CORPORATE REPORTING

Suggested Answers
November-December 2024

Answer to the Question# 1:

Consolidated Statement of Financial Position
As at 30 June 2024

	Lumina	Vista	Consol Adj	Consolidated
Assets				
Non-current assets				
Property, plant and equipment	300,243,199	42,278,420		342,521,619
Right of use assets	11,482,645	529,148		12,011,793
Goodwill (W-6)	-	-	4,412,230	4,412,230
Investments (W-9)	50,540,627	1,313,802	(34,284,883)	17,569,546
	362,266,471	**44,121,370**		376,515,188
Current assets				
Inventories (W-3)	145,173,219	21,197,393	(110,000)	166,260,612
Inter-company receivables	50,518,204	20,742,592	(71,260,796)	-
Trade and other receivables (W-3)	568,791,834	26,875,982	(750,000)	594,917,816
Advances, deposits and prepayments	59,885,975	3,394,220		63,280,195
Cash and cash equivalents (W-3)	48,671,355	9,983,786	750,000	59,405,141
	873,040,587	**82,193,973**		**883,863,764**
Total assets	**1,235,307,058**	**126,315,343**	**(101,243,449)**	**1,260,378,952**
Equity				
Share capital	100,000,000	30,000,000	(30,000,000)	100,000,000
Retained earnings (W-8)	314,395,609	24,339,622	(10808,578)	**327,926,653**
Non-controlling interest in Vista(W-7)	-	-	10,845,925	10,845,925
Total equity	**414,395,609**	**54,339,622**		**438,772,578**
Liabilities				
Non-current liabilities				
Employee benefits	25,974,211	1,055,500		27,029,711
Lease liability	8,140,246	346,360		8,486,606
Deferred tax liabilities	5,006,951	3,174,689		8,181,640
Long term bank loans	28,215,686	-		28,215,686
	67,337,094	**4,576,549**		**71,913,643**
Current liabilities				
Lease liability- current portion	3,117,070	214,213		3,331,283
Bank overdrafts	100,998,879	327,171		101,326,050
Short term borrowing	453,920,700	12,938,858		466,859,558
Trade and other payables	174,795,114	3,400,726		178,195,840
Inter-company payables	20,742,592	50,518,204	(71,260,796)	-
	753,574,355	**67,399,172**		**749,712,731**
Total liabilities	**820,911,449**	**71,975,721**		**821,626,374**
Total equity and liabilities	**1,235,307,058**	**126,315,343**	**(101,243,449)**	**1,260,398,952**

Consolidated Statement of Profit or Loss and Other Consolidated Income
For the year ended 30 June 2024

	Lumina	Vista	Consol Adj	Consolidated
Revenue (W-3)	674,853,449	82,225,297	(1,100,000)	755,978,746
Cost of sales (W-3)	(420,966,247)	(58,463,160)	1,100,000	(478,329,407)
Cost of sales – PURP (W-3)	-	(110,000)	-	(110,000)
Gross profit	**253,887,202**	**23,652,137**		**277,539,339**
Other income	18,750,882	1,238,609		19,989,491
Income from Associate (W-2)	186,662	-	-	186,662
Admin, selling and distribution expenses (W-4)	(187,225,197)	(14,110,542)	(80,000)	(201,415,739)
Operating profit	**85,599,549**	**10,780,204**		**96,299,753**
Finance costs, net	(10,998,847)	(3,505,213)		(14,504,060)
Profit before contribution to WPPF	**74,600,702**	**7,274,991**		**81,795,693**
Contribution to WPPF	(3,720,702)	(369,250)		(4,089,952)
Profit before tax	**70,880,000**	**6,905,741**		**77,705,741**
Income tax expenses	(17,188,365)	(1,800,406)		(18,988,771)
Deferred tax income/(expense)	2,493,462	169,698		2,663,160
Profit after tax	**56,185,097**	**5,275,033**		**61,380,130**
Other comprehensive income	(1,677,213)	-		(1,677,213)
Total comprehensive income	**54,507,884**	**5,275,033**	**(80,000)**	**59,702,917**

Profit attributed to:

Non-Controlling Interest (5,275,033 x 20%) =1,055,007
Profit attributed to Lumina (59,702,917-1,055,007) =58,647,910
Total Consolidated profit **= 59,702,917**

Workings 1: Group Structure

- Lumina owns 80% shares of Vista Limited indicating that Lumina has significant control over Vista. Therefore, financial statements of Vista will be included in the consolidation process.
- Although Lumina owns only 25% shares in Arcadia Limited, Lumina's chairman also owns 35% shares on personal level. Each entity has common shareholder and majority shares (25%+35% =60%) of Arcadia is jointly owned by Lumina and its chairman. Despite controlling majority shareholding, both investors need to act together to collectively control an investee. According to para 9 of IFRS 10, when no investor can direct the activities without the co-operation of the others, no investor individually controls the investee and should not include in consolidation. Therefore, Lumina should account Arcadia as an associate and account for the investment under equity method.

