

CORPORATE REPORTING

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. Copper Ltd. owns 80% shares of Nickel Ltd., acquired on 01 January 2015 when retained earnings of Nickel Ltd. was BDT 5,914,722. There were no actuarial gain/loss at the time of acquisition. Considering the high growth potential, purchase price of acquisition was set at BDT 487,246,624. Nickel Ltd. owns a piece of land which has a cost of BDT 2,000,000. At the time of acquisition, the land was valued at BDT 9,500,000. Both Copper and Nickel prepared its financial statements for the year ended 31 December 2021. After the preparation of financial statements, Copper identified that some of the transactions have not been considered while preparing the financial statements.

On 31 December 2021, Copper Ltd. entered into a five-year lease of a building which has a remaining useful life of 10 years. Lease payments are BDT 550,000 per annum, payable at the beginning of each year. Copper incurred initial direct costs of BDT 250,000. There is no transfer of the asset at the end of the lease and no purchase option. Incremental borrowing rate is 5%.

During the year Copper and Nickel entered into multiple transactions among them. Copper purchased inventory worth BDT 31,657,081 from Nickel. In turn, Nickel purchased inventory worth BDT 19,213,894 from Copper. By the reporting date, Copper sold off all the inventories purchased from Nickel, whereas Nickel had sold only half of the inventories purchased from Copper. Copper made 20% profit from the sold inventories.

During the year Nickel took short term loan from Copper which was repaid before the year end. Nickel incurred finance expense of BDT 749,552. Copper recognized interest income as other income. No dividend was declared/paid by either Nickel Ltd. or by Copper Ltd. since its acquisition of Nickel Ltd. on 01 January 2015.

Exhibit 2: Statement of Financial Position as at 31 December 2021

	Copper Ltd BDT	Nickel Ltd. BDT
ASSETS		
Non-current assets		
Property, plant and equipment	59,115,335	2,853,915
Intangible asset	2,010,107	133,713
Deferred tax assets	34,867,628	783,390
Defined benefit assets	3,432,844	-
Investment in subsidiaries	487,246,624	-
	586,672,538	3,771,018
Current assets		
Inventories	91,362,996	114,702,039
Trade & Other receivables	597,107,447	101,155,660
Inter-company receivable	33,672,160	165,671,551
Advances, deposits and prepayments	576,604,120	105,169,650
Cash and Bank balances	237,391,120	184,728,753
	1,536,137,843	671,427,653
Total assets	2,122,810,381	675,198,671
EQUITY AND LIABILITIES		
Equity		
Share capital	25,000,000	223,555,000
Retained earnings	30,860,646	80,914,722
Actuarial Gain/(loss)	(15,198,375)	59,418
	40,662,271	304,529,140
Non-Current liabilities		
Defined benefit obligation	3,585,000	4,010,634
	3,585,000	4,010,634
Current liabilities		

Inter-company payable	165,671,551	33,672,160
Contract liabilities	528,730,432	33,432,040
Trade payables	771,997,603	171,102,424
Provision for income tax	612,163,524	128,452,273
	2,078,563,110	366,658,897
Total equity and liabilities	2,122,810,381	675,198,671

Exhibit 1: Statement of Profit or Loss & OCI for the year ended 31 December 2021

	Copper Ltd.	Nickel Ltd.
	BDT	BDT
Revenue	1,921,389,313	633,141,620
Cost of sales	(1,878,390,976)	(457,062,244)
Gross profit	42,998,337	176,079,376
Administrative and selling expenses	(275,669,136)	(118,219,667)
Other operating income	216,707,949	16,513,765
Operating profit	(15,962,850)	74,373,474
Finance expenses	(402,967)	(4,997,013)
Profit before tax	(16,365,817)	69,376,461
Income tax expense	(102,518,580)	(46,542,703)
Profit for the year	(118,884,397)	22,833,758
Other comprehensive income	2,283,201	1,918,692
Profit for the year	(116,601,196)	24,752,450

Requirements:

- a) Suggest appropriate adjustment on the Copper Ltd. financial statements for the year ended 31 December 2021. 5
 - b) Perform consolidated adjustments and prepare consolidated financial position and consolidated profit or loss statement of Copper Ltd. for the year ended 31 December 2021. 15
2. a) Rose Trading Company (RTC) operates in Ukraine and its functional currency is the Ukraine Hryvnia (UAH). Due to the war with Russia, Ukrainian economy has deteriorated massively due to high inflation. Management of the TRC concluded that the economy has become hyperinflationary, and the relevant IAS is to be applied. Company prepared its financial statements as of 30 June 2022. At that date Rostock's statement of financial position was summarised as follows.

