

CORPORATE REPORTING

Time allowed- 3:30 hours

Total marks- 100

Nov-Dec 2022

[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. You are currently auditing Orbit Group Limited (OGL) for the year ended 31 March 2022. From your initial discussion with management, you have learned that Orbit Limited owns 90% shares of Galaxy Limited and 100% shares of Comet Limited. Galaxy Ltd. and Comet Ltd. have different auditors who have not yet submitted their audit reports. Galaxy Limited is material for the group. Management has not yet consolidated the financial statements. However, management provided you separate statement of financial position for all the entities as at 31 March 2022.

	Orbit	Galaxy	Comet
	BDT	BDT	BDT
Assets			
Non-Current Assets:			
Property, Plant & Equipment	7,928,400	7,623,600	3,139,200
Intangibles	1,215,600	864,000	-
Investments	4,200,000	-	-
	13,344,000	8,487,600	3,139,200
Inventories	2,824,800	2,766,000	788,400
Trade & Other Receivables	2,098,800	945,600	679,200
Advance, Deposits & Prepayments	1,143,600	752,400	-
Cash & Cash Equivalents	884,400	142,800	40,800
	6,951,600	4,606,800	1,508,400
Total Assets	20,295,600	13,094,400	4,647,600
Equity and liabilities:			
Equity			
Share capital	1,200,000	6,000,000	1,200,000
Revaluation surplus	1,500,000	-	-
Retained earnings	13,092,000	3,745,200	144,000
	15,792,000	9,745,200	1,344,000
Current liabilities			
Trade & other payables	2,414,400	1,221,600	1,648,800
Provision for expenses	1,069,200	1,167,600	1,200,000
taxation	1,020,000	960,000	454,800
	4,503,600	3,349,200	3,303,600
Total equity & liabilities	20,295,600	13,094,400	4,647,600

Additional information:

- i) OGL acquired 90% of Galaxy Ltd.'s ordinary shares on 1 April 2020 for total cash consideration of BDT 8,500,000. BDT 3,000,000 was payable on the acquisition date and the remaining 5,500,000 two years later, on 1 April 2022. The directors of Orbit have not considered deferred consideration payable when preparing the draft financial statements above. They are not sure how to account for deferred consideration and requested your assistance.

On the date of acquisition, retained earnings on Galaxy's book was BDT 2,500,000. Orbit used proportionate method while calculating the non-controlling interest and goodwill from acquisition of Galaxy.

- ii) OGL incorporated Comet Limited as 100% owned subsidiary on 01 October 2019 and invested entire share capital amount. However, due to Covid-19, operation of Comet Limited could not take off properly. Comet Limited has growth potential but requires immediate financing. OGL accordingly divested Comet on 31 March 2022 for BDT 2,800,000. OGL has not yet recorded divestment in its financial statements.

OGL then invested the proceeds to acquire 80% shares of Asteroid Limited on 01 May 2022. On the date of acquisition, Asteroid had share capital of BDT 2,000,000 and retained earnings

of BDT 675,000. Orbit plans to measure the non-controlling interest at the non-controlling interest's share of Asteroid's net assets.

- iii) The fair values of the assets, liabilities and contingent liabilities of Galaxy at the date of its acquisition by Orbit were equal to their carrying amounts, with the exception of a building purchased on 1 April 2018, which had a fair value on the date of acquisition of BDT 1,440,000. This building is being depreciated by Galaxy on a straight-line basis over 50 years and is included in the above statement of financial position at a carrying amount of BDT 1,104,000.
- iv) Galaxy sold a machine (PURP) to Orbit immediately after acquisition. The machine had been purchased by Galaxy on 1 April 2018 for BDT 120,000 and was sold to Orbit for BDT 180,000. The machine was originally assessed as having a total useful life of five years and that estimate has never changed.
- v) During the year, Orbit plc sold goods at 20% margin to Galaxy for BDT 144,000 and to Comet for BDT 60,000. All these inventories remain unsold at the year end.
- vi) Orbit's trade receivables on 31 March 2022 includes BDT 248,800 due from Comet Ltd.
- vii) On 31 March 2022 impairment losses of BDT 300,000 in respect of goodwill arising on the acquisition of Galaxy need to be recognised in the consolidated financial statements.
- viii) Orbit determined discount rate appropriate for entire group is 5% p.a.