Workings 2: Increase of investment in associate

- As Lumina will be accounted for in equity method, investment will be increased by net profit of Arcadia allocated to Lumina.
  PAT reported by Arcadia = 746,647 x 25% = 186,662
  Less: Excess Depreciation as Per Lumina's Policy = 80,000
  = 666,647 x 25% = 166,662

  Excess Depreciation:
  Depreciation as per Lumina's Policy = 2,000,000/5 = 400,000
  Less: Depreciation as per Arcadia's Policy = 2,000,000*.80*.2 = 320,000
  = 80,000
  Following entry will be posted in Lumina's books:

  Investments Dr. 166,662
  Other income Cr. 166,662

Workings 3: Omission of intra-group transactions and balances

- Intercompany Receivables and Payables need to be omitted in the consolidation process.
- Cash payment by Lumina at the year-end has not yet been received by Vista. It is a timing difference. Therefore, Vista need to consider it as receipt and adjust it from trade receivables. In the consolidation process, Trade receivable will be reduced by 750,000 and cash will be increased.
- During the year Vista sold inventory of BDT 1,100,000 to Lumina earning 10% margin. Entire inventory remained unsold at Lumina's warehouse. This intra-group transaction will be removed in the consolidation. Furthermore, unrealized profit will be removed from seller's profit or loss and retained earnings. It will be done by following entry:

Vista Sales	Dr	1,100,000	
Lumina CoS	Cr.		1,100,000

There is unrealized profit of (1,100,000 x 10% = 110,000) which need to be removed from inventory by following entry:

Vista CoS	Dr.	110,000	
Lumina inventories	Cr.		110,000

Workings 4: Consolidation Schedule of P&L

	Lumina	**Vista**	**Consol Adj**	**Consolidated**
Revenue	674,853,449	82,225,297	(1,100,000)	755,978,746
Cost of sales	(420,966,247)	(58,463,160)	1,100,000	(478,329,407)
Cost of sales - PURP	-	(110,000)	-	(110,000)
Other income	18,750,882	1,238,609		19,989,491
Income from Associate	186,662	-	-	186,662
Admin, selling and distribution expenses	(187,225,197)	(14,110,542)	(80,000)	(201,415,739)
Finance costs, net	(10,998,847)	(3,505,213)		(14,504,060)
Contribution to WPPF	(3,720,702)	(369,250)		(4,089,952)
Income tax expenses	(17,188,365)	(1,800,406)		(18,988,771)
Deferred tax income/(expense)	2,493,462	169,698		2,663,160
Profit after tax	**56,185,097**	**5,275,033**	**(80,000)**	**61,380,130**

Attribution of Vista's Profit:

Non-controlling interest = 5,275,033 x 20% = 1,055,007
Lumina interest = 5,275,033 x 80% = 4,220,026

Workings 5: Calculation of net Asset in Vista:

Particulars	Balance Sheet Date	Acquisition Date	Post Acquisition
Share Capital	30,000,000	30,000,000	-
Retained Earnings	24,339,622	8,234,713	16,104,909
PURP	(110,000)	-	(110,000)
	54,229,622	**38,234,713**	**15,994,909**
Share of Lumina (80%)		30,587,770	12,795,927

Workings 6: Calculation of Goodwill in net asset method:

Cost of investment (Consideration transferred)	35,000,000
Less: Net asset acquired (working-6)	30,587,770
Goodwill acquired	**4,412,230**

Workings 7: non-controlling interest:

Net asset of Vista on 30 June 2024 (Working-6)	54,229,622
Non-controlling percentage	20%
Non-controlling interest	**10,845,924**

Workings 8: Retained Earnings:

Reported retained earnings of Lumina	314,395,609
Add: Share of retained earnings in Vista (W-6)	12,795,927
Add: Share of Post acq. RE of Arcadia (2,940,467-80,000)*25%)	715,117
Consolidated Retained Earnings	**327,926,653**

Workings 9: Elimination of Investments

Increase in Investment in Arcadia (W8)	715,117
Elimination of Investment in Vista	(35,000,000)
	34,284,883

Answer to the Question# 2 (a):

The financial statements have not been appropriately prepared. Followings are the deviations from IFRSs which need to be corrected.

a) ***Inter-unit transactions***

Inter-unit transactions have not been removed while preparing the financial statements which lead to overstatement of total assets and total liabilities both in the financial statements. Transactions like loan given to inter-units and credit sales to inter-units are within the company. Therefore, it does not create any asset, liability or revenue for the company. Hence, reporting these inter-unit transactions leads to overstatement of company's financial statements.