Total Assets	UAH	Total Equity & Liabilities	UAH
Property, plant and equipment	55,200	Share capital	16,000
Trade receivables	21,600	Revaluation reserve	14,000
Cash	2,600	Retained earnings	22,600
		Trade payables	26,800
	79,400		79,400

The share capital was issued on the date the company was formed, 1 July 2020. The property, plant and equipment were acquired on the same date and revalued on 31 December 2020. The trade payables were acquired on 31 March 2021 and the trade receivables on 30 June 2022.

The general price index of Ukraine has been as follows.

	2020	2021	2022
30 June	1000	1400	1800
31 December	1200	1600	
31 March	1400	1800	
Average for the year	1160	1560	

Requirement:

- Prepare the balance sheet as on 01 July 2022 in accordance with the applicable IAS. 10
- b) Karim Trading Limited (KTL) is an electronic home appliance retailer. It is very popular for product quality and after sales service. KTL Books of accounts for 2021 shows that it generated revenue of BDT 28,500,000 with standard warranty for 24 months. Experience indicates that 80

per cent of home appliance item sold require no warranty repairs. However, experience shows 15% of items sold require minor repairs costing 25% of the sale price whereas 5% items sold require major repairs or replacement costing 80% of sale price.

KTL expects that 65% of the expenditures for warranty repairs and replacements for sold appliances will incur in 2022 and remaining 35% in 2023. KTL estimates that in each case, expenditures will be incurred at the end of the year. KTL uses government bonds rates with the same term to discount its expected cash outflows. At present government bonds yield annual 5% coupon for one-year bonds and 7% for bonds with two or more years term.

During December 2021, KTL has a special promotion on its refrigerators. The selling price of the refrigerator is BDT 55,000. Customers will receive a free 36-month extended warranty in addition to the 24-month standard warranty. The same 36-month extended warranty can be purchased from KTL for 10,000. Refrigerators can be purchased at BDT 55,000 with standard warranty. KTL sold 15 refrigerators in the special promotion which is included in the annual revenue.

Requirements:

- i) Determine the revenue to be recognized from special promotion and annual revenue to be reported in the profit or loss statement in accordance with relevant IFRSs. 3
- ii) Calculate the warranty expenses and liabilities to be reported in the financial statements. Suggest the adjustment journal entries to KTL Management. 5

3. a) Triple Garments introduced a pension scheme on 28 February 2021 as one of its strategies to promote retention of its employees. However, the scheme became operational on 1 April 2021 immediately after Triple Garments had made a contribution of BDT 15,000,000. Triple garments has guaranteed pension benefits which employees will get at retirement age. Further, all the employees were eligible including those who were due for retirement in 2021.

The following information relates to the pension plan for the year to 31 December 2021:

- i) Pension benefits of BDT 1,150,000 were paid on 30 September 2021.
- ii) Fair value of pension assets were BDT 15,000,000 and BDT 15,425,000 on 1 April 2021 and 31 December 2021 respectively.
- iii) Present value of pension obligations amounted to BDT 16,300,000 on 1 April 2021 and BDT 18,850,000 on 31 December 2021.
- iv) Current service costs were equal to BDT 1,800,000.
- v) The yield on high quality corporate bonds at 1 April 2021 was 12.5%.

The Directors of Triple Garments need your advice on the accounting treatment of the scheme in their financial statements for the year ended 31 December 2021.

Requirement:

Advise the Directors of Triple Garments on how the pension scheme should be treated in the financial statements of the company for the year ended 31 December 2021. 10

- b) MCL was established in 2001 and currently operating in toiletries industries. Its primary brand is Mita Soap which have earned much popularity across all demographics. It sells its products through the distributors who in turn sells to retailers. Distributors are responsible for ensuring proper supply of products to meet the demands and MCL is responsible for creating market demands through sales promotion. MCL distributors has the right to return the expired goods or claim compensation for giving away free goods to customers in accordance MCL sales promotion.

