

HONG KONG INSTITUTE OF CPAs

CPD Programme

Practice Review Seminar

CASE 1

ABC LIMITED

AUDITED
FINANCIAL STATEMENTS

31 DECEMBER 2004

[Extracts only]

ABC LIMITED

Report of the directors

The directors present their annual report and the audited financial statements for the year ended 31 December 2004.

Principal Activity

The Company's principal activity is trading in toys.

Financial Statements

The loss of the Company for the year ended 31 December 2004 and the state of the Company's affairs at that date are set out in the financial statements on pages 5 to 12.

Dividend and Reserve

The Directors do not recommend the payment of a dividend or the transfer of any amount of reserve for the year ended 31 December 2004.

Fixed Assets

Movements in fixed assets during the year are set out in note 6 to the financial statements.

Directors

During the year, the following Directors held office:-

Mr. ABC
Mr. DEF

In accordance with the Company's Articles of Association, all directors retire from the Board and, being eligible, offer themselves for re-election.

ABC LIMITED

Report of the directors

(CONTINUED)

Directors' Interests in Contracts

No contracts of significance, to which the Company was a party and in which a director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Directors' Rights to Acquire Shares or Debentures

At no time during the year was the Company a party to any arrangements to enable a director of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Auditors

XYZ & Company have expressed their willingness to continue as auditors of the Company.

For and on behalf of the Board

Signed

Chairman

HONG KONG: 16 July 2005

Auditors' Report to the Shareholders of
ABC LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages 5 to 12 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Auditors' Report to the Shareholders of
ABC LIMITED
(Incorporated in Hong Kong with limited liability)

(CONTINUED)

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2004 and of its loss and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

Signed

XYZ & Company
Certified Public Accountants (Practising)
Hong Kong

Hong Kong: 16 July 2005

ABC LIMITED

Balance Sheet as at 31 December 2004
(Amounts in Hong Kong dollars)

<u>31/12/2003</u>	<u>NON-CURRENT ASSETS</u>	
\$1,934,566	Fixed assets	\$1,728,313
3,950,000	Investments in a subsidiary	4,375,000
<u>2,370,000</u>	Investments in an associate	<u>2,580,000</u>
<u>\$8,254,566</u>		<u>\$8,683,313</u>
	<u>CURRENT ASSETS</u>	
\$ 10,166,733	Cash and bank balances	\$1,235,679
21,940,745	Accounts receivable	26,673,876
1,754,326	Prepayments and deposits	2,347,059
1,896,234	Inventories	1,457,629
1,324,608	Amount due from a director	3,003,279
4,324,606	Amount due from a related company	4,975,961
<u>\$41,407,252</u>		<u>\$39,693,483</u>
<u>\$49,661,818</u>		<u>\$48,376,796</u>
	<u>CURRENT LIABILITIES</u>	
\$ 23,645,029	Accounts payable and accrued charges	\$34,157,246
<u>21,368,032</u>	Bills payable	<u>16,950,423</u>
<u>\$45,013,061</u>		<u>\$51,107,669</u>
	<u>SHAREHOLDERS' EQUITY</u>	
\$ 1,000,000	Authorised, issued and fully paid up (1,000,000 shares of \$1 each)	\$1,000,000
<u>3,648,757</u>	(Accumulated loss)/ Retained profits	<u>(3,730,873)</u>
<u>\$ 4,648,757</u>		<u>(2,730,873)</u>
<u>\$49,661,818</u>		<u>\$48,376,796</u>

The financial statements on pages 5 to 12 were approved and authorised for issue by the board of directors on 16 July 2005.

Signed

Director

Signed

Director

ABC LIMITED

Income Statement

For the year ended 31 December 2004
(Amounts in Hong Kong dollars)

01/01/2003 to 31/12/2003			
<u>\$ 207,456,259</u>	Turnover		<u>\$317,258,639</u>
	Less: Cost of sales:		
\$ 1,357,269	Opening inventory	\$ 1,896,234	
<u>144,462,061</u>	Purchases	<u>239,152,054</u>	
\$ 145,819,330		\$ 241,048,288	
<u>(1,896,234)</u>	Less : Closing inventory	<u>(1,457,629)</u>	
\$ 143,923,096			\$239,590,659
917,259	Packing charges		1,764,567
<u>7,165,038</u>	Transportation		<u>11,359,207</u>
<u>\$ 152,005,393</u>	Cost of sales		<u>\$252,714,433</u>
\$ 55,450,866	Gross profit		\$ 64,544,206
(49,475,209)	Less: Selling expenses		(66,543,265)
<u>(4,962,965)</u>	Less: General and administrative expenses		<u>(5,380,571)</u>
\$ 1,012,692	Profit/(Loss) before taxation		\$ (7,379,630)
(69,626)	Taxation		-
<u>\$ 943,066</u>	Profit/(Loss) after taxation		<u>\$(7,379,630)</u>
2,705,691	Retained profits brought forward		3,648,757
<u>\$ 3,648,757</u>	Retained profits/(Accumulated loss) carried forward		<u>\$(3,730,873)</u>

ABC LIMITED

Statement of Changes in Equity

For the year ended 31 December, 2004
(Amounts in Hong Kong dollars)

	Retained profits/ (Accumulated loss)
1 January 2003	\$2,705,691
Profit after taxation	<u>943,066</u>
31 December 2003	\$3,648,757
Loss after taxation	<u>(7,379,630)</u>
31 December 2004	<u>\$(3,730,873)</u>

ABC LIMITED

Notes to financial statements For the year ended 31 December 2004

1. GENERAL

The Company's principal activity is trading in toys. The Company is a wholly-owned subsidiary of PQR Limited, which is the Company's ultimate holding company and was incorporated in Hong Kong.