In order to correct the financial statements, inter-unit transactions need to be omitted while preparing the consolidated financial statements. Therefore, transactions like Loan to Unit – II, Receivable from Unit-I, Loan from Unit-I, Payable to Unit-II and inter-unit Sale and purchase need should be removed.

b) ***Unrecorded gratuity liability:***

Daily Fashion Limited has contractual obligation toward the employees which has not been recognized in the financial statements. Current practice is to pay off the gratuity when an employee leaves the organization and expense the payment. Estimated gratuity liability is BDT 8,970,000 and expense for the current year is BDT 2,170,000 and BDT 1,950,000 in the previous year. The entity should recognize the liability on accrual basis instead of cash basis which violates the accounting principles

It appears that the liability and the expense would be material. Hence, the liability should be recognized restating in the financial statement as on 1 January of 2022. DFL should recognize expense and liability of BDT 2,170,000 in 2023 and BDT 1,950,000 in prior year. Rest liability of BDT 4,850,000 should be recognized after adjusting the opening balance of comparative year retained earnings. . Gratuity obligation should be split between current and non-current liability depending on expected year of payment

c) ***Correction of error:***

The asset was disposed in prior year but not removed from asset register. Erroneously it has charged depreciation for the full year. Furthermore, it has not recognized the loss on disposal as well. These errors have been corrected by adjusting the current year opening balance of retained earnings. However, this correction is not appropriate.

Correct adjustments of the error would be to recognize the disposal loss of BDT 550,000 in 2022, and reverse half of the depreciation (BDT 50,000) charged on this asset.

d) ***Deferral of FDR liquidation:***

Bank has refused to liquidate the matured FDR of BDT 1,500,000 for 6 months without interest. The entity has not recognized any credit loss on this in accordance with IFRS 9.

The entity should recognize a loss by calculating the present value of amount to be received after 6 months. As the FDR was done for a year at 10%, the entity is expected to receive BDT 1,500,000 + 150,000 =

1,650,000 on maturity value. Present value of these amount is 1,650,000/ (1+(10%/2)) = 1,650,000/1.05 = 1,571,429. Therefore, the loss is 78,571 which should be recognized in the current year profit or loss. In addition, this present value of FDR should be recognized in current asset.

Furthermore, the entity should perform impairment review on the entire FDR as per IFRS 9.

Answer to the Question# 2 (b):

Analyze and comment on the overall financial statements after adjustment:

<u>Current Ratio:</u>

For 2023: Current Asset/Current Liabilities
= (662,890,763 - 168,924,490 + 1,571,429)/ (694,675,760 - 168,924,490)
= 0.94

For 2022: Current Asset/Current Liabilities
= (732,928,371 - 125,082,412 + 1,500,000)/ (815,097,879 - 125,082,412)
= 0.88

Comment:
Current ratio for 2023 was 0.94 which has increased from 0.88 of the prior year. This shows slight improvement in working capital management. This Daily Fashion Limited has almost full capability to pay off its current obligation with its current asset. However, as the current ratio is still below 1, there is still room for improvement. It can be achieved by investing in working capital.

<u>Quick Ratio:</u>

For 2023: (Current Asset- inventories)/Current Liabilities
= (662,890,763 - 168,924,490 + 1,571,429 - 221,543,851)/ (694,675,760 - 168,924,490)
= 0.52

For 2022: Current Asset- inventories)/Current Liabilities
= (732,928,371 - 125,082,412 + 1,500,000 – 367,505,422)/ (815,097,879 - 125,082,412)
= 0.35

Comment:
Quick ratio shows how quickly current liability can be met by the liquid assets. Considering the inventory as most illiquid asset, quick ratio has been calculated. Quick ratio in 2023 is only 0.52 which has improved from prior year quick ratio of 0.35. This shows that although there has been improvement in quick ratio, but the ratio is very low. Significant investment in liquid current asset is required to improve the ratio.

<u>Debt to Equity Ratio:</u>

For 2023: Total interest-bearing debt/ Total equity
= (Term Loan + Lease Liabilities + Gratuity Liabilities)/(Total Equity – Gratuity liability – disposal loss – loss on FDR)
= (94,441,582+ 36,283,628+ 76,655,041+ 5,985,117+ 8,970,000)/ (286,163,136 - 8,970,000 - 550,000 + 50,000 - 78,571)
= 0.80

For 2022: Total interest-bearing debt/ Total equity
= (Term Loan + Lease Liabilities + Gratuity Liabilities as of 2022)/ (Total Equity – Gratuity liability as of 2022 – disposal loss)
= (64,023,883+ 31,678,805+ 94,021,108+ 1,023,853 + 1,950,000 + 4,850,000)/ (278,636,590 - 1,950,000- 4,850,000 - 550,000 + 50,000)
= 0.73

Comment:

Debt to equity ratio shows the gearing level in entity's capital structure. Debt to Equity ratio in 2022 was 0.73 which has increased to 0.80 in 2023. In 2023, debt has increased in the capital structure. In both years, the debt is too high in the capital structure. This shows DFL is a highly geared company. It would face difficulties to serve the loans if income level decreases.

Gross Profit margin:

For 2023: Gross Profit/ Revenue
= 126,393,222/1,016,582,641
= 12.43%

For 2022: Gross Profit/ Revenue
= 128,883,759/1,190,986,602
= 10.82%

Comment:
Gross profit margin of DFL was 12.43% which has increased from 10.82% in the previous year. This shows that gross profit margin has increased in 2023. However, company's overall gross profit has decreased as the revenue has decreased significantly.

