CORPORATE REPORTING

July-August 2024

Time allowed- 3:30 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 manner in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order of sequence.]

Marks

1. Your firm is currently engaged with Signature Footwork Limited (Signature) to assist in preparing consolidated financial statements for the year ended 31 December 2023 and you have been assigned for the engagement. You have collected the financial statements of Signature and its subsidiaries (Platinum Shoes Limited and Prestige Footwear Limited) (Exhibit-1). You also obtained further relevant information (Exhibit-2) from management and audit reports. It is assumed that revenue and expenses are accrued evenly throughout the year.

Exhibit-1

Statement of Financial Position
As at 31 December 2023

	Signature	**Platinum**	**Prestige**
Assets	BDT	BDT	BDT
Non-current assets			
Property, plant and equipment	448,559,430	155,997,260	68,032,820
Right of use assets	173,430,849	-	-
Investment	320,000,000	-	-
	941,990,279	**155,997,260**	**68,032,820**
Current assets			
Inventories	125,131,070	127,963,703	930,213
Trade and other receivables	459,970,924	121,146,461	3,592,278
Short term investments	9,644,767	55,882,270	1,225,000
Advance, deposits & prepayments	4,882,824	58,713,716	3,346,831
Cash and cash equivalents	341,170,862	4,123,336	86,719,846
	940,800,447	**367,829,486**	**95,814,168**
Total assets	**1,882,790,726**	**523,826,746**	**163,846,988**
Equity and liabilities			
Equity			
Share capital (face value @ BDT 10)	127,600,000	284,400,000	107,500,000
Retained earnings	363,616,736	129,723,913	13,009,149
	491,216,736	**414,123,913**	**120,509,149**
Non-current liabilities			
Deferred tax liabilities	5,176,962	10,667,007	5,702,013
Long term loan	-	15,814,423	-
Employee benefits	80,257,553	3,168,939	75,377
Lease liabilities	152,605,069	-	-
	238,039,584	**29,650,369**	**5,777,390**
Current liabilities			
Lease liabilities	17,601,047	-	-
Trade and other payables	1,034,412,930	32,609,195	29,539,425
Accrual for expenses	41,910,312	35,668,718	1,361,629
Current tax liabilities	59,610,117	11,774,551	6,659,395
	1,153,534,406	**80,052,464**	**37,560,449**
Total equity and liabilities	**1,882,790,726**	**523,826,746**	**163,846,988**

Statement of profit or loss and other comprehensive income
For the year ended 31 December 2023

	Signature	Platinum	Prestige
	BDT	BDT	BDT
Revenue	786,293,042	285,876,148	3,791,243
Cost of goods sold	(528,237,730)	(241,311,618)	(1,532,483)
Gross profit	**258,055,312**	**44,564,530**	**2,258,760**
Selling and distribution expenses	(50,257,519)	(10,297,796)	(42,585)
Administrative expenses	(64,392,797)	(5,148,898)	(1,083,082)
Profit from operation	**143,404,996**	**29,117,836**	**1,133,093**
Other income	16,575,979	5,038,382	-
Finance cost	(14,794,432)	(407,080)	-
Workers' profit participation fund	(6,913,645)	-	(53,957)
Profit before tax	**138,272,898**	**33,749,138**	**1,079,136**
Income tax expense	(21,109,860)	(3,769,129)	(244,132)
Profit after tax	**117,163,038**	**29,980,009**	**835,004**
Other comprehensive income	-	-	-
Total comprehensive income	**117,163,038**	**29,980,009**	**835,004**

Exhibit-2

- Prestige Footwear Limited was incorporated in 2012 as joint venture between Signature Footwork Limited and King Limited. Signature owned 51% shares of Prestige Footwear Limited which was acquired for BDT 54,825,000. On 30 June 2023, Signature sold 26% shares of Prestige at BDT 40,000,000 and kept remaining 25% shares. Sales transaction and related gain and loss has already been accounted for in Signature's books of accounts.
- Platinum Shoes Limited is a publicly listed company trading its shares in Dhaka & Chittagong Stock Exchanges. On 01 April 2022, Signature acquired 15% shares of Platinum Shoes Limited from secondary market at BDT 12 per shares. At the time of acquiring the shares, Signature has retained earnings of BDT 79,795,123. At the beginning of the year Signature acquired further 25% shares of Platinum at BDT 18 per share. On 01 July 2023 signature acquired further 15% shares of platinum when market price was BDT 22 per share.
- Notes to Platinum's audited financial statements show Trade & other receivable includes a contingent asset of BDT 25,000,000 against insurance claim from Advance Insurance Limited. One of Platinum's warehouses caught on fire and suffered a loss equivalent to claim amount. Platinum raised compensation claim to insurer. However, insurer refused to settle the claim as Platinum did not maintain sufficient fire safety measures at the warehouse as per insurance agreement. Platinum recognized the claim as contingent asset by adjusting the inventories.
- At the year-end Signature reported a receivable from Platinum for BDT 1,200,000 from sales of inventories. Platinum sold these inventories on 01 November 2023 and earned a margin of 10%. At the year-end, 50% of these inventories remain unsold in Platinum inventory.
- Platinum have not accounted for contribution to workers profit participation fund (WPPF). As per the law, Platinum is required to contribute 5% of profit before WPPF to workers profit participation fund within 9 months from the year end.