Requirements:

- a) Prepare the consolidated statement of financial position of Orbit Group Limited as of 31 March 2022. 18
 - b) Set out your responsibilities as auditor of consolidated financial statements. What matters you should need to consider before accepting a group engagement. 5
 - c) Identify the risks of misstatements in Orbit's consolidated financial statements and suggest appropriate audit procedures to address the identified risks. 10
2. Mr. Nahid, Accounting Manager of Confident Woodworks Limited (CWL), is preparing CWL financial statements for the year ended 30 June 2022. He has been facing challenges in few matters and requested assistance from your firm. You have been assigned to assist Mr. Nahid to address his challenges. Mr. Nahid has shared following information:

Issue 1: Valuation of inventories

Mr. Nahid has been trying to evaluate the inventories at hand for determining the inventory to be reported in the Statement of Financial Position. On 30 June 2022, Factory record shows that CWL had following inventories at its workshop and warehouses.

Inventory Category	Cost Amount (BDT)
Raw woods	4,785,433
Chemicals & Dyes	2,434,962
Furniture Manufacturing in Process	9,856,287
Finished furniture	17,845,391
Total	34,922,073

Factory manager has informed Mr. Nahid raw woods and chemicals are booked at invoice value plus import taxes to the factory. CWL incurs additional approximately 2% cost clearing and transportation costs which are booked as cost of sales. During the year CWL spent BDT 2,232,796 as clearing and transportation cost. Because of significant variation in weight or mass of wood per unit volume, CWL is unable to determine the quality of furniture could be produced with these raw woods. For the same reason, CWL is unable to estimate the consumption of chemicals and dyes. CWL imports these raw woods and chemical for own use.

Work-in-process are processed raw woods and basic structure has been built for this furniture. At this stage furniture are considered 50% complete and includes 30% of the labour cost required for manufacturing. However, these does not include any overhead or chemical costs. CWL workers then use their skills to complete remaining manufacturing process and polish it with dyes and chemicals to bring it to saleable condition. It has been estimated that 40% of the chemicals and dyes at hand will be consumed in completion of work-in-process furniture.

Finished furniture are delivered to customer premises once sales order is received. Cost component of the finished furniture includes 45% raw wood cost, 35% Labour cost, 13% overhead expenses and 7% chemical & dye cost. CWL generally adds 20% markup on its cost and spends approximately 1% of the sale price as delivery costs. It provides free delivery to its customers. At the year end, CWL identified that 35% of reported finished furniture is out of fashion and can only be sold at 50% discount on sales price.

Issue 2: Valuation and presentation of foreign currency transactions:

During the year CWL has engaged in several transactions denominated in foreign currency.

- i) Purchased a wood seasoning machine for USD 32,000 from Bespoke Engineering Limited, Italy. Payment was made from Letter of Credit (LC) opened with ABC Bank Limited for the import purpose. LC was opened when exchange rate was BDT 87/\$. During the year CWL made payment to ABC Bank equivalent to 50% of the LC value. At the payment date spot rate was BDT 94/\$. Rest of the LC value remains payable to ABC Bank Limited.
- ii) Entered into a sales contract with Wood Art Limited, Japan for JPY 5,500,000 when exchange rate was BDT 0.7692/JPY. Entire amount was received as advance. By reporting date, CWL has exported furniture 70% of the contract value before year end when the spot rate was BDT 0.7143/JPY. Rest of the performance obligation remains unfulfilled.

None of the entries were posted at the year end. Exchange rates on 30 June 2022 was BDT 106/\$ and BDT 0.6667/JPY whereas rates on 31 October 2022, when the financial statements are being prepared, are BDT 103/\$ and BDT 0.6897/JPY. Mr. Nahid is not sure how these transactions should be recorded and what balance to be reported at the year end. He is planning to use the exchange rates of 31 October 2022 as this recent and be more relevant to users of the financial statements.