Net Profit margin:

For 2023: Net Profit – Gratuity Expenses – loss on FDR/ Revenue
= (17,503,214 - 2,170,000 -78,571)/1,016,582,641
= 1.5%

For 2022: Net Profit – Gratuity Expenses – Loss on disposal + Depreciation added back / Revenue
= (18,057,254 - 1,950,000 -550,000 + 50,000) /1,190,986,602
= 1.3%

Comment:
Company's net profit margin is 1.5% which has increased barely by 1.3% from prior year. Although the net profit percentage has increased, the net profit is still at very low level compared to market return. DFL is unable to provide sufficient return for the shareholders where the bank interest rate is 10%.

Other Financial Analysis:

Revenue Growth = (Current year revenue-Prior Year revenue)-1
= (1,016,582,641 - 1,190,986,602)-1
= -14.6%

Comment:
During the year company had negative revenue growth. DFL experienced a decline of revenue by 14.6%. This is significant decline in revenue indicating weakness in company's performances. However, despite significant decline in revenue, entity's net profit is still positive and slightly increased. This clearly indicates that DFL has increased operating efficiency by reducing costs. DFL should aim to increase operating efficiency.

Answer to the Question# 3 (a):

IFRS accounting treatment:

(1) Goodwill arising on a business combination

Per IFRS 3, Business Combinations, goodwill should be calculated as the excess of the fair value of the consideration transferred plus any non-controlling interest less the fair value of the net assets acquired. When calculating goodwill, all three elements of the consideration not just the cash element should therefore have included.

The fair value of any quoted equity investments should have been taken as the market price at the acquisition date. The deferred consideration should have been accounted for as a liability at the present value of the amount payable.

Consideration is therefore:

	BDT Million
Cash	20.0
Ordinary shares (5.2 million x 13)	67.6
Deferred consideration (20/1.08)	18.52
	106.12

The ordinary shares should be credited to ordinary share capital (BDT 52 million = (5.2*10)) and share premium (BDT 15.6 million = {5.2*(13-10)}) in the books of GSC).

The discount on the deferred consideration should be unwound for the period 1 July 2024 to 31 December 2024. This would give a finance cost of BDT 0.74 mn ((20m – 18.52 m) x 6/12). At 31 December 2024, the deferred consideration would be shown as a current liability of BDT 19.26 mn (18.52 mn + 0.74 mn).

Per IFRS 3, the calculation of the fair value of net assets acquired should have included recognition of BIP's contingent liability, in spite of the fact that this will not have been recognised in BIP's statement of financial position. The liability existed at 1 July 2024 as the proceedings commenced on 15 june 2024. Once recognised, the contingent liability should be carried at the higher of the amount under IAS 37 (here Nil) and the fair value at the acquisition date of BDT 39 million, therefore BDT 39 million should be used.

Fair value of net assets acquired is therefore:

	BDT Million
Share capital and retained earnings at 31 December 2024 (10 X 10 + 18.5) m	118.5
Less: Profit 1 July 2024 to 31 December 2024 (6/12 x 12.7 m)	(6.35)
Contingent liability	(39.00)
	73.15

When calculating goodwill, CFO should have used the fair value method to value the non-controlling interest instead of proportionate net asset method, as agreed by the board. Goodwill should therefore be calculated as:

	BDT Mn
Fair value of consideration	106.12
Fair value of non-controlling interest	42.0
Fair value of net assets acquired	(73.15)
	74.97

Intangible assets in the consolidated statement of financial positon as at 31 December 2024 will therefore be increased by 5.25 million (74.97 mn – 69.72 mn). An impairment review in accordance with IAS 38, Intangible Assets, should be carried out on this goodwill at every year end.

Non-controlling interest at 31 December 2024 will be stated at BDT 43.27 million (42 m + (6.35m x 20%).

(2) Share issues

Equity instruments reacquired by the entity which issued them are known as treasury shares. Treasury shares should be deducted from equity, and shown as a separate (ie negative) reserve. The original share capital and share premium amounts remain unchanged. No gain or loss should be recognized on the issue, sale, purchase or cancellation of treasury shares.

Treasury Stock Dr- 78 Million
Cash Cr – 78 Million

The bonus issue was based on the correct number of shares (ie 133 mn shares– see (b)) so 33.25 mn shares were issued, and ordinary share capital should be credited with this amount.

Assuming that GSC wishes to maximize distributable profits, the premium should firstly be charged to the share premium account, with the balance going to retained earnings.

Share Premium Acc. Dr – 220
Retained Earnings Dr – 112.5
Ordinary Share Capital Cr- 332.5

(3) Related party transaction

Salvation Pipes is wholly-owned by one of the close family members of a member of GSC's key management personnel, so this is a related party of GSC as per IAS 24. Mr. Faruk and his son are also related parties of GSC. This transaction with Salvation is therefore a related party transaction.

Disclosure is required of all related parties and related party transactions amount, nature and balance due, even if the transactions took place on an arm's length basis. The fact that the transactions took place on an arm's length basis may be disclosed, but only if such terms can be substantiated.

Disclosure should be made of:

- The nature of the relationship (a company owned by the son of a key management personnel of GSC)
- The amount of the transactions (BDT 15 mn)
- The amount of any balances outstanding at the year- end (BDT 4 mn)
- Any provision against outstanding balances and the expense recognised for bad or doubtful debts due from related parties (BDT 1.5 mn).

There is no requirement to identify related parties by name.

Since Salvation is in financial difficulties, consideration should be given to making an allowance for the remainder of the debt, ie for an additional BDT 2.5 mn (4 – 1.5).

(4) Revenue recognition

Per IFRS 15, Revenue, where a package of goods and services is sold then the components of the package should be identified, measured and recognized as if sold separately.

If the total of the fair value exceeds the overall price of the contract the same discount percentage should be applied to each separate component, unless specific discount rates are known.

In this case a package with a usual retail price of BDT 13 mn has been sold for BDT 10.4 mn, i.e; at a discount of 20%. The two components of the package should be split out and accounted for as follows:

Equipment: Revenue of 8.8 mn (11 x 80%) should be recognised in the year ended 31 December 2023 because the equipment was sold in the year and therefore the risks and rewards of ownership were transferred.

Support services: Revenue of BDT 1.6 mn (2 x 80%) should be accounted for based on the stage of completion. In the absence of other information, on a straight-line basis over the period of the contract (12 months). In the year ended 31 December 2024 only 3/12 of the 1.6 mn should be recognised as revenue, i.e; 0.40 mn.

Alan has therefore overstated revenue (and profit for the year) by BDT 1.2 mn (10.4 – 8.8 – 0.40) and understated liabilities (deferred income) by the same amount.

Answer to the Question# 3 (b):

Ethical issues:

Faruk's financial accounting knowledge seems lacking, given that he failed to take the contingent liability and the deferred consideration into account when calculating goodwill. As an ICAB Chartered Accountant, he is obliged to comply with the ICAB code of ethics, including the principle of professional competence and due care, and should keep his knowledge up to date.

He makes other "errors", all of which have the effect of either understating the number of ordinary shares in issue, or overstating the profit for the year, with the result that EPS for the current year, to which Faruk's bonus is linked, is massively overstated. There is a clear self-interest threat here for Faruk. In accordance with the code of ethics, Faruk should have ignored this self- interest threat and calculated the figures accurately, in accordance with the principles of objectivity, independence and professional behavior.

The fact that Faruk has failed to disclose the related party relationship/transaction with his son's company also points to a possible lack of integrity.

We should take the following action:

- Discuss each of the errors found with Faruk, explaining the correct IFRS accounting treatment to him.
- If Faruk appears genuinely to be out of date tactfully suggest that he goes on an update IFRS course arranged by ICAB.
- Ensure that the financial statements are corrected by rectifying all identified misstatements.
- If Faruk refuses to amend the financial statements seek support from the managing director and refer to the audit committee in the meeting between external auditor and audit committee.
- Document all discussions.

Answer to the Question# 4 (a):

Ethical issues and Evaluation of Appointment in compliance with law

Ethical Issues in GSL's Business Operations

► **Related Party Transactions**
GSL has engaged a consulting firm for market analysis which is owned by CEO's brother. This has created a potential self-interest threat as there is a risk of favoritism in selecting the consulting firm. Furthermore, there is risk of inappropriate of capitalizing and amortizing the payment. This could compromise integrity and objectivity. In order to ensure transparency as per IAS 24 (Related Party Disclosures), it is critical to make proper disclosure of the related-party transactions.

► **Revenue Recognition and Asset Valuation**

GSL has not created a bad debt allowance for the BDT 1,500,000 outstanding from NeoTech Limited (NTL) despite its known financial distress. Management's decision will lead to overstatement of receivables and understatement of expenses. This will potentially mislead stakeholders about entity's financial position and performance. This undermines the ethical principle of faithful representation. GSL should recognize Expected Credit Loss following the IFRS 9.

► **IT Manager's Role in Financial Reporting**

The IT manager is responsible for maintaining the accounting system. However, he has been maintaining recording transactions and preparing financial statements despite lacking formal accounting expertise. Combining roles increases the risk of errors and fraud due to the lack of segregation of duties. This undermines professional competence and creates an advocacy threat. Management's decision may compromise financial reporting quality and the reliability of internal controls. Also, assisting him on accounting standards related issues create self-review threat to us.

► **IT Risks and Security**

GSL's website domain renewal lapse and the lack of an updated SSL certificate exposes sensitive customer data and operational continuity to significant risk. This negligence compromises customer trust and could lead to ethical breaches concerning data protection and confidentiality. These lapses could result in reputational damage and potential legal ramifications under data protection laws.

► **Urging auditor to start audit without obtaining professional clearance**

GSL has urged its auditor to start the audit in order to complete the audit on earliest. Indirectly the entity is restricting auditor to communicate with prior year auditor. This has created independence risk.

