The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

Model paper
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Section A

[This section will be of 25-35 marks and will comprise of 1) short questions not exceeding 08 marks; 2) multiple choice questions with one or more than one correct choices; and/or 3) fill in the blanks.]

Q.1 (a) On 1 May 2018 Karachi Limited (KL) acquired following equity investments:

	Purchase price	Transaction cost	Total
	-------------------- Rs. in million --------------------		
Investment A	100	2	102
Investment B	150	3	153

Investment A was designated as measured at fair value through profit or loss whereas investment B was irrevocably elected at initial recognition as measured at fair value through other comprehensive income.

In October 2018, KL earned dividend of Rs. 12 million and Rs. 9 million on investment A and B respectively.

As on 31 December 2018, fair values of the remaining investments are given below:

	Fair value	Transaction cost on disposal	Net amount
	------------- Rs. in million -------------		
Investment A	113	2.1	110.9
Investment B	160	2.6	157.4

Required:
Prepare the Journal entries relevant to the above transactions for the year ended 31 December 2018, in accordance with the IFRSs. **(07)**

(b) Briefly explain the term "biological asset" and state when a biological asset is recognised in the financial statements under the International Financial Reporting Standards. **(03)**

(c) Square Limited (SL) is a dealer of electronic items. SL acquires refrigerators of a particular model from a manufacturer at a discount of 15% on the retail price of Rs. 300,000 per unit.

On 1 January 2018, SL sold 12 refrigerators to Cube Hotel at retail price on lease. The rate of interest implicit in the lease was 10% per annum. The payment is to be made in three equal annual instalments payable in advance. Residual value at the end of 3 years is nil.

The market rate of interest is 14% per annum.

Required:
Prepare journal entries in the books of SL in respect of above transaction for the year ended 31 December 2018. **(07)**

(d) Baqir, ACA is working as Finance Manager at Kiwi Limited (KL), a listed company, and reports to Shahid, FCA who is the Chief Financial Officer of the company.

Before the date of authorization for issuance of KL's financial statements for the year ended 30 June 2018, Zahoor (a mutual friend of Baqir and Shahid) informed Baqir that Shahid has recommended him to purchase KL's shares as higher EPS is expected this year. Zahoor also sought Baqir's advice on this matter.

Required:
State the potential threats that Baqir may face in the above circumstances and how he should respond. **(05)**

(e) Naba Power Limited (NPL) is preparing its financial statements for the year ended 30 June 2018. On 1 November 2017 a new law was introduced requiring all factories to install specialized safety equipment within five months. The equipment costing Rs. 15 million was ordered in February 2018 to be installed by 30 April 2018. However, the supplier delayed installation till 31 July 2018. On 5 August 2018 the company received a notice from the authorities levying a penalty of Rs. 1.6 million i.e. Rs. 0.4 million for each month during which the violation continued. It is probable that this penalty will be recovered from the supplier.

Required:
Discuss how the above issue should be dealt with in NPL's financial statements for the year ended 30 June 2018. ***(Quantify effects where practicable)*** **(04)**

Q.2 Select the most appropriate answer from the options available for each of the following Multiple Choice Questions (MCQs).

(i) The following information has been extracted from the records of Stylo Limited (SL):

(1) SL operates a chemical plant which has polluted the surrounding countryside. The Board of Directors has decided to clean up the environmental damage. This decision has been published in the local press on 15 June 2018. However, SL is not legally required to clean up the environmental damage.
(2) SL has decided to close down one of its operating segment. However, the decision was made public after 30 June 2018.

In the financial statements for the year ended 30 June 2018, SL should recognize a provision for the best estimate of costs in respect of:

(a) (1) only
(b) (2) only
(c) Neither (1) nor (2)
(d) Both (1) and (2) **(02)**

(ii) Which of the following events arising after the balance sheet date is an adjusting event?

(a) The discovery of fraud or error which shows that financial statements are incorrect.
(b) Announcement of a plan to discontinue an operation.
(c) Destruction of a major production plant by fire.
(d) Restructuring of a major loan. **(01)**

(iii) On 1 January 2017, Swan Limited (SL) acquired significant influence over the activities of Teal Limited (TL) by purchasing 30% of the ordinary share capital of the company for Rs. 30.0 million. Following information is available in respect of TL, for the financial years ended 31 December 2017 and 2018.