MCL manufactures products locally at its factory which is in Kalurghat, Chittagong. Most of its raw materials are imported from neighbouring countries. MCL has been making loss in last 4 years due to increased competition, increase of raw material cost and promotional costs. Furthermore, MCL is incurring significantly high amount of tax expenses.

Last year management revalued its land and factory building. Prior year auditor has concluded that revaluation has been overstated and accordingly expressed qualified opinion.

Your firm is currently auditing Mita Cosmetics Limited (MCL) where you have been assigned the role of Audit Manager. This is the first year your company is auditing MCL. MCL Management of the company has just shared the draft financial statements for the year ended 31 December 2021.

Mita Cosmetics Limited

Statement of Financial Position
As of 31 December 2021

	31-Dec-21	31-Dec-20
Non-Current Assets		
Property, Plant and Equipment	882,882,561	905,785,370
Right of Use Assets	29,091,338	37,212,968
Intangible Assets	42,695,572	49,164,004
Other non-current assets	28,316,910	28,407,384
	982,986,381	1,020,569,726
Current Assets		
Inventories	270,781,865	265,718,810
Trade & Other Receivables	303,971,512	380,811,372
Advance, deposits & prepayments	195,330,696	202,181,020
Cash and Cash Equivalents	176,109,286	193,253,376
	946,193,359	1,041,964,578
Total Assets	1,929,179,740	2,062,534,304
Equity		
Share Capital	1,202,606,663	1,202,606,663
Retained Earnings	(201,880,270)	(160,720,414)
Revaluation Surplus	364,308,272	364,308,272
	1,365,034,665	1,406,194,521
Non-Current Liabilities		
Deferred Tax liabilities	88,967,617	96,825,484
Defined Benefit Liabilities	9,557,317	16,691,035
Lease Liabilities	2,538,875	11,765,567
	101,063,809	125,282,086
Current liabilities		
Lease Liabilities	2,534,472	6,580,309
Trade & Other Payable	149,549,855	136,419,787
Intercompany Payable	285,558,471	357,893,529
Tax Payable	25,438,468	30,164,072
	463,081,266	531,057,697
Total Equity & Liabilities	1,929,179,740	2,062,534,304

Mita Cosmetics Limited
Statement of Profit or Loss and Other Comprehensive Income
For the year ended 31 December 2021

	<u>31-Dec-21</u>	<u>31-Dec-20</u>
Revenue	1,600,764,406	1,748,884,859
Cost of Revenue	(1,315,916,521)	(1,454,793,930)
Gross Profit	284,847,885	294,090,929
Administration Expenses	(188,988,000)	(223,487,749)
Selling & Distribution Expenses	(108,033,833)	(105,010,343)
Other Operating Income	2,103,180	(2,980,569)
Profit Before Interest & Taxes	(10,070,768)	(37,387,732)
Finance Income	2,349,725	2,152,059
Finance Expenses	(4,912,215)	(3,945,798)
Foreign Exchange Gain/(Loss)	(1,765,107)	(32,960,117)
Profit Before Taxation	(14,398,365)	(72,141,588)
Current Tax Expenses	(34,619,358)	(60,344,755)
Deferred Tax Expenses	7,857,867	6,509,549
Net profit for the year	(41,159,856)	(125,976,794)
<i>Other comprehensive income</i>		
Revaluation of Property, Plant & Equipment	-	385,828,272
Less: Related Tax	-	(21,520,000)
Total Comprehensive Income	(41,159,856)	238,331,478

Requirements:

- i) Analyse and comment on the financial statements of Mita Cosmetics Limited. 10
 - ii) Identify and assess risks for your audit of MCL financial statements. Design audit procedures to address those risks. 5
4. You are an audit manager of Khan Bahadur & Co. who is in charge of the audit of Prima Doc Ltd. You have received an instruction note from your audit engagement partner Mr. Bahadur which contains:

The audit of the financial statements of Prima Doc Ltd. for the year ended 30 June 2022 is nearly complete and the auditor's report is due to be issued after the meeting scheduled with management within the next two (2) weeks. The draft financial statements recognize profit before taxation for the year of BDT 324 mn million and total assets of BDT 2,220 million. The Audit Supervisor has drafted the following points:

Intangible Assets

Prima Doc incurred BDT 240 million during the year on research and development. BDT 204 million of this expenditure has been capitalized while BDT 36 million has been expensed. The Audit Supervisor has proposed that an additional BDT 48 million should be expensed since it does not meet the criteria in IAS 38 Intangible assets for recognition as an asset. The Finance Director is of the opinion that the BDT 48 million does meet the criteria specified by the standard.