Evaluation of Compliance with the Companies Act, 1994 of Bangladesh

- ► **Validity of AGM**

  According to the companies Act, 1994, auditor is required to be appointed in the AGM which needs to be hold within 9 months from the financial year end unless permission obtained from RJSC beforehand. As GSL has year-end on 30 June 2023, it is required to hold its AGM by 31 March 2024. However, GSL has held its AGM on 30 April 2024 which exceeded the timeline. Although it is not clear whether GSL has obtained permission from RSJC beforehand or not. If no permission was obtained, GSL has violated the law and validity of the AGM will be in question. Accordingly, appointment of by GSL might become invalid.

- ► **Accepting engagement without professional clearance**

  According to ISA, professional clearance is required from prior year auditor before accepting an engagement. According to ICAB bye-laws, if prior year auditor does not reply within 14 days, incoming auditor may proceed to accept the engagement. In case of GSL auditor appointment, auditor has sent professional clearance to prior year auditor for which no response has been received. However, the new auditor has accepted and initiated the audit without waiting 14 days.

Based on these, it appears that appointment of my firm is not compliant with the applicable laws and regulations.

Answer to the Question# 4 (b):

Potential Risks from GSL's Business Environment

1. **Sole dependence on E-commerce**:

   GSL's entire business model is based on its e-commerce site gadgetshop.com. As GSL's revenue is entirely online based, its revenue generation and business can be disrupted very easily in case unavailability of internet, restriction by government agency, unavailability of domain or hosting servers.

2. **Inaccessibility of website due to missed renewal impacting revenue generation.**

   Website domain address (site address) and its hosting need to be renewed in order to be remain active and accessible for internet users. However, if domains and hosting is not renewed regularly, site will become unavailable to the users causing service disruption. Furthermore, the website will become available for purchasing by anyone. If third party takes this opportunity and buys the domain address, GSL will not be available to use the website anymore. The website will be out of GSL's hand and new owner can exploit it to earn money or damage GSL reputation.

3. **Data security risk due to lack of SSL certification**:

   An SSL certificate is a digital certificate that authenticates a website's identity and enables an encrypted connection. Lack of SSL certification indicate risks to continuity and customer data security. When customers transact over an unsecured site, they become exposed to breach of confidential data including personal and financial data. Furthermore, GSL itself faces cyber security threats including risk of being hacked.

4. **Elevated customer credit risk**:

   NeoTech Limited (NTL) is a regular customer of GSL. However, receivables of BDT 1,500,000 from NTL have been outstanding for long time. This indicates challenge of receivables collection and potential bad debts. Because of long outstanding receivables, customer credit risks have been elevated and GSL will require to recognize increased amount of expected credit loss.

5. **Risk of unreasonable transaction and conflict of Interest arising from related party transactions**:

   Appointing a related party (CEO's brother) for market analysis raises governance and valuation risks. Service compensation to the related party may not be done at arm's length price. Furthermore, there is potential for conflict of interest that related party appointment was to give benefit to the CEO's brother rather than considering his expertise on the subject matter.

6. **Inadequate accounting competence and lack of segregation of duties**:

   The IT manager has been given additional responsibility of maintaining the accounting software, recording transactions and preparation of financial statements. However, this is not the core expertise of IT manager, and he lacks sufficient training in accounting standards. This has created risks of misstatements either due to omission of transaction, inaccurate recording, improper classification and incorrect presentation. Furthermore, in absence of segregation of duties, susceptibility to errors or fraud has increased.

Answer to the Question# 4 (c):

Risk Assessment

In order to assess whether the identified risks contain significant risks or fraud risks, their likelihood of occurrence, impact on financial statements need to be evaluated. Below is the risk assessment for each identified risk and their impact on audit assertions:

1. Sole Dependence on E-commerce

Likelihood:

The entire business model depends on a single e-commerce platform, making it highly vulnerable to external disruptions like technical outages, government restrictions, or hosting/server issues. However, it is not very common that internet service is frequently disrupted. Therefore, the likelihood of occurrence is low.

Impact:

If the website becomes inaccessible, GSL's revenue generation and cash flows will be directly affected. Therefore, impact on financial statements is high.

Risk Conclusion:

As the impact is high but the likelihood is low, the risk is not a significant risk.

Account being impacted **:** Revenue
Assertions being impacted **:** Occurrence; Valuation.

2. Inaccessibility of Website Due to Missed Renewal impacting revenue generation.

Likelihood:

Missed domain/hosting renewals are avoidable with proper controls. However, likelihood of occurrence is high in absence of control as evident from recent missed renewal.

Impact:

If the domain is lost, it could irreparably harm business continuity and brand reputation. Therefore, impact on financial statements is high.

Risk Conclusion:

As both likelihood and impact are high, this risk is a significant risk.

Account being impacted **:** Revenue
Assertions being impacted **:** Occurrence; Measurement.

3. Data Security Risk Due to Lack of SSL Certification

Likelihood:

Absence of an SSL certificate significantly increases cyber threats. As SSL certificate has not yet installed, the likelihood of occurrence is high.

Impact:

Data breaches could expose GSL to financial losses, legal liabilities, and customer trust erosion. Therefore, impact on financial statements is high.

Risk Conclusion:

As both likelihood and impact are high, this risk is a significant risk.

Account being impacted **:** Administrative Expenses
Assertions being impacted **:** Occurrence; Measurement.

4. Elevated Customer Credit Risk (NTL Receivables)

Likelihood:
Long-outstanding receivables indicate poor credit management. This shows likelihood of incurring expected credit loss is high.

Impact:
GSL may require recognizing expected credit loss impacting profit. However, GSL may also recover in the future. Therefore, impact on financial statements is low to medium.

Risk Conclusion:
As the impact to the financial statements not high, this risk is not a significant risk.

Account being impacted **:** Trade Receivables
Assertions being impacted **:** Existence; Valuation.

5. Risk of Unreasonable Transaction and Conflict of Interest (Related Party Transactions)

Likelihood:
Appointing a related party (CEO's brother) without clear justification increases governance risks. As management has already appointed a related party for service, likelihood for happening it again is high.

Impact:
Unjustified payments could lead to improper expense classification or overstatement of expenses. However, the impact in the financial statements may not be high as the market analysis service was actually required.

Risk Conclusion:
As the impact to the financial statements not high, this risk is not a significant risk.

Account being impacted **:** Administrative Expenses
Assertions being impacted **:** Occurrence; Completeness; Measurement.

6. Inadequate Accounting Competence and Lack of Segregation of Duties

Likelihood:
Assigning accounting tasks to untrained personnel significantly increases error risks. Therefore, likelihood of error is very high.

Impact:
Errors in transaction recording or financial statement preparation can lead to material misstatements. Therefore, the financial impact is very high.

Risk Conclusion:
As both the likelihood and impact are both high, this risk contains a significant risk.

Account being impacted **:** All significant Accounts
Assertions being impacted **:** Existence/Occurrence; Completeness; Measurement/ Valuation; Rights & Obligation; and Presentation & Disclosure.

Answer to the Question# 4 (d):

<u>General and Specific Audit procedures to address significant risks:</u>

Risk 1: Inaccessibility of Website Due to Missed Renewal

<u>General Audit Procedures</u>

- Understand the renewal process for the website domain and hosting, including responsible personnel and timelines.
- Evaluate the design and implementation of controls for tracking and renewing the domain and hosting.
- Perform a walkthrough of the domain renewal process to identify potential control gaps.
- Assess the impact of missed website availability on GSL's revenue through discussions with management and review of records.

Specific Audit Procedures

- Inspect the domain and hosting renewal agreement and confirm renewal timelines, terms, and conditions.
- Review evidence of payment for domain and hosting renewal (e.g., payment receipts, bank statements).
- Confirm whether the website was accessible throughout the audit period by reviewing IT logs or external evidence (e.g., customer feedback or downtime reports).
- Perform a trend analysis of revenue to identify potential reductions during the February website inaccessibility.
- Obtain and evaluate management's assessment of the financial and operational impact of the missed renewal and assess if it is adequately disclosed in the financial statements.

Risk 2: Data Security Risk Due to Lack of SSL Certification

General Audit Procedures

- Understand the IT system's cybersecurity framework, focusing on SSL certification and other measures in place.
- Assess the adequacy of internal controls over cybersecurity and customer data protection.
- Review the policies and procedures for addressing IT risks and data breaches.

Specific Audit Procedures

- Inspect evidence of SSL certificate procurement and determine whether it was installed during the audit period.
- Conduct inquiries with the IT team about incidents involving cybersecurity threats or data breaches.
- Inspect system logs for any suspicious activities or unauthorized access to customer data.
- Review administrative expense accounts to confirm the proper recording of cybersecurity-related expenses, ensuring occurrence and classification.
- Evaluate management's disclosures related to cybersecurity risks and assess whether the financial impact of potential data breaches has been considered.

Risk 3: Inadequate Accounting Competence and Lack of Segregation of Duties

General Audit Procedures

- Understand the roles and responsibilities assigned to the IT manager and assess their suitability.
- Evaluate the internal controls over financial reporting, focusing on segregation of duties.
- Assess management oversight and monitoring processes to mitigate the risks of misstatements or fraud.

Specific Audit Procedures

- Review the qualifications of the IT manager to assess their competence in accounting and financial reporting.
- Test a sample of journal entries for accuracy, completeness, and proper authorization, focusing on those prepared or modified by the IT manager.
- Inspect reconciliations prepared by the IT manager to confirm accuracy and proper review by senior personnel.
- Perform substantive tests on key accounts (e.g., revenue, receivables, payables) for accuracy, classification, and compliance with applicable financial reporting standards.
- Inspect supporting documents for unusual or significant transactions (e.g., large adjustments, manual entries) to identify potential misstatements.
- Evaluate the adequacy of disclosures in the financial statements regarding the financial reporting process and any control deficiencies.
- Consider the need for additional audit procedures, such as fraud testing or IT general controls testing, to address the increased susceptibility to errors and fraud.

Answer to the Question# 5 (a) (i):

Since the likelihood of winning the litigation is more likely than not, no provision would be required but still the chance of losing the case has been increasing 40% from 5%, hence this should be consider as contingent liabilities and provide a disclosure as per IAS 37. The auditor should carefully assess the disclosure in the financial statement as there’s a contingent liability..