Requirements:

a) Determine the gain or loss from disposal of Signature's interest in Prestige. 4

b) i) Prepare a consolidated statement of financial position and Consolidated Statement of profit or loss for the year ended 31 December 2023 after giving effect the required adjustments. 12

ii) Submit all working notes for the adjustments. 8

2. Violette Industries Limited (Violette) is looking for investment to finance one of the investment projects. It is planning to raise finance either by borrowing from bank or by issuing new equity shares. Modern Capital Limited (MCL), where you work, is currently considering investing in Violette and received the following draft financial statements from Violette management. MCL's Chief Financial Officer has forwarded them to you for understanding Violette's business process and analysing its financial statements. Furthermore, you had several meetings with Violette accountant to understand the business better and identified the following information:

- Advance deposits and prepayment in both 2023 and 2022 include a security deposit of BDT 20,000,000 paid for Titas Gas Transmission and Distribution Company. The advance will be refunded only when Titas Gas connection in factory is closed. Violette does not intend to cancel the gas connection in next few years.

- Long term loan includes its current portion of BDT 122,926,286 in 2023 and BDT 121,946,210 in 2022.

Violette has a very good employee turnover ratio. It doesn't expect any payment for gratuity in next 12 month. There was no gratuity payment in the 2023.

Violette Industries Limited
As at 30 June 2023

	2023	2022
Assets	BDT	BDT
Non-current assets		
Property, Plant & Equipment	546,564,717	527,128,662
Intangible assets	4,085,150	1,304,197
Capital work-in-progress	168,180,033	136,094,851
Investments	412,611,738	448,075,217
Non-current advance payment	58,666,667	44,000,000
	1,190,108,305	**1,156,602,927**
Current assets		
Inventories	364,176,219	335,230,300
Trade & other receivables	25,466,331	52,604,889
Advance, deposits & prepayments	184,340,264	179,926,183
Cash & cash equivalents	113,257,312	79,267,156
	687,240,126	**647,028,528**
Total Assets	**1,877,348,431**	**1,803,631,455**
Equity & Liabilities		
Shareholders' Equity		
Share Capital	266,585,181	266,585,181
Retained earnings	669,580,795	462,082,512
	936,165,976	**728,667,693**
Non-current liabilities		
Long term loan	358,228,088	458,613,133
lease liabilities	2,929,697	-
Deferred tax liabilities	23,245,092	22,863,787
	384,402,877	**481,476,920**
Current liabilities		
Short term loan & overdraft	325,954,534	300,869,188
Lease liabilities- current portion	1,454,611	1,620,952
Trade payable	71,720,878	128,493,273
Liabilities for expenses	23,490,979	25,870,719
Contract liabilities	41,049,535	74,100,278
Tax payable	69,903,254	49,164,244
Gratuity payable	23,205,787	13,368,188
	556,779,578	**593,486,842**
Total Liabilities	**941,182,455**	**1,074,963,762**
Total equity & liabilities	**1,877,348,431**	**1,803,631,455**

Violette Industries Limited
For the year ended 30 June 2023

	2023	**2022**
	BDT	BDT
Revenue	3,438,033,017	2,858,509,030
Cost of sales	(2,621,074,693)	(2,202,460,397)
Gross profit	**816,958,324**	**656,048,633**
Administrative expenses	(56,737,713)	(56,968,612)
Selling expenses	(466,104,511)	(391,996,033)
Operating profit	**294,116,100**	**207,083,988**
Finance cost	(22,292,861)	(17,001,010)
Other income	34,122,078	34,545,301
Profit before WPPF	**305,945,317**	**224,628,279**
Contribution to WPPF	(14,568,825)	(10,696,585)
Profit before tax	**291,376,492**	**213,931,694**
Current tax expenses	(83,496,904)	(54,146,310)
Deferred tax expenses	(381,305)	901,717
Profit after tax	**207,498,283**	**160,687,101**
Other comprehensive income	-	-
Total comprehensive income	**207,498,283**	**160,687,101**