Issue 3: Recognition and measurement of Building Construction in Progress

CWL has been operating at full capacity and was planning to increase its production capacity by constructing a new workshop. On 01 July 2021, CWL took a loan from ABC Bank Limited at 9% annual interest for BDT 12,500,000 for construction of new workshop. It incurred a processing expense equivalent to 1.5% of the borrowed amount. On the same date as borrowing, CWL entered into a 10-year lease contract for a vacant land on which workshop will be constructed. Monthly rent for the lease is BDT 45,000. However, construction has not started before 01 January 2022 due to obtaining construction permission and performing administrative issues. Management inefficiencies delayed permission process by 3 months.

During this period between borrowing date and construction commencing date, 50% of the borrowed amount was invested in fixed deposit at 6.5% interest rate. Rest 50% of the borrowed amount was invested in stock market. CWL experienced a loss of BDT 165,000 when it liquidated its stock market investment to meet the construction costs.

By reporting date, 80% construction was completed. CWL recorded material and labour cost of BDT 8,745,923 related to construction. At the end of reporting period, CWL reported interest on lease liabilities for BDT 857,428 and Depreciation on leased assets for BDT 994,172 in addition to the finance expense for borrowed fund.

Md. Nahid is not sure how much to report as construction in process.

Requirements:

- a) Explain the issues to Mr. Nahid with guidance from IFRSs and assist him in recognition and presentation of the issues. 15
 - b) Suggest adjustment journal entries to be posted for fair measurement. 5
3. Your firm has recently accepted appointment as Statutory auditor of Ideal Builders Limited (IBL) to audit the financial statements for the year ended 30 June 2022. This is the first year your firm is going to audit IBL. Management has provided you draft financial statements in **Exhibit 1**.
- During an initial meeting, IBL management informed your firm that they are engaged in construction & engineering business and mostly supports international customers setting up plant or factories in Bangladesh. Construction works generally needs 2 to 3 years. Therefore, they raise invoices to these foreign customers on milestone basis as agreed in the contract.

IBL was significantly impacted during Covid-19 period, but it was slowly improving. However, due to Russia-Ukraine war, global economy has been disrupted. Accordingly, foreign investors have reduced or postponed their investment. IBL has not awarded any new contract in last 6 months. Invoicing for existing contracts has also been delayed.

Recently in a newspaper an article was published regarding workers' safety of construction sites. Article provided an example of death of a construction worker in IBL construction site due to inadequate safety equipment and training. Article also reported that this incident was not the first time in IBL construction site.

In most of the contract won, IBL was price quotation was lowest. In order to provide low-cost construction, IBL has focused on low-cost sourcing of construction materials. These materials sometimes are found of inferior quality and causes higher consumption rate or increase wastage. In recent inspection by authority, it was discovered that IBL have ignored payment of VAT BDT 10,000,000 and Suppliers' Tax at source worth of BDT 5,000,000. These were not accounted for in the financial statements. Authority further penalized BDT 5,000,000 for non-payment of Tax & VAT.

You have been assigned as engagement manager of the audit. You have obtained professional clearance from predecessor auditor, but they have mentioned in their letter that their prior year audit fees have not yet been paid despite several reminder and meeting.

Exhibit 1: Draft Financial Statements

Statement of Financial Position		
	2022	2021
	BDT	BDT
Assets		
Non-current assets		
Property, plant and equipment	21,120,933	19,744,030
Right-of-use assets	91,094,654	38,571,783
Deferred tax assets	6,855,570	5,498,561
Goodwill	477,955,036	477,955,036
	597,026,193	541,769,410
Current assets		
Inventories	169,977,330	291,122,296
Trade receivables	343,513,529	301,142,121
Contract assets	120,166,655	88,069,834
Advances, deposits and prepayments	152,171,565	190,695,869
Cash and cash equivalents	573,490,338	606,454,715
	1,359,319,417	1,477,484,835
Total assets	1,956,345,610	2,019,254,245
Equity and Liabilities		
Equity		
Share capital	679,607,200	679,607,200
Reserve for actuarial loss	(6,198,403)	(5,977,032)
Retained earnings	112,440,163	217,128,005
	785,848,960	890,758,173
Non-current liabilities		
Post-employment benefit obligations	38,365,953	35,497,193
Lease liabilities- non-current portion	75,215,391	10,910,180
	113,581,344	46,407,373
Current liabilities		
Lease liabilities- current portion	14,249,486	27,706,234
Trade and other payables	805,225,240	805,103,945
Contract liabilities	120,295,640	103,054,627
Income tax payable	117,144,940	146,223,893
	1,056,915,306	1,082,088,699
Total liabilities	1,170,496,650	1,128,496,072
Total equity and liabilities	1,956,345,610	2,019,254,245

