

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. King Limited (King) is a tech start-up company incorporated in 2016. It is involved in providing technological and software solutions to its clients. Since incorporation of the company, King Limited has been growing significantly. It was able to win many large local and international contracts which helped King to achieve this tremendous growth.

On 01 January 2021, King acquired 95% shares of Queen Limited (Queen) which was once one of the oldest companies in this sector. It was owned and controlled by Mr. Kader, founder and managing director of the company who owned 95% shares of the company. After his death, two sons of Mr. Kader inherited the shares who were not experienced in this business sector. Although Queen still had good reputation in the market, it failed to maintain liquidity and manage the expenses. Soon it found itself wrapped up with high amount of loan to finance its working capital. Unable to find a solution to improve business condition, two sons of Mr. Kader decided to sell their shares of Queen to King Limited.

King Ltd. purchased 95% of 5,100,00 shares (each with face value of Tk. 10) when it had retained earnings of BDT 23,173,853. Purchase price were agreed at BDT 320,732,980 considering the market shares, reputation, and customer relationships of Queen. At the date of acquisition, Queen reported a Land which had cost of BDT 48,000,000. King assessed that the land had a fair value of BDT 65,000,000. Furthermore, King assessed that BDT 750,000 of the reported receivables by Queen will not be collectable.

On further investigation, King identified that Queen had one ongoing revenue contract and a confirmed contract at the acquisition date. Both the contracts will remain valid for two more years and each contract will generate revenue of BDT 5,500,000 per year. Queen generally earns 8% margin from similar contracts. King identified that incremental borrowing rate is 10%.

King Ltd. and Queen Ltd. both follows calendar year and prepared financial statements as of 31 December 2021 (Exhibit 1 and Exhibit 2). After the preparation of financial statements, King Ltd identified that it has not considered any transaction related to a secrete project on Smart Shoes which started on April 2021. King spent BDT 2,400,000 as research expenses and further BDT 1,800,000 for developing commercially viable design which could be sold to end customers. King also incurred BDT 300,000 as promotional expense to create awareness and demand for its Smart Shoes. Payments for all these were made from company overdraft account which has also not been considered in preparation of the financial statements. King Ltd believe that their smart shoes would have life cycle of 5 years and plans to capitalize all these research, development, and promotional expenses to amortize it over the product life cycle. Amortization would commence on January 2022.

During 2021, King Ltd introduced a new policy under which an employee can enjoy 25 days paid leaves during the year which may be carried forward for one year. However, no payment will be paid to employees if they leave the company without utilizing the earned leave. There were 400 employees at King as of 31 December 2021 who have 5 days of unutilized earned leave on average. King determines that around 5% employees at the year-end will leave the company and there are approximate 255 working days in a year. King incurred BDT 8,200,000 as payroll expenses during the financial year 2021.

Exhibit 1: Statement of Financial Position as at 31 December 2021

	King Ltd.	Queen Ltd.
ASSETS		
Non-current assets		
Property, plant and equipment	5,821,960	120,595,110
Intangible assets	272,850	4,100,604
Deferred tax assets	1,598,000	71,130,006
Investment in subsidiaries	320,732,980	-
	328,425,790	195,825,720
Current assets		
Inventories	233,992,180	434,906,172
Trade and other receivables	223,594,500	1,432,904,570
Advances, deposits and prepayments	214,546,000	1,706,924,508
Cash and cash equivalents	376,846,530	552,969,030
	1,048,979,210	4,127,704,280
Total assets	1,377,405,000	4,323,530,000
EQUITY AND LIABILITIES		
Equity		
Share capital	456,052,200	51,000,000
Retained earnings	173,368,990	31,950,990
	629,421,190	82,950,990
Current liabilities		
Liabilities for expenses	349,049,000	1,360,738,854
Trade payables	214,526,600	1,631,026,616
Provision for income tax	184,408,210	1,248,813,540
	747,983,810	4,240,579,010
Total equity and liabilities	1,377,405,000	4,323,530,000

Exhibit 2: Statement of Profit or Loss for the year ended 31 December 2021

	King Ltd.	Queen Ltd.
Revenue	1,367,585,900	4,150,200,917
Cost of sales	(987,254,447)	(4,057,324,509)
Gross profit	380,331,453	92,876,408
Administrative and selling expenses	(294,810,295)	(225,959,565)
Other operating income	35,669,733	135,850,889
Operating profit	121,190,891	2,767,732
Finance expenses/ other income	(18,241,100)	14,382,455
Profit before tax	102,949,791	17,150,187
Income tax expense	(22,433,128)	(8,373,050)
Profit for the year	80,516,663	8,777,137

Requirements:

- Calculate purchase goodwill amount from acquisition of Queen Ltd. 8
- Suggest appropriate adjustment on the Kind Ltd. financial statements for the year ended 31 December 2021. 5
- Perform consolidated adjustments and prepare consolidated financial position and consolidated profit or loss statement of King Ltd. for 31 December 2021. 15

2. You are the Financial Controller of Green Home Ltd., a DSE & CSE listed company which manufactures environmentally friendly equipment furniture and household products. The accounting year-end of the Company is 31 December 2021.

It is now 15 March 2022, and the company's auditors are currently engaged in their work. Shahid Khan, the Finance Director, is shortly to go into a meeting with the Audit Engagement Partner, Mozammel Ahmed, to discuss some unresolved issues relating to Company assets. To save his time, he wants you to prepare a memorandum detailing the correct accounting treatment. He has sent you the following email, in which he explains the issues:

To: Financial Controller

From: Shahid Khan

Date: 15 March 2022

Subject: Assets

As a matter of urgency, I need you to prepare a memorandum on the correct accounting treatment of the items below, so that I can discuss this with the auditors.

Stolen lorries

As you know, we acquired a wholly owned subsidiary, a small road-haulage company, on 1 January 2021 to handle major deliveries once we start producing larger items. So far, it has proved more profitable to hire out its services to other companies, so the company is a cash-generating unit. We paid BDT 460,000 for the business, and the value of the assets, based on fair value less costs to sell, at the date of acquisition were as follows:

	BDT'000
Vehicles (lorries)	240
Intangible assets (licenses)	60
Trade receivables	20
Cash	100
Trade payables	(40)
	<u>380</u>

Unfortunately, three of the lorries were stolen on 1 February 2021. The lorries were not insured, because the road haulage company manager had failed to complete the paperwork in time. The lorries had a net book value of BDT 60,000, and we estimate that BDT 60,000 was also their fair value less costs to sell.

I believe that, as a result of the theft of the uninsured lorries, the value in use of the cash generating unit has fallen. We should recognize an impairment loss of BDT 90,000, inclusive of the loss of the stolen lorries.

We have another problem with this business. A competitor has started operating, covering similar routes and customers. Our revenue will be reduced by one quarter, which will in turn reduce the fair value less costs to sell and the value in use of our haulage business to BDT 310,000 and BDT 300,000 respectively. Part of this decline is attributable to the competitor's actions causing the net selling value of the licenses to fall to BDT 50,000. There has been no change in the fair value less costs to sell of the other assets, which is the same as on the date of acquisition.

The company will continue to rent out the lorries for the foreseeable future.

Own brand

This year, Green Home has been developing a new product, the Envikitchen. Envikitchen is a new range of environmentally friendly kitchen products and an ergonomic kitchen design service. The expenditure in the year to 31 December 2021 was as follows:

<i>Period from</i>	<i>Expenditure type</i>	<i>BDTm</i>
1 Jan 2021 – 31 March 2021	Research on size of potential market	6
1 April 2021 – 30 June 2021	Prototype kitchen equipment and product design	8
1 July 2021 – 31 August 2021	Wage costs in refinement of products	4
1 September 2021–30 November 2021	Development work undertaken to finalise design of kitchen equipment	10
1 December 2021–31 December 2021	Production and launch of equipment and products	<u>12</u>
		<u>40</u>

Currently an intangible asset of BDT 40 million is shown in the financial statements for the year ended 31 December 2021. Included in the costs of the production and launch of the products are the cost of upgrading the existing machinery (BDT 6 million), market research costs (BDT 4 million) and staff training costs (BDT 2 million).

Requirement:

Prepare the memorandum required by the Finance Director.

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3. You are audit manager of Sultana Razia & Co. Chartered Accountants (SRC) and assigned with audit of Textile Origin Limited (TOL) for the year ending 31 December 2021. You have received following draft financial statements from the management.

Textile Origin Limited		
Statement of Profit or Loss and Other Comprehensive Income		
For the year ended 31 December 2021		
	31-Dec-21	31-Dec-20
Revenue	9,877,736,600	7,488,983,684
Cost of Revenue	(9,546,353,906)	(7,373,690,098)
Gross Profit	331,382,694	115,293,586
Administration Expenses	(647,991,834)	(725,576,168)
Selling & Distribution Expenses	(331,367,765)	(159,677,984)
Other Operating Income	224,462,451	215,017,365
Profit Before Interest & Taxes	(423,514,454)	(554,943,201)
Finance Expenses	(99,097,986)	(60,815,318)
Profit Before Taxation	(522,612,440)	(615,758,519)
Income Tax	(70,908,721)	(26,641,126)
Net profit for the year	(593,521,161)	(642,399,645)
Actuarial gain/(loss) for the year	-	(49,721,110)
Total Comprehensive Income	(593,521,161)	(692,120,755)

Textile Origin Limited		
Statement of Financial Position		
As of 31 December 2021		
	31-Dec-21	31-Dec-20
Non-Current Assets		
Property, Plant and Equipment	2,966,683,912	3,182,495,673
Capital work-in-progress	87,201,625	64,857,125
FDR investment	67,351,418	67,351,418
Rental deposits	41,339,772	40,050,729
Intangible Assets	1,816,804	2,693,197
	3,164,393,531	3,357,448,142
Current Assets		
Inventories	1,763,840,186	1,448,384,652
Cash and Cash Equivalents	1,415,715,019	1,840,445,753
Advance, deposits & prepayments	21,446,481	33,400,451
	3,201,001,686	3,322,230,856
Total Assets	6,365,395,217	6,679,678,998

Non-Current Liabilities

Long-term loans	713,864,319	624,561,044
Defined benefit liability	151,248,624	239,693,022
Lease Liability	173,504,160	167,114,062
Deferred Tax liability	646,761	646,762
	1,039,263,864	1,032,014,890

Current liability

Contract Liability	1,513,548,411	1,238,647,489
Account Payable	655,358,168	647,931,991
Tax Payable	1,419,365	11,758,058
	2,170,325,944	1,898,337,538

Equity

Share Capital	2,365,067,230	2,365,067,230
Retained Earnings	895,449,666	1,488,970,827
Accumulated actuarial gain/(loss)	(104,711,487)	(104,711,487)
	3,155,805,409	3,749,326,570

Total Equity & Liabilities

	6,365,395,217	6,679,678,998
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Notes:

1. TOL receives advance from customer which are settled upon delivery of goods.
2. Other operating income is generated from cash incentive received and exchange gain/loss.
3. Property, Plant & Equipment includes Right of Use Asset of 225,434,728.
4. TOL management has not performed Actuarial valuation of define benefit liability as at 31 December 2021.

Requirements:

- (a) Analyse the financial statements of Textile Origin Limited and comment on it. 10
 - (b) Identify the audit risks from your analysis of the financial statements and prepare a briefing note for the team members explaining the audit procedures to be carried out. 7
4. Willis Limited was established in 2010 and operates several businesses in Bangladesh with a total revenue of BDT 385m and PBT of BDT 77m in FY19-20 and total assets of BDT 200m as at 30/06/20. Willis Limited was established as a non-listed company, and its current shareholdings are as below:

Shareholder	30/06/20
Local Individuals – Mr Willis	10%
Local Corporate – Watson Ltd	30%
Foreign Corporate – Wyatt Ltd	60%

Willis Limited operates several businesses in Bangladesh some of which require highly specialized human resources which are scarce in Bangladesh. To mitigate this scarcity of resources, Willis Limited has embarked on a strategy of horizontal integration through which they established Monarch College to provide tertiary education in the subjects required by resources who could then progress on to work for organisations such as Willis Limited after graduation.

Monarch College was established by Willis Ltd. on 1st July 2018 to provide a 4-year degree course leading up to a BSc qualification. To start the college operations from July 2018, Willis Limited had entered into a rental agreement with Mrs Wastson for a building based in Bashundhara where Willis Limited established the college campus and hostel. The rental contract was for a period of 6 years from 1st July 2018 at an initial rent of BDT 2.5m per month with an escalation clause of 10% after every 2 years. An Advance was paid equal to 50% of the rental for the 1st 2 years to be adjusted against the monthly rental payments of the 1st 2 years. The rental payments are booked as rental expenses as and when they are physically paid and the Advance is amortized over the full term of the rental contract. Operating costs other than costs already mentioned above amount to BDT 1.5m per month.

The contract also included a standard termination clause whereby either party may terminate the rental contract by providing 3 months' notice and a standard clause requiring Willis Limited to return the property back to the property owner in the same condition in which it was received at the start of the contract subject to normal wear and tear.

On 1st July 2018, Willis Limited invested BDT 20m in leasehold improvements, BDT 6m in Computer equipment, BDT 6m in furniture and BDT 4m in electrical installations. The depreciation policy of the company is as follows:

Asset Category	Rate	Years
Buildings	2%	50
Leasehold improvements	10%	10
Computers & IT equipment	20%	5
Furniture, fixtures & fittings	10%	10
Electrical installations	10%	10

The financial year runs from July to June. However, the college delivers the education across 3 terms during the year running from 1st September to 15th December (Winter Term), 1st January to 15th March (Spring Term) and 1st April to 30th June (Summer Term). There are no educational activities delivered between July to August and the college is closed to students during this period. The year-end exams take place every June and the results are published on 15th August based on which successful completion of the academic year results in progression to the next academic year. At the end of the 4th academic year successful students are awarded their BSc qualification.

The student fees are currently BDT 200,000 per annum, i.e. BDT 800,000 for the full course, and BDT 200,000 per annum for students staying in the hostel. The fees are booked as revenue over the course of the year. As an incentive to attract students to the college, Monarch College allowed student to pay 50% of their annual tuition fee in 2 installments, the 1st instalment at the start of the 1st Term and the 2nd instalment at the start of the 2nd Term every year.

The remaining 50% of the tuition fee could be paid post qualification provided the student took up employment with Willis Limited, in which case the remaining amount of the tuition fee would be adjusted from the employee's salary over a period of 3 years. To ensure that students paid the rest of their tuition fee, it was agreed that Monarch College would withhold the BSc certificate until the full tuition fee was recovered. As Willis Limited was a well reputed employer in a highly sought-after industry, all 120 students took up the incentive offered.

On 27th March 2020 due to the Global COVID Pandemic the Government of Bangladesh declared a lockdown which continued until June 2020, as a result, Monarch College was unable to deliver any classes to students during this period.

Requirements:

KPwC are appointed as the statutory auditors for Willis Limited for the year ended 30th June 2020 and you have been selected to lead the Audit. You are required to identify:

- (a) the relevant accounting issues with reference of the related IASs/ IFRSs; and 10
- (b) the key audit issues based on your answer to (a) above.

You may answer both the requirements together or separately, as you may deem fit. 15

5. (a) You are auditing Cutting-Edge Technologies Limited (CETL) for the year end 31 December 2021. This is the first year your firm is auditing CETL. Your firm received appointed on 01 October 2021 and issued acceptance letter to the client and Form 23B to registrar of Joint Stock Companies & Firms (RJSC) on the same date. As there was prior year auditor of CETL, you firm issued a request for professional clearance to prior year auditor on 3rd October 2021 and subsequently received clearance on 7th of October 2021.

You and your team members started working on 9-month end financial statements which was provided to you on 10th of October 2021. Your team annualized the financial statements and performed an analysis which reveals that company will make a loss in 2021 like last 2 years. Revenue of the company has increased compared to last year but still have not reached to pre-covid period.

While obtaining an understanding of company's operation, you came to know that company is not operating at full capacity as there were sufficient supply of logic chips which was very essential for the products CETL produces. Your team has also noted that most of the employees of the company works from home which started from the beginning of Covid pandemic. Earlier employees needed to obtain written approval for making purchase and payment. However, to facilitate the remote working, management now allows email approval of the purchase. Email approvals are then made PDF file and attached as supporting evidence which is used to demonstrate that purchase was approved.

CETL generally had a listed vendor for each category of raw materials and items it purchases. However, during covid pandemic business were disrupted and many of the vendors failed to supply products as per CETL demands. To ensure continued business, CETL has decided to introduce additional vendors for each of the category. Purchase officer quickly ran a search and found out several vendors for which CETL purchases on regular basis. While including these new vendors as listed vendors, legal documents and price quote of these vendors were obtained. CETL generally performs due diligence on new vendors. However, considering the covid situation, due diligence was skipped by management. Price for products delivered by those new suppliers were somewhat higher than regular vendors but were made justified with an understanding of shortage of supply during pandemic period.

On 31 December 2021 your team members attended physical count of inventories. During count your team members identified that some inventories were kept in an offsite premises held under 3rd party. Team member could not perform the count, but CETL warehouse manager provided a certificate issued by the 3rd party offsite premises owner on 25 December 2021 when inventories were stored at 3rd party offsite premise. Certificate which is dated confirms a list of inventories held by them.

On 15th January 2022, you have received draft financial statements from management which shows an insignificant amount of profit and higher decrease in revenue than expected. Management have disclosed significant amount of contingent liabilities in the notes to the financial statements.

Requirements:

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|---|---|
| i) Identify and explain the professional misconducts done by your firm. | 3 |
| ii) Identify the impacts of Covid-19 on your audit. | 5 |
| iii) Identify covid-19 related fraud risks and suggest appropriate audit procedures to address those risks. | 5 |
- (b) You are a third-year student of Hassan Biswas & Co., Chartered Accountants (HBC) and a finalist of CA exam under ICAB. You plan to attend upcoming CA exam session and few days away from the start of approved study leave for CA final exams. Your current audit assignment is almost at the end and your team plans to issue the audit opinion before going to the exam leave. Your manager called you and informed you that your immediate reporting senior has become sick last night and admitted to hospital. He was auditing a complicated hedge accounting of your ongoing assignment. In absence of your reporting senior, audit manager instructed you to complete the audit of hedge accounting before your exam leave. You do not have sufficient experience on hedge accounting and feel that you might not perform the work without supervision. Furthermore, with audit tasks already in your hand and with new task assignment, you understand that it would be unrealistic to complete the task before your study leave and quality of work will deteriorate significantly. You wanted to discuss the matter with your manager, but you feel slightly intimidated. You also feel pressure to support your firm under this challenging time.

Requirements:

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|---|---|
| i) Identify the ethical issues involved and the factors you should consider resolving the ethical issues. | 4 |
| ii) What would be your course of actions to resolve identified issues. | 3 |

---The End---