Requirements:

a) i) Calculate the revised financials after making the necessary adjustments to be made. 2

ii) Analyse the financial statements of Violette after adjustments. Comment on Violette's financial position and performance in terms of Liquidity, Solvency, and Profitability. 9

b) i) Based on your analysis, recommend MCL management whether it can invest in Violette. 2

ii) Mention any limitation of your analysis which MCL should consider. 2

3. a) You recently joined as finance manager at Atlas Electronics Limited which is a consumer electronics company and has faced a challenging year due to increased competition. Atlas has a year end of 31 December 2023 and the unaudited draft financial statements report an operating loss.

The finance director, Nishat Karim has asked you to look at the following reporting matters which need to be finalized before the start of the audit in the last week of July 2024.

Restructuring

Atlas has announced two major restructuring plans. The first plan is to reduce its capacity by the closure of one of its plants, which have already been identified in December 2023. This will lead to the redundancy of 20 employees, who have all individually been selected and communicated with on 20 December 2023. The costs of this plan are BDT 3 million in redundancy costs, BDT 2 million in retraining costs and BDT 500,000 in lease termination costs. The board expect that this restructuring plan will be completed by the end of February 2024.

The second plan is to re-organise the finance department and information technology (IT) department over a one-year period but this will not be implemented for two years. The plan results in 20% of finance staff losing their jobs during the restructuring. The costs of this plan are BDT 2.5 million in redundancy costs, BDT 3 million in retraining costs and BDT 2 million in equipment lease termination costs.

No entries have been made in the financial statements for the above two plans.

Share based payments

On 1 January 2022, Atlas made an award of 10,000 share options to each of its seven directors. The condition attached to the award is that the directors must remain employed by Atlas for three years. The fair value of each option at the grant date was BDT 50 and the fair value of each option at 31 December 2023 was BDT 55.

At 31 December 2022, it was estimated that three directors would leave before the end of years vesting period. Due to an economic downturn the estimate of directors who were going to leave was revised to one director at 31 December 2023. The expense for the year as regards the share options had not yet been included in profit or loss for the current year 2023 and no directors had left by 31 December 2023.

Preference shares

On 1 January 2023, Atlas received BDT 20 million cash from a private equity fund in exchange for preference shares from Atlas which provides cumulative dividends of 7% per annum. These preference shares can either be converted into a fixed number of ordinary shares in two years' time, or redeemed at par on the same date, at the choice of the holder. The finance director asked you to explore whether the preference shares can be classified as equity because the conversion is into a fixed number of ordinary shares on a fixed date ("fixed for fixed") and conversion is certain (given the current market value of the ordinary shares).

Deferred tax asset

Atlas includes a deferred tax asset in its statement of financial position, based on losses incurred in the current and the previous two years. The finance director has asked you to consider whether the deferred tax asset can be recognized in full. He has suggested to consider the basis that Atlas will return to profitability once its funding issues are resolved and the economic downturn is over.

Requirement:

Write a memo to the finance director providing appropriate accounting treatment along with calculations where appropriate which Atlas should adopt for all issues identified.

i) Restructuring 5
ii) Share based payments 5
iii) Preference shares 3
iv) Deferred tax asset 3

b) **Digonta Entertainments Limited**

You are manager for the audit of Digonta Entertainments Limited (commonly known as Digonta) for the year ended 31 March 2024. There was a plan to have an audit close out meetings next week. Digonta is famous for event managements and catering services and does have both retail customers and corporate customers.

Your firm has been auditing Digonta for four years. You have received an e-mail below from audit senior manager:

"There is still couple of few audit and reporting matters to be resolved before we go for an audit close out meeting with CFO next week. (Exhibit 1) and (Exhibit 2). Audit planning materiality is BDT 1.8 million based on Digonta's profit before tax of BDT 30 millions."

Exhibit 1: Matters of concern – prepared by audit senior manager.

From my review of the audit working papers, I identified the following matters where I have concern about both the financial reporting treatment and the lack of adequate audit procedures.

(1) My Digonta

Revenue has increased due to the success of a new incentive scheme, "My Digonta" which was introduced on 1 April 2023 and closed to new members on 30 September 2023.

During the six months to 30 September 2023, customers who booked for services of Diganta for an event were invited to pay an annual membership fee of BDT 5,000 for the "My Digonta" scheme. This entitles the members of My Digonta to a discount of 20% for any additional events they book within one year of joining My Digonta. All booked events under the discount scheme must take place before 31 March 2026.

Many customers have signed up for My Digonta. Membership fees totaling BDT 9,000,000 were received and recognised as revenue in the year ended 31 March 2024.

In the year ended 31 March 2024, My Digonta members booked additional events totaling BDT 30 million, after deducting the 20% discount. At the time of booking, My Digonta members are required to pay a deposit of 50% of the total amount for the event, which is non-refundable. These deposits have been recognised in the revenue in the year ended 31 March 2024.

(2) Payments by share options

During the year ended 31 March 2024, Digonta issued share options to a key supplier rather than paying them in cash. A comment in the Board minutes suggests that the total value of the goods received by Digonta in return for the options was BDT 12 million and the share options issued had a fair value of BDT 11 million.

No entries were recorded for the share options issued or for the goods received, as the options cannot be exercised until 30 April 2026.

Exhibit 2: Other audit matter - Investment Property Vs PPE

Digonta carries all land and buildings, including investment property, at fair value. On 20 December 2023 the Community Centre building in Dhaka was made empty and is to be leased out for the next five years. The building was originally purchased BDT 45 million back on 5 January 2020 and as at last valuation on 31 March 2021 it was valued at BDT 56 million. Its fair value on 20 December 2023 was BDT 62 million and on 31 March 2024 is BDT 64 million. The depreciation policy for buildings is straight line over 50 years, measured to the nearest month.

Our audit work to date shows that the asset has been included in property, plant and equipment in the year end statement of financial position, but no other audit works on this issue has been performed.

Requirements:

For each of the matters of concern identified in **Exhibit 1:**

i) Set out and explain the correct financial reporting treatment, identifying any additional information you require; and 4

ii) Explain the key audit risks that arise. 4

For Exhibit 2:

iii) set out how to account for the change in the use of this asset and outline the audit adjustments required; and 4

iv) List the audit procedures which should be performed. 4

4. You are a senior manager at Kazi Hoque & Co., Chartered Accountants (KHC). Your firm has recently accepted appointment as auditor of Lifeline Pharma Limited (Lifeline) for the year ended 30th June 2024 on request of its Board chairman. This is the first year of KHC has been appointed as auditor and you have been assigned as audit manager for Lifeline. As part of the obtaining understanding of the entity, your team members have prepared a memo for your review (***Exhibit 1***). Your team also collected prior year audited financial statements and bought few matters for your attention (***Exhibit 2***).

Exhibit 1:

Memo on background and business model of Lifeline Pharma Limited

Background of Lifeline Pharma Limited

Lifeline Pharma Limited (Lifeline) is a private pharmaceutical company with registered office at Dhaka and a factory at Gazipur. The company specializes in the manufacturing generic medications and biosimilars. Lifeline has experienced rapid growth over the past five years, expanding its market presence across the country. Furthermore, it has recently started exporting its manufactured medicine in different countries including Africa and Middle East.

Mission and Vision:

Lifeline’s mission is to enhance and extend lives by providing access to affordable, high-quality medications. The company envisions a world where every individual has the opportunity to live a healthier, longer life, supported by advanced medical treatments.

Business model

Lifeline’s business model includes two types of sale: Retail sales and Institutional sales. Retail sales are generated through sell of distributor. Lifeline uses distributor warehouse for storing its produced medicines. Lifeline is responsible for creating demand for its product through various market development and promotional activities though its sales force. Once customers places orders in lifeline’s portal, it automatically triggers a notification to distributor for dispatching products. The distributor is responsible for transporting and distributing Lifeline’s product to the customers across the country. When dispatch notifications are triggered, distributors take goods from its warehouse and delivers the product to the customer. Lifeline recognizes revenue when products are dispatched by the distributor from warehouse. The distributor is responsible for collecting sales proceeds from customer and maintaining goods in the warehouse. However, Sales price and credit period to the customers are determined by Lifeline.

Second type of sale is Institutional sales where Lifeline sells its product to various government or non-government institutions within and outside Bangladesh. Most of the institutional sales are made to government institutes and hospitals. It is partial sales to different NGOs that work with health and hygiene of mass population. Lifeline submits tender to these institutions offering prices of its products. Once a tender is won, products are delivered by the distributor from its warehouse.