However, the audit team should further re-assess the documentation risk to identify whether further risks are there for other cases. The auditor should consider raising the risk in the management letter as well. Considering exposure under the litigation, the auditor might ask for an independent legal assessment, as well.

Answer to the Question# 5 (a) (ii):

For such large number of similar cases, historical trend of litigation result may be used to estimate and recognize financial exposure from the group of customers. Based on historical outcome from a large number of instances, below amount needs to be recognized, unless otherwise decided upon specific assessment for each case (which will probably be impracticable)-

Provision required = 1,000 x 20% x 100,000 + 1,000 x 5% x (100,000 x 60%)
= 20,000,000 + 3,000,000 = 23,000,000

Answer to the Question# 5 (a) (iii):

Net realizable value of the customized machine
= Expected sale price- Cost required for further modification.
= 1.9 billion – 0,3 billion
= 1.6 billion

NRV adjustment = 2Bn – 1.6Bn = 400million.

Filing of bankruptcy is an indication that the customer was facing the issue for some time and event should be treated as an adjusting event.

Answer to the Question# 5 (a) (iv):

The company should have recognized full liability in 2023 with corresponding increase in goods/ inventory in transit-

Goods in transit	Dr.	Tk. (200 x110) million
Cash/bank	Cr.	Tk. (20x 110) million
Deferred LC	Cr.	Tk. (180x110) million

Since delivery was not complete by the end of 2023, the amount received from customer should have been recognized as a liability/ unearned revenue. The amount is material, hence a restatement would be needed.

Since the delivery was complete in 2024, revenue should be recognized in full in 2024 as follows-

Unearned revenue	Dr.	Tk. (20x110) million
Receivable	Dr.	Tk. (180x120) million
Cost of goods sold	Dr.	Tk. (200x110) million
Currency gain/loss	Dr.	Tk [20x (120-110)]million
Revenue	Cr.	Tk. (230x120) million
Goods in transit	Cr.	Tk. (200x110) million

At the end of the year, currency gain/loss would be recognized as follows-

Currency gain on receivable	=	210x (125-120) million
Currency gain on deferred LC	=	180x (125-110) million

Answer to the Question# 5 (a) (v):

Despite the fact that the company has appropriate process for procurement, the contract/ relationship with Mrs. Payel needs to be disclosed.

The profit or loss and financial position of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.

Answer to the Question# 5 (b):

Subject: Advice on Handling Allegations Related to Bank Collapse

1. Understand the Scope of Responsibility
   As joint auditors, the scope of your responsibility is limited to the areas assigned to your firm during the audit. Since your designated areas were deposits and property, plant, and equipment (PPE), your responsibility does not extend to advances unless there was evidence directly impacting your audit areas. Reliance on the other auditor's work for areas outside your scope is a standard practice, provided it was done in good faith.

2. Assess the Quality of Audit Work
   - Review your firm's audit documentation for deposits and PPE to ensure that your work complied with audit standards (ISA/IFRS) and professional guidelines.
   - Confirm that your firm did not overlook any red flags or indicators of systemic issues related to advances that could have indirectly affected your audit areas.

3. Collaborate with the Other Auditor
   Engage with the other auditor to understand their assessment of advances. This helps clarify whether their work complied with audit standards and whether any significant findings were omitted.

4. Communicate Transparently
   Prepare a public or formal statement addressing the situation. Key points to include:
   - Clarify your scope of work and explain that your audit responsibilities were limited to deposits and PPE.
   - Emphasize that your firm relied upon the other auditor's work for advances, in accordance with auditing standards.
   - Highlight the rigorous process your firm followed to fulfill its assigned audit responsibilities.

5. Cooperate with Investigations
   If a regulatory investigation or litigation arises, your firm should:
   - Cooperate fully with authorities.
   - Provide complete and accurate audit documentation to demonstrate your compliance with professional standards.
   - Highlight any concerns raised during the audit (e.g., the rumor about improper client assessments) and show how you evaluated their impact on your scope.

6. Evaluate Legal Liability
   Consult with your legal advisors to:
   - Assess the potential liability and risks your firm faces.
   - Determine whether the audit engagement letter contains any indemnity clauses that limit your responsibility.
   - Prepare a defense strategy if legal proceedings are initiated.

7. Strengthen Risk Management
   Take proactive measures to prevent similar situations in the future:

- Enhance communication and collaboration between joint auditors to ensure potential issues are addressed collectively.
- Conduct additional training on identifying systemic risks, even in areas outside the immediate audit scope.
- Implement a policy for documenting and escalating concerns (e.g., rumors) that may affect the overall financial health of the entity being audited.

8. Seek Professional Support
   Engage with your professional body (e.g., Institute of Chartered Accountants of Bangladesh) for guidance and support in navigating this situation. Professional bodies often have mechanisms to assist firms in dealing with allegations and defending their reputation.

Conclusion

While the current situation is challenging, your firm's primary defense lies in demonstrating that you adhered to audit standards within your scope of work. Transparent communication, cooperation with investigations, and proactive steps to address future risks will help mitigate reputational and legal damage.

---The End---