2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The financial statements have been prepared on a going concern basis on the basis that the shareholders of the Company have agreed to provide support to the Company.

3. PRINCIPAL ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention. The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are set out below:

a) Inventories

Inventories are stated at the lower of cost and net realisable value.

b) Related Company

Related company is a company in which a shareholder and/or a director of the Company is also a shareholder/director of the related company.

c) Investments in a subsidiary

The result of subsidiary is accounted for on the basis of dividends received and receivable during the year. Investments in subsidiaries are included in the balance sheet at cost less any identified impairment loss. No consolidated financial statements have been prepared as the Company is a wholly-owned subsidiary of PQR Limited.

d) Investments in an associate

The result of associate is accounted for on the basis of dividends received and receivable during the year. Investments in associate are stated at cost, as reduced by any identified impairment loss.

ABC LIMITED

Notes to financial statements
For the year ended 31 December 2004

e) Impairment

At each balance sheet date, the Company reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimated of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

ABC LIMITED

Audit section: Amount due from a director

	<u>2004</u>	<u>2003</u>
Amount due from a director	<u>\$3,003,279</u>	<u>\$1,324,608</u>

Audit work done

1. Balance confirmed. See attached.
2. Balance fairly stated.
3. No problem for recoverability of the balance as confirmed by the director, Mr. ABC.

ABC LIMITED

Audit section: Amount due from a director

XYZ & Company

Certified Public Accountants (Practising)

CONFIRMATION FOR AUDIT PURPOSES

THIS IS NOT A REQUEST FOR PAYMENT

Our Ref:

Date: 8 July 2005

Mr. ABC

Dear Sir,

Re: ABC Limited

In the course of our regular examination of the accounts of the above Company, we find that the balance on your account is as follows:

<u>Balance as at</u>	<u>Due from You</u>	<u>Due to You</u>
31 December 2004	HK\$3,003,279	\$Nil

If the above balance agrees with your records, please confirm by signing and returning this letter direct to us by using the enclosed envelope. If you do not agree the above balance, please give details of the difference in the space below.

Confirmed Signed

Yours faithfully,

Date 16 July 2005

Signed

For and on behalf of
XYZ & Company
Certified Public Accountants (Practising)

ABC LIMITED

Audit section: Amount due from a related company

	<u>2004</u>	<u>2003</u>
Amount due from a related company	<u>\$4,975,961</u>	<u>\$4,324,606</u>

Audit work done

1. Balance confirmed. See attached.
2. Balance fairly stated.
3. No problem for the recoverability of the amount due as confirmed by the director, Mr. ABC.

ABC LIMITED

Audit section: Amount due from a related company

XYZ Company
Certified Public Accountants (Practising)

CONFIRMATION FOR AUDIT PURPOSES

THIS IS NOT A REQUEST FOR PAYMENT

Our Ref:

Date: 8 July 2005

MNO Limited

Dear Sir/Madam,

Re: ABC Limited

In the course of our regular examination of the accounts of the above Company, we find that the balance on your account is as follows:

<u>Balance as at</u>	<u>Due from You</u>	<u>Due to You</u>
31 December 2004	HK\$4,975,961	\$Nil

If the above balance agrees with your records, please confirm by signing and returning this letter direct to us by using the enclosed envelope. If you do not agree the above balance, please give details of the difference in the space below.

Confirmed Signed

Date 16 July 2005

Yours faithfully,

Signed

For and on behalf of
XYZ & Company
Certified Public Accountants (Practising)

ABC LIMITED

Audit section: Investments in a subsidiary

	<u>2004</u>	<u>2003</u>
CBA Limited – 100% owned		
Unlisted shares, at cost (3,500 shares of HK\$1,000 per share)	\$3,500,000	\$3,500,000
Amount due	<u>875,000</u>	<u>450,000</u>
	<u>\$4,375,000</u>	<u>\$3,950,000</u>

Audit work done

1. Check to annual return of CBA Limited.
2. Balance confirmed. See attached.
3. Balance fairly stated.

ABC LIMITED

Audit section: Amount due from a subsidiary

XYZ & Company

Certified Public Accountants (Practising)

CONFIRMATION FOR AUDIT PURPOSES

THIS IS NOT A REQUEST FOR PAYMENT

Our Ref:

Date: 9 July 2005

CBA Limited

Dear Sir/Madam,

Re: ABC Limited

In the course of our regular examination of the accounts of the above Company, we find that the balance on your account is as follows:

<u>Balance as at</u>	<u>Due from You</u>	<u>Due to You</u>
31 December 2004	HK\$875,000	\$Nil

If the above balance agrees with your records, please confirm by signing and returning this letter direct to us by using the enclosed envelope. If you do not agree the above balance, please give details of the difference in the space below.

Confirmed Signed

Date 16 July 2005

Yours faithfully,

Signed

For and on behalf of
XYZ & Company
Certified Public Accountants (Practising)

ABC LIMITED

Audit section: Inventories

	<u>2004</u>	<u>2003</u>
Finished goods	<u>\$1,457,629</u>	<u>\$1,896,234</u>

Audit work done

1. Stocks held by HIJ Limited. Balance confirmed.
2. The inventories balance is fairly stated.

ABC LIMITED

Audit section: Inventories

XYZ & Company
Certified Public Accountants (Practising)

10 July 2005

--- We confirm that we held stocks of HK\$1,457,629 for ABC Limited as at 31 December 2004.

For and on behalf of HIJ Limited

Signed

Mr. KLM, Director

ABC LIMITED

Audit section: Going concern

Board of directors
ABC Limited
16 July 2005

We, shareholders of ABC Limited, agree to provide financial support to ABC Limited as and when needed to maintain the Company's continuation of its operations.

For and on behalf of PQR Limited

 Signed
Mr. ABC, Director