Legal claim

On 25 June 2022, the company's directors received a legal claim from a client regarding the malfunctioning of the accounting software bought on 1 March 2022. The client is demanding a refund of BDT 1,440,000. It is alleged that Prima Doc's engineers have failed to rectify the problem. The company's lawyers have advised that there is a 10% chance that Prima Doc will lose the case. Included in the draft financial statements is a provision of BDT 144,000 (10% X 1,440,000). The Audit Supervisor is of the opinion that the provision is unnecessary although no audit procedures have been carried out.

Earnings per Share (EPS)

The draft financial statements for the year ended 30 June 2022 show EPS of BDT 0.60. The Audit Supervisor has discovered that the EPS is overstated because the preference dividends have not been deducted from the earnings in the computation of EPS. The correct EPS is BDT 0.58. I have confirmed the accuracy of the Audit Supervisor's computation. The Finance Director, however, is proposing that no correction should be made because the difference is immaterial.

Uncorrected misstatements on receivables

The Audit Supervisor has sent me an email regarding uncorrected misstatements on receivables. He wants me to advise him on the action to take, if any. My conclusion was that the uncorrected misstatement is clearly trivial.

Requirements:

I want you to make a memorandum which will cover the following:

- a) Describe the auditors' responsibility regarding the uncorrected misstatement in receivables. 2
 - b) For each of the above points: (i) Comment on the matters you should consider, and (ii) The evidence you should expect to find, in undertaking your review of the audit working papers and draft financial statements of Prima Doc. 15
 - c) Describe the audit procedures which should be carried out to obtain sufficient and appropriate audit evidence in relation to a legal claim. 5
5. You are currently auditing Agro Food Processing Limited (AFPL) which has a factory in a village of Rangamati and head office in Dhaka. Primary products are agro based items which has very short shelf life. You firm have recently been appointed as auditor of AFPL as the previous auditors resigned on the ground that engagement was no longer commercially viable for them. Mr. Jayanta, engagement partner, met with the Mr. Hassan, MD of AFPL, on several professional events and had a good relationship. When Mr. Hassan offered Mr. Jayanta to be the auditor of AFPL, Mr. Jayanta accepted the appointment based on their good relationship.

You have received and analysed the financial statements of AFPL. You have checked the underlying accounting records and noticed that prior year auditor fees are still pending. You have also noted that local holding tax for its factory premises has not been paid for last 5 years. You have also noticed AFPL reported payable to a customer from whom no purchase was made. Upon inquiry to management, you have come to know that local Union Parishad (City Council) has doubled the holding tax for AFPL on the ground that AFPL factory is causing noise and environmental pollutions. AFPL has disagreed with the increased holding tax and stopped paying the tax entirely until the issue is settled. However, AFPL is making provisions against annual holding tax payable. You have noticed that the total tax outstanding is insignificant for the company.

Your inquiry also found out that last year a customer has paid AFPL twice for the same invoice. AFPL management showed that they have sent a letter to the customer informing about the double payment. AFPL has the banking details of the customer but is not remitting the excess receipt to the customer as has not claimed the amount. It is AFPL policy to extinguish unpaid liability over three years by recognizing it as income.

In relation to unpaid audit fees, AFPL management has informed that prior auditor has not placed any invoice. Hence the fee remains payable. Management has not taken any action to notify prior auditor to raise invoice. You then remembered that you have not received any clearance from prior year auditor. Also, they have not given access to their working papers for the previous year.

Form your analysis you have also noticed that significant portion of inventories remained unsold at the end the year end. Your analysis of the company also shows that AFPL has been facing liquidity issues as it is facing difficulties in collecting from some customers. Accordingly, they are trying to match the cash flows by deferring the payments to the vendors. This practice by AFPL has led to bitter relationships with its suppliers.

Requirements:

- a) Identify and explain ethical issues involved for the audit firm & the client. 8
- b) Identify and assess the risks of material misstatements. Design appropriate audit procedures to address the identified issues & risks. 7

---The End---