Additional Note:

The board of Lifeline is chaired by its majority shareholder Mrs. Shamima Ahmed who is the spouse of Mr. Kawser Ahmed who is a senior bureaucrat of the Government. Several news media have published news in the past that Mrs. Ahmed has used power and connections of his husband to win various government contracts and bank loans. There are several media allegations against Lifeline that it repeatedly uses expired raw materials in medicine manufacturing. However, Lifeline has always declined the allegation.

Exhibit 2:

Matters from prior year audited financial statements:

- Prior audit report has been signed off by Wasim & Co. who have expressed a qualified audit opinion in relation to inventory as the entity didn't create allowance for obsolete and slow-moving raw materials which represents a significant portion of inventories.
- Prior year audit fee was BDT 350,000 whereas KHC has been appointed with a Fee of BDT 275,000.
- Prior year audit report includes an 'other matter' paragraph which explains that there was a predecessor auditor who expressed an unmodified audit opinion the comparative of prior year financial statements.
- Opening retained earnings of the financial statement has been adjusted due to reversal of income tax provision.
- Subsequent event disclosure mentions that Lifeline has received a claim by VAT authority for an amount of BDT 15,000,000 as unpaid VAT.

Requirements:

a) Identify independence and ethical issues involved in accepting audit engagement with Lifeline, Suggest remediation options. 4

b) Discuss briefly about the risk and safeguards an auditor should consider while engaging with entities having Politically Exposed Persons (PEPs) in the board. 3

c) Discuss the initial audit procedures you plan to perform as first year auditor. Evaluate the impact of qualified audit opinion by predecessor auditor in your current year audit procedures and audit opinion. 4

5. You are currently managing the audit engagement of Dynamic Apparels Limited (Dynamic) for the year ended 31 December 2023. In a review meeting, your team members have brought following matters to your attention:

Change of functional currency

Dynamic is engaged in exporting sportswear in various countries. Sales are done through Letters of Credit (LC) where USD is the transaction currency. Invoices are also raised in USD. Therefore, management of Dynamic has decided to change its functional currency to USD from BDT. They believe changing functional currency would help them to avoid the risk of currency fluctuations.

Heavily automated accounting software

Dynamic uses CrystalPro as its accounting software. Software is highly automated as it maintains fixed asset and Lease register, perform automatic depreciation calculation of Assets and ROU Assets, and interest expenses on lease liabilities. CrystalPro automatically post relevant journal entries at month end. The software further perform Expected Credit Loss (ECL) calculation based on outstanding receivable data and post necessary adjustments. Purchase and sales order are raised and approved through CrystalPro. It automatically recognizes purchase or sales when goods are received or delivered against purchase or sales order. Dynamic has 3 user accounts in CrystalPro which are used by 5 employees for review and approval of transactions.

Actuarial valuation of employment benefits:

At the end of the financial year, Dynamic performed actuarial valuation of its employee benefit obligation. Dynamic appointed an Actuary to perform the valuation considering various actuarial assumptions. Actuary provided a report which shows that Dynamic experienced an actuarial loss of BDT 28,058,694 on Plan Liabilities. Dynamic recognized the loss in statement of profit or loss.

Service Organization for payroll service

Dynamic has appointed "HR Solutions" (HRS) for providing payroll service. Under this service arrangement, HRS prepare the monthly salary sheet based on attendance data from HR System. Salary Sheets are reviewed by senior employee of HRS before they are sent for payment to the finance team.

HRS only share the Employees' Bank account number, bank name and payable amount. This is done to avoid leakage of salary related sensitive information.

Insufficient income tax provision:
During our initial review of the financial statements, we have noticed that Dynamic have kept only half of the required provision. Dynamic's tax manager has informed us that they plan to settle the tax assessment by paying only half of the calculated amount. This has been done earlier year as well. Accordingly, there is no necessity of keeping entire provision in the financial statements.

Requirements:

a) Evaluate whether management assessment for changing its functional currency is appropriate. Determine the probable impact of change in functional currency in your audit. 4

b) Design audit procedures to be performed in non-current asset, lease accounting, purchase and sales transaction that uses automated IT software. 6

c) Explain auditor responsibilities regarding service organization and management specialists. Design audit procedures to be performed regarding actuarial valuation of employee benefits and Payroll processed by HRS. 4

d) Appraise tax manager's position on income tax provision. Determine your course of actions as auditor. 4

---The End---