of the client.

- >Self-review means that there is too little separation between the client and the auditor with respect to that part of the audit, that is, the auditor is testing or reviewing itself.

- >It is a problem for the audit because self-review impairs the primary source of value of a financial report audit, that is, the independence of the auditor from the client. The lack of independence could mean that the auditor acts inappropriately during the audit.

- >If a threat is identified, the auditor should consider appropriate safeguards (e.g. use an external expert to provide assurance of the work that poses self-review threats, separate staff to perform each service, implement appropriate policy/procedure to prevent individuals providing audit

services from making any managerial decisions on behalf of the assurance client).

>If the audit team judges the above threats to its independence to be significant, the audit team should withdraw from the audit tendering process or withdraw the conflicting service.

ii)

>Familiarity refers to a general closeness between the auditor (including the whole audit team) and the client.

>If there is a relationship that is more one of friendship than that between independent auditor and client. The auditor could lose their objectivity during the audit and act inappropriately. The auditor should not proceed in an engagement if there is an unprofessional relationship identified between themselves and the client.

>Auditors should not accept any gifts from the client during the engagement this can influence the auditor not to be independent (in mind and appearance) when performing their professional duties. This may result in low quality audits.

**c. Evaluate issues to do with (i) Advocacy and (ii) Intimidation threats to independence that could potentially arise from performing a statutory audit on the financial statements of Kathmandu. Explain why these issues could be a threat to the credibility of the financial statements and how those issues should be addressed before accepting the audit engagement?**

i)

>Advocacy Threat occurs when audit firm or assurance staff act on behalf of client.

>If auditor is involved in promoting the client, and acting on behalf of the client (e.g encouraging others to buy clients shares/bonds, it compromises the objectivity of the audit (loss in independence in appearance if not also mind).

>Auditors should consider the background of the members in the audit team, such as firms they worked at prior to joining the audit firm/team. This will allow the audit firm to reduce the risk of threat of advocacy.

ii)

>Intimidation Threat occurs when members of assurance team feel threatened by client's staff or directors causing them unable to act objectively due to the fear of negative consequences (e.g loss of income). This will lead to poor quality of audit opinion and reporting.

>Teamwork and trust between the members of assurance team is important to reduce the intimidation threat as they are more likely to communicate concerns of intimidation. If threats of intimidation arises the team should withdraw from the engagement.

>It is also important to make sure not to accept every single client that comes to the firm asking for audit. There will need to be evaluation of the client against standards as to how the client is accepted to insure that they do not have a history of intimidation with past auditors and they have an appropriate attitude towards a fair audit engagement.

**d. What are the key accounting issues from your review of other sections in the annual reports and financial statements, including the accounting policies? Based on your understanding of the business and the accounting issues, what specialist skills and competencies will you need to carry out the audit?**

**Considerations:**

>At 31 July 2021, the Group held inventories of \$216.5 million. Inventory valuation and existence was an audit focus area due to the number of locations that the inventory was held at, the judgement applied in the valuation of inventory on hand, and the continued uncertainty presented by COVID-19 related travel restrictions.

>The risk that the Group's indefinite life assets of \$626.5 million may be materially impaired is considered a Key Audit Matter, due to the material nature of these assets and the significant judgement exercised by management.

**Competencies and skills:**

- We would need to have/hire staff overseas in these area's who would be able to perform appropriate test/checks on the various locations of which the inventory is held.
- Historical data to evaluate inventory trends from previous years (e.g expected acquisition cost, expected shrinkage level, expected inventory level, recorded at lower cost and net realisable value by testing a sample of inventory items to the most recent retail price which includes any impact of COVID-19).
- We would be able to translate foreign currency - functional currency that are different from presentation currency are translated into presentation currency.
- We would need to have/hire staff overseas to ensure the consistent quality of internal controls at overseas locations and perform necessary tests of subsidiary holdings.
- We would need to have/hire staff overseas to ensure the consistent results of substantive tests of subsidiary holdings.
- Time and resources to understand the processes and controls in place for assessing the recoverability of indefinite life intangibles and confirmed their consistent implementation at year end.
- Historical data is obtained of indefinite life asset valuation for comparison.
- Staff must have expertise to: assess the internal controls, gather sufficient and appropriate evidence, verify information on client's records by reading documents to confirm existence, rights and obligations, trace documents to clients records to confirm assertions, gather persuasive evidence.
- Resources to mitigate threats to independence.
- Resources to investigate the client's integrity before accepting the engagement.