	2017	**2018**
	--- Rs. in million ---	
Profit/(Loss) after tax	9.0	(2.0)
Dividend paid	3.0	-

The carrying amount of the investment to be included in SL's consolidated statement of financial position at 31 December 2018 is:

(a) Rs. 29.1 million
(b) Rs. 32.4 million
(c) Rs. 32.1 million
(d) Rs. 31.2 million **(02)**

(iv) Goldfinch Limited has identified four business segments. The relevant details are as follows:

Segment	**Revenue**		**Profit**	**Assets**
	Internal	**External**		
	------------------ Rs. in million ------------------			
1	-	70.00	15.00	50.00
2	30.00	5.00	3.00	4.50
3	-	13.00	1.00	5.00
4	-	10.00	1.75	5.00

Which of the above segments are to be reported separately under IFRS 8 "Operating Segments"?

(a) 1 only
(b) 1 and 2 only
(c) 1, 2 and 3 only
(d) All of them **(02)**

(v) Consider following statements related to IFRS 8 "Operating Segments":

Which of the following is true?
(1) IFRS 8 only applies to entities whose equity securities are traded in a public market.
(2) The identities of major customers need not be disclosed.

(a) (1) only
(b) (2) only
(c) Both statements
(d) None of them **(01)**

(vi) Which of the following is **NOT** dealt with by IAS 41 "Agriculture"?

(a) Accounting for biological assets
(b) Accounting treatment of government grant received in relation to a biological asset
(c) Accounting treatment of the processing of agriculture produce after harvesting
(d) Measurement of agricultural produce harvested from entity's biological assets **(01)**

Section B

[This section will be of 65-75 marks and will comprise of questions not exceeding 20 marks]

Q.3 Banana Limited (BL) is listed on Pakistan Stock Exchange and has registered office in Karachi. BL engages in manufacturing and marketing of fertilizers. It operates a manufacturing plant at Nawabshah.

Summarized trial balance of BL as at 30 June 2018 is given below:

Description	Rs. in million
Advance from customers	576
Cash and bank balances	831
Intangible assets	444
Investment in 3 months term deposit	500
Land and building – revaluation model	2,000
Long term deposits with utility companies	10
Long term investments	1,500
Ordinary share capital	6,000
Plant and equipment – cost model	3,086
Provision for doubtful receivables	80
Revaluation surplus on land and building	468
Running finance	800
Share premium	500
Stock-in-trade	2,670
Trade and other receivables	1,470
Trade payables	1,150
Un-appropriated profit	2,885
Unclaimed dividend	52

Additional information:

(i) Trade and other receivables include receivables from BL's associate i.e. Strawberry Limited (SL) and BL's subsidiary i.e. Pear Limited (PL) amounting to Rs. 50 million and Rs. 20 million respectively. Provision for doubtful receivables includes provision of Rs. 10 million against receivables from SL.

(ii) Bad debts of Rs. 35 million were written off during the year. These include an amount of Rs. 8 million receivable from SL.

(iii) Authorised share capital consists of 1 billion shares of Rs. 10 each.

(iv) 80 million shares were issued as bonus shares in the previous years whereas 20 million shares were issued as a consideration for purchase of building at market price of Rs. 15 per share. Remaining shares were allotted for consideration paid in cash.

(v) Guarantees issued by BL to Cherry Bank Limited against loans granted to BL's employees amounting to Rs. 16 million.

(vi) During the year, BL produced 3 million tonnes of urea operating at 75% production capacity. The shortfall was due to lower demand of product in the market.

(vii) Following decisions were taken by the board of directors in their meeting held on 16 August 2018:

- Cash dividend of Rs. 3 per share for the year ended 30 June 2018 was proposed.
- Financial statements for the year ended 30 June 2018 were approved.

Required:

Prepare BL's statement of financial position as at 30 June 2018 along with the relevant notes showing possible disclosures as required under the IFRSs and the Companies Act, 2017. ***(Comparative figures and note on accounting polices are not required)*** **(16)**

Q.4 The following balances are extracted from the records of Present Limited (PL) and Future Limited (FL) for the year ended 30 June 2018:

	PL		FL	
	Debit	Credit	Debit	Credit
	-------------- Rs. in million --------------			
Sales		2,060		1,524
Cost of sales	1,300		846	
Selling and administrative expenses	350		225	
Investment income		190		50
Gain on disposal of fixed assets - net		35		
Taxation	80		60	
Share capital (Rs. 10 each)		3,500		2,600
Retained earnings on 30 June 2018		1,996		704

Additional information:

(i) PL acquired 65% shares of FL on 1 September 2017 against the following consideration:

- Cash payment of Rs. 900 million.
- Issuance of shