

CORPORATE REPORTING

March-April 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

- Best Ceramics Limited (BCL) is a ceramic tableware manufacturing company. It is currently preparing its consolidated financial statements for the year ended 31 December 2023. Your firm has been appointed by BCL management to assist them in consolidation process and you have been assigned with the engagement. Management has shared relevant business information in **Exhibit-1** and the financial statements of BCL, Elite Distribution Limited (Elite) and Prime Porcelain Limited (Prime) in **Exhibit 2**.

Exhibit-1

- BCL acquired 75% shares of Elite for BDT 225,000,000 on 01 January 2015 when Elite was a small distribution company with retained earnings of BDT 30,844,844.
- Prime is engaged in manufacturing porcelain tiles. On 01 January 2020, Prime was incorporated as a joint venture with a foreign investor where BCL owns 50% shares.
- Elite distributes products of BCL as well as other companies. 25% of BCL's revenue were generated by selling inventories to Elite. BCL earned 30% margin on these sales.
- At the end of the year, 10% of these inventories sold by BCL remained unsold at Elite warehouse. Physical inspection at the year-end by Elite's auditor identified that broken inventory of BDT 250,000 was purchased from BCL.
- During the year Elite also purchased tiles from Prime on test basis which represents 15% revenue generated by prime. Prime made 8% profit on these sales. None of these tiles remained in the Elite's inventory at the year end.
- Elite issued 8% interim dividend during the year. At the year end, Elite made dividend payment deducting 20% applicable source tax which BCL received on 2nd January 2024. Source tax deducted by Elite remained payable at the year end. BCL reported the dividend income as other income and receivable within financial assets.

Exhibit-2:

Statement of profit or loss and other comprehensive income

For the year ended 31 December 2023

	Best	Elite	Prime
Revenue	1,079,801,962	701,871,276	230,671,178
Cost of revenue	(798,703,886)	(563,074,259)	(193,556,777)
Gross Profit	281,098,076	138,797,017	37,114,401
Administrative expenses	(130,085,355)	(59,475,529)	(22,043,982)
Selling & distribution expenses	(52,442,429)	(29,868,611)	(11,727,822)
Foreign exchange loss	(15,956,324)	-	-
Other income	49,817,531	-	-
Profit before interest & taxes	132,431,499	49,452,877	3,342,597
Finance income	1,365,240	-	-
Finance expenses	(7,140,037)	(2,781,723)	(1,043,146)
Profit before taxes	126,656,702	46,671,154	2,299,451
Tax expenses	(15,622,076)	(2,625,859)	(643,846)
Profit for the year	111,034,626	44,045,295	1,655,605
Other comprehensive income	-	-	-
Total comprehensive income	111,034,626	44,045,295	1,655,605

**Statement of Financial Position
As at 31 December 2023**

	Best	Elite	Prime
Assets			
Non-current assets			
Property, plant & equipment	705,964,200	228,726,826	137,785,440
Investment in other entities	260,000,000	-	-
Right-of-use assets	170,257,921	60,549,954	28,458,233
Intangible assets	204,729,618	100,639,803	41,335,632
Deferred tax	41,528,309	-	5,797,000
	1,382,480,048	389,916,583	213,376,305
Current Assets			
Financial assets	231,968,195	99,311,434	41,645,828
Trade receivables	342,086,753	240,779,079	71,624,210
Inventories	348,400,821	199,718,131	77,890,071
Cash & cash equivalents	392,033,467	144,950,861	68,650,339
	1,314,489,236	684,759,505	259,810,448
Total assets	2,696,969,284	1,074,676,088	473,186,753
Equity & liabilities			
Equity			
Share capital (Face Value of 10 taka)	828,000,000	150,000,000	70,000,000
Retained earnings	330,944,439	123,379,375	45,105,396
	1,158,944,439	273,379,375	115,105,396
Non-current liabilities			
Long-term interest-bearing loan	284,040,472	72,500,108	44,162,348
Non-current lease liabilities	84,812,517	24,837,951	27,818,505
Deferred tax liabilities	-	9,719,389	-
Gratuity liability	153,381,855	37,037,774	-
	522,234,844	144,095,222	71,980,853
Current liabilities			
Current lease liabilities	38,898,922	11,676,651	13,077,849
Short-term interest-bearing loan	118,313,953	-	11,292,161
Trade and other payables	335,982,788	305,785,746	96,600,181
Accruals and provisions	263,461,215	228,949,935	94,009,077
Other financial liabilities	259,133,123	110,789,159	71,121,236
	1,015,790,001	657,201,491	286,100,504
Total Equity & liabilities	2,696,969,284	1,074,676,088	473,186,753

Requirement:

Prepare Consolidated Financial Position and Consolidated Statement of Profit & Loss for Best Ceramics Limited.

2. Your firm has been appointed as auditor of Spring Bakehouse Limited (Spring) to audit the financial statements for the year ending 31 March 2023 and you have been assigned as engagement manager. This is the first year of audit engagement for you and your firm with Spring. Although the client acceptance procedures are not yet completed, you have deployed your team to understand the client business operation before the year end. Your team member has performed various procedures and prepared a memo (**Exhibit 1**) for your review. You also received an email instruction (**Exhibit 2**) from your partner which you need to consider.

Exhibit 1 – Company Background

Spring Bakehouse Limited is a private limited company and has been operating since 1995. It produces and sells various bakery items including loaf breads, buns, biscuits, cookies, cakes, pies, muffins, doughnuts, pastries and sweet rolls. It's factory and office both are located in Dhaka, Bangladesh. Spring sells its products through its 10 outlets across various locations within Dhaka City. The outlets sell only the bakery items produced at its own factory and branded as spring product. The outlets also sell party accessories like candles, birthday hats etc. It also takes customized orders through its outlets, company website or Facebook page.

In order to produce the bakery items Spring sources raw materials like wheat flour, sugar, eggs, oil, milk powder, yeast, salt, assorted fruits, baking powder, caramel colour, vanilla, butter, cream, etc. directly from the manufacturer. For each of these items, Spring has enlisted a single vendor. For other items like packaging materials and accessories, Spring has multiple vendors enlisted. According to the company policy Spring can purchase from enlisted vendors only.

Bakery items are produced throughout the night and fresh batches are delivered to the outlets in the morning. Most of the products has expiry of two or three days and gets sold before the expiry date. Outlet accepts both cash and cards as payment methods. Outlet manager daily sends sales report to the head office mentioning the inventory level, items sold, sale amount and amount collected through each payment modes. Products expired in the outlets are destroyed by the outlet manager and reported in daily sales report.

Recently Spring factory has been inspected by Food Safety Authority (FSA) and found that production facility is in violation of health code. Furthermore, it questioned the production staffs regarding quality of ingredients of food items. However, the staffs were unable to provide satisfactory response. FSA also identified usage of expired raw materials and usage of industrial grade colour instead of food grade colour. Furthermore, it has not taken license from Bangladesh Standards & Testing Institution (BSTI). Accordingly, FSA has fined Spring with a hefty amount and issued warning to Spring management.

In response, Spring Management has performed an inspection of the production facilities and identified that factory does not have clear production plan and manager often orders excess amount on vendors' request which leads to expiry of items before usage. Colours used in the food item are purchased on cash by an employee who is not aware of the difference between industrial and food grade colour.

Though Spring uses an accounting software, most of its transactions including purchase and issue of raw materials, sales, etc. are maintained manually. Workers are paid monthly in cash.

Exhibit 2 – Email instruction from partner.

Date : 12 March 2024
To : You
From : Engagement Partner
Subject : Spring Audit 2024

Hello!

Yesterday I had a meeting with Chairman of Spring who is my school friend and owns majority share in Spring. He has informed that Spring is currently planning to set up a new production facility outside Dhaka in order to expand the business. Spring's board has agreed to raise the required financing by issuing new shares. In this regard board is negotiating with prospective investor who wanted to review the signed financial statements. Therefore, board requires the audit report to be issued by mid of April 2024. Chairman has requested us to cooperate and complete the audit as early as possible.

Let us focus on completing the audit before 15th April and issue the audit report within the deadline set by Spring's chairman. While we are waiting to receive clearance from predecessor auditor, I want you to continue the risk assessment and develop audit strategies.

Requirements:

- a) Identify and assess what could go wrong in Spring's business operations that would lead to misstatements in the financial statements. Suggest appropriate audit procedures to address those risks.

- b) Perform a fraud risk analysis on Spring's business and suggest the controls it should implement to address the fraud risks. 8
- c) Identify the ethical issues involved with Spring audit engagement and suggest remediation options. 6
3. You have recently joined at Mahmud Dewan & Co. Chattered Accountants (MDC) as senior manager in assurance department. Your partner has assigned you to statutory audit of Highland (Highland) Group Limited.

MDC has been auditing Highland for the second year. Engagement consists of auditing its consolidated financial statements and separate financial statements. Highland has two subsidiaries Apex Limited and Zenith Limited where Highland owns 100% and 75% shares respectively. Both of these subsidiaries are significant to Highland and are being audited by separate auditors. Highland Audit team had a discussion with management and received the draft consolidated financial statements. They have summarized a few matters for your attention:

• **Intercompany transactions and balances:**

There have been significant intercompany transactions among highland and its subsidiaries. Highland has received management charges from these subsidiaries and provided an interest free long-term loan to Apex Limited. In addition, there has been significant amount of purchase and sales transactions between Apex and Zenith. Outstanding balances among these parties have been reported in the draft consolidated financial statements under trade receivables or trade payables.

• **Revaluation of land and buildings of the subsidiaries:**

Notes to the consolidated financial statements show that land and buildings of Apex and Zenith has been revalued during the year. Accordingly, a revaluation surplus and related deferred tax liabilities have been recognized. In its separate financial statements, highland has reported the land and building under cost model.

• **Business update from management:**

During our audit planning meeting, Highland management informed us that they are planning for IPO in 3 years and expecting to be listed by end of third year. Management is planning to finetune and clean up the financial statements before initiating IPO procedures in 3 years. Management has offered our firm a consulting engagement for Apex Limited which is currently being evaluated for acceptance.

Your team members are currently drafting audit instructions for the component auditors and requested your input.

Requirements:

- a) Identify and assess key risks in Highland consolidated financial statements. Suggest appropriate audit procedures to address those risks. 8
- b) Suggest the matters that should be added in the group audit instructions. 4
4. Galaxy Ltd. is an importer and wholesaler of home appliances. Its summarized financial statements for the year ended 31 December 2023 (and 2022 comparatives) are as follows:

Statement of Financial Performance for the year ended 31 December

	2023	2022
	BDT million	BDT million
Revenue	1,800	1,000
Cost of sales	-650	-180
Gross profit	1,150	820
Operating costs	-300	-180
Investment income	72	72
Finance costs	-300	-90
Profit (loss) before taxation	622	622
Income tax expense	-60	-60
Profit for the year	562	562
Other comprehensive income (amounts that will not be reclassified to profit or loss):		
Fair value gains on equity investments	180	30
Revaluation losses on property plant & equipment	-270	0
	-90	30
Total comprehensive income (loss) for the year	472	592

Statements of Financial Position as at 31 December

	2023 BDT million	2022 BDT million
Assets		
Non-current assets:		
Property, plant and equipment	7,200	4,500
Intangible asset – franchise	150	-
Equity investments designated “fair value through OCI”	1,500	900
	<u>8,850</u>	<u>5,400</u>
Current assets		
Inventory	280	130
Trade receivables	350	180
Bank	300	100
	<u>930</u>	<u>410</u>
Total assets	<u>9,780</u>	<u>5,810</u>
Equity and liabilities		
Equity:		
Equity shares of BDT 10 each	1,500	1,200
Share premium	400	--
Other components of equity	390	290
Retained earnings	2,400	2,100
	<u>4,690</u>	<u>3,590</u>
Non-current liabilities:		
Bank loan	4,500	1,800
Current liabilities:		
Trade payables	260	72
Other accruals	270	288
Current tax payable	60	60
	<u>590</u>	<u>420</u>
Total equity and liabilities	<u>9,780</u>	<u>5,810</u>

On 1 January 2023, the directors of Galaxy Ltd. decided to expand the business by purchasing a franchise to import and distribute additional lines of products. The franchise cost BDT 120 million and had a six-year life. However, it can be renewed at an additional fee, subject to satisfactory performance.

The new business required significant investment in warehouses and distribution vehicles. To finance this expansion, additional shares were issued and the existing bank loan was replaced by a bigger one. The bank charged a higher interest rate on the new loan due to the higher gearing ratio that resulted from the increased debt level. The new capital was raised on 1 January 2023, and the loan is repayable on 31 December 2028.

During a board meeting held to review the year’s performance, some of the directors expressed dissatisfaction with the financial results, noting that despite significantly increased revenue, profit for the year posted zero growth, and total comprehensive income decreased by BDT 120 million.

The finance director agreed that there was a disappointing outcome for the year ended 2023. He presented some information that he felt might be helpful in analysing the cause of the poor results and likely trends in the future performance of the business. He also made the following points:

- In the year ended 2023, the pre-existing product lines (which excluded the expansion) reported revenue of BDT 875 million, cost of sales of BDT 165 million and operating expenses of BDT 140 million.
- There had been production problems with the manufacturer of some of the new products, leading to a shortage of supply. The Company had to source product from another supplier at a higher cost to meet contractually agreed deliveries. This added BDT 110 million to cost of sales in the period. These problems have now been resolved and are not expected to recur.
- Dividends of 2.00 per share were paid in 2023, in accordance with a previous board decision. This was the same amount per share as the previous year.

Requirement:

Being the consultant of the Company, perform an extensive analysis on the performance and position of Galaxy Ltd. and produce a report to review the concerns of the dissatisfied directors and make recommendations (if applicable) to address the concern. [You are not required to prepare Financial Statements]

16

5. a) On first July 2021, Bee Limited entered into the following transactions which require urgent attention. Management has requested your assistance for these transactions:

Bee has entered into a triparty agreement with its employees and Alpha Finance Limited for a car facility scheme. Under this scheme, Bee Limited plans to provide car to each of its 10 senior employees by taking loan from Alpha Finance Limited at 10% annual interest for 5 years. Estimated car purchase and registration cost is BDT 2,000,000 for each car. Loan will be taken in the employees account and car will be registered in the name of employees. However, ownership of the car will remain with the finance company until the loan is paid off. Bee Limited has agreed to provide the financial guaranty in favour of the employees.

Bee Limited offered each of its 10 senior employees that Bee Limited will bear the interest and related annual financing expenses for each of these employees on the condition that they will stay with Bee Limited for next 5 years. At the end of the 5th year, ownership of the car will be transferred to the employees. However, if employees leave Bee Limited before 5th year, outstanding amount of loan will have to be paid by the employees. No employee left the Bee as of reporting date. Annual lease payment is BDT 4,796,318.

On first July 2021, Bee Limited entered into a rental agreement with Spider Limited for its office space. Rent agreement is for 1 year period but has option for renewal. Bee Limited has agreed to pay entire annual rent equal to 30,000,000 upfront as advance. Bee Limited has determined the annual discount rate at 10%. It has made significant investment for head office and doesn't plan to vacate the office space in next 5 years. It plans to renew the contract annually. As the lease contract is for 1 year only, Bee Limited is not sure whether it should be considered for lease accounting under IFRS 16.

Requirement:

Assist Bee Limited in recognition and presentation (journal entries) of these transactions at its annual financial statements.

8

- b) You are Kabir Siddiqui, a qualified Chartered Accountant working as Director in a big CA firm in Bangladesh. You have got an e-mail from one of the senior partners of the Firm, Mr. Kader Sinha. The message of the e-mail reads as follows:

We have an audit client named Guaranteed Quality Air Conditioner (GQAC) whose accounting year ends at March 31, 2024. The audit team finished the audit and prepared a working paper for unresolved accounting issues as noted below:

Issue -1: Financial instruments

Foreign exchange implications of all trading transactions have been correctly accounted for. However, there is confusion about the correct treatment of the two financial assets for which no year-end adjustments had been made.

On 01 April 2023, GQAC invested in 10% of the issued ordinary share capital (500,000 shares) of KRR in Japan. The investment was recognized as Fair Value through Other Comprehensive Income (FVTOCI) at BDT 42.5 million. On 31 March 2024, the shares in KRR were quoted in an active market at 125 Japanese Yen (JPY) per share.

On 1 July 2023, GQAC invested in 5% of the issued ordinary share capital of another Japanese company, PXYG. GQAC bought 150,000 shares at BDT 1,500,000. GQAC correctly classified this investment as fair value through profit or loss. On 31 March 2024, the shares in PXYG were quoted in an active market at JPY 17 per share.

The exchange rates for the JPY at 31 March 2024

BDT 1 = JPY 1.5

Issue – 2: Revenue

Until recently, GQAC sold Air Conditioners without service contracts. On 01 February 2024, GQAC signed a new contract with a large corporate, LLQ Ltd, to supply AC together with a three-year

fixed-term service contract under which GQAC's technical team will make quarterly visits to the client.

Sales made under this contract in February and March 2024 were BDT 50,000,000, comprising machine sales of BDT 41,000,000 and services valued at BDT 9,000,000. No service visits are due until June 2023 at the earliest, so no service costs were incurred under this contract before 31 March 2024.

The Company recognized full amount of BDT 50,000,000 in revenue.

Issue- 3: Deferred tax

A deferred tax balance of BDT 1,750,000 was brought forward on 1 April 2023. This relates entirely to temporary differences in respect of the revaluation of land and buildings. Adjustments may be required in respect of the following:

- Land and buildings are carried at revalued amounts. The revaluation on 31 March 2024, which increased the value to BDT 45 million from the original cost of BDT 30 million. No tax allowances are given for depreciation charged on land and buildings by tax authority. A taxable capital gain will arise in future on the sale of land and buildings. This capital gain is calculated as the difference between the sale proceeds and the original cost. A tax on capital gains of 15% will apply when the land and buildings are sold.
- Any temporary differences arising in respect of adjustments in financial instruments from issue - 1 above. The tax treatment for financial instruments follows the accounting treatment in respect of gains and losses recognised through profit or loss. Deferred tax arises in respect of gains or losses on financial instruments which are recognised in other comprehensive income.

Issue – 4: Current tax

Adjustments on financial instruments and revenue from issue 1 and 2 above may require adjustments to the current tax charge. Regular tax is charged at 25%.

Requirement:

Explain the financial reporting implications of all the above issues and suggest necessary adjustments needed. State all journal entries for each adjustment.

16

---The End---