Statement of Profit or Loss & Other Comprehensive Income

	2022	2021
Revenue	1,891,295,270	1,708,575,633
Cost of sales	(1,298,739,694)	(1,177,579,831)
Gross profit	592,555,576	530,995,802
General and administrative expenses	(399,610,719)	(386,895,550)
Other operating income/(expenses)	69,697,007	66,628,071
Exchange gain/(loss)	(3,408,286)	(7,198,630)
Operating profit	259,233,578	203,529,693
Finance expenses	(8,980,247)	(639,052)
Profit before Contribution to WPPF	250,253,331	202,890,641
Contribution to Workers' Profit Participation Fund	(11,916,825)	(9,661,459)
Profit before tax	238,336,506	193,229,182
Income tax expenses	(125,957,808)	(146,081,931)
Profit for the year	112,378,698	47,147,251
Other comprehensive income/(loss)	(221,372)	(6,157,662)
Total comprehensive income for the year	112,157,326	40,989,589

Statement of Changes in Equity

Particulars	Share capital	Reserve for actuarial differences	Retained earnings	Total
Balance as at 30 September 2020	679,607,200	(5,977,031)	217,128,005	890,758,174
Dividends paid for the year 2020	-	-	(217,066,540)	(217,066,540)
Reserve for actuarial differences	-	(221,372)	-	(221,372)
Profit for the year	-	-	112,378,698	112,378,698
Balance as at 30 September 2021	679,607,200	(6,198,403)	112,440,163	785,848,960

Requirements:

- a) Perform Overall analytical review of IBL financial statements with available financial & non-financial information. 10
 - b) Identify and explain ethical issues involving for your firm & IBL. 6
 - c) Prepare a briefing note for the team members explaining the areas with high audit risk based on your analysis and available non-financial information. 5
 - d) Design audit procedures to be carried out in response to identified risks. 5
4. You are the CFO of Crystal Limited (Crystal) and the year-end of the company is 30th June. Crystal Limited has a wholly owned subsidiary, Ash Limited (Ash).

In 2021 the Audited Consolidated Financial Statements were reviewed by the Board Audit Committee on 1st December 2021, approved by the Board on 6th December 2021 and adopted by the shareholders at the AGM on 16th December 2021.

In 2022 the Audited Consolidated Financial Statements were reviewed by the Board Audit Committee on 9th November 2022, approved by the Board on 12th November 2022 and adopted by the shareholders at the AGM on 16th December 2022.

Requirements:

As the CFO of the company, what are the expected accounting treatments and or disclosures (if any) which you would have made as per requirements of the International Accounting Standards for the years ended 30th June 2021 and 30th June 2022 for the issues listed below:

a) VAT Audit of Crystal Limited

The VAT authorities engaged with Crystal in January 2021 with the intention of conducting an audit of Crystal for the period 2015 to 2020. However, as a previous VAT audit had been conducted from 2015 to 2017, management engaged with the authorities and agreed to provide information from 2017-2018 onwards to 2019-2020.

An internal assessment of the issue by management revealed that Crystal had not correctly applied VDS rules resulting in a potential shortfall of VDS from vendors of BDT 8 million which would attract interest of a further BDT 3 million. Crystal accounted for a BDT 8 million provision in expenses and a further BDT 3 million in interest expense as of 30th June 2021.

As the audit came to conclusion Crystal was verbally informed that the VAT authorities intended to issue a show cause notice under Section 55(1) of the VAT Act 2012 request Crystal to explain why BDT 6.5 million of VAT had not been paid, resulting in a potential claim (including interest) of BDT 8.75 million. Therefore, on 18th September 2021 Crystal deposited BDT 8.75 million with the Govt. Treasury.

In line with the VAT Act 2012, a show cause notice under section 55(1) was issued on 30th September 2021 to which Crystal responded on 10th October 2021 indicating that the non-payment of VAT was not intentional but an oversight and that the amount identified as not paid along with interest has been paid.

On 10th December 2021, Crystal received a notice under section 55(3) recognising the amount due has been paid, and that no further penalty will be imposed. The remaining provision was reversed on 11th December 2021.

b) Holding tax of Crystal Limited - Dhaka North City Corporation (DNCC)

An S.R.O. number 13-ayeen/2016 published in the Gazette by the Ministry of Local Government, Rural Development, and Co-operative on 31 March 2018, stated that Crystal is required to have an annual assessment of holding value under the City Corporation Ordinance.

In reference to the above Gazette, Crystal received a letter from the Revenue Department, Region 9, Dhaka North City Corporation (DNCC), Dhaka, dated 29 June 2021, requesting Crystal to submit required documents by 6 July 2021. On 30 June 2021, Crystal submitted the relevant documents to the DNCC's Revenue Department.

On 10 September 2021, Crystal received a notice from the Revenue Department, Region 9, Dhaka North City Corporation (DNCC), dated 26 August 2021, stating that Crystal has been assessed as having an annual holding value of BDT 150 million as of 21 June 2018, under 2 bylaws of the 24th Rule, 1986 Municipal Corporation. The notice also included a comprehensive computation based on quarterly instalments, showing that land and building taxes of BDT 2.90 million; sewer/drain cleaning rate of BDT 0.84 million; and street light rate of BDT 1.26 million, which resulted in the total quarterly holding tax of BDT 5 million or an annual holding tax of BDT 20 million.

Crystal submitted an application to the Chief Revenue Officer, DNCC, Dhaka, on 25 September 2021, requesting them to reconsider the extent of the yearly holding tax. However, on 31st October 2021 Crystal received a demand for BDT 5m relating to the period April to June 2018. Crystal had sought legal advice on the issue which confirmed that the demand from DNCC is legally valid. The legal opinion was received on 15th November 2021. There was no further communication from DNCC as of 31st December 2022.

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c) Property revaluation of Crystal Limited and Ash Limited

The accounting policy of the Group states the following:

“After initial recognition of an asset, an item of PPE whose fair value can be measured reliably shall be carried at the revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

When an asset’s carrying amount is increased as a result of a revaluation, the increase is recognised in other comprehensive income and accumulated in equity as a revaluation reserve. However, the increase is recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

When an asset’s carrying amount is decreased as a result of a revaluation, the decrease is recognised in profit or loss. However, the decrease is recognised in other comprehensive income to the extent of any credit balance existing in the revaluation reserve in respect of that asset.

The revaluation reserve included in equity in respect of an item of PPE is transferred directly to retained earnings when the asset is derecognised. However, some of the surplus is transferred as the asset is used by the Company. In such a case, the amount of the surplus transferred would be the

difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost."

Crystal appointed Asian Surveyors on 21st August 2021 to conduct a reassessment of the value of the land. The valuation report dated 7th September 2021 indicated that the land which was previously recognized in the Audited Financial Statements at BDT 4 billion was now worth BDT 5.5 billion. The last time the land had been revalued was in 2011 (10 years ago).

Ash appointed Asian Surveyors on 9th October 2022 to conduct a reassessment of the value of the land. The valuation report dated 12th October 2022 indicated that the land which was previously recognized in the Audited Financial Statements at BDT 150 million was now worth BDT 450 million. The last time the land had been revalued was in 2010 (12 years ago).

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5. You are Rashid Kabir, a recently qualified chartered accountant, who has joined in a reputed CA firm. On your first day, chief operating partner has given you two assignments.

Assignment – 1: One of our banking clients has had its ICT system hacked and large sums of customers' money were taken. We advised the client to have a robust cyber security policy and cyber security audit.

Assignment – 2: You most probably are aware about the database leakage of lawyer Massack Fonseca who was alleged to have aided the people involved to form off-shore companies which enabled them to evade tax and indulged in money laundering. Unfortunately, one of directors of our audit client has name on that leaked database. This revelation has implications for professional accountants like us who are required to report suspicious transactions and activities of clients.

Requirements:

You are required to prepare write-up which will cover following:

(i) Assignment -1:

Discuss about cyber security audit and what it wishes to achieve

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(ii) Assignment – 2:

Recommend elements that should be included in anti-money laundering programme for an accounting firm.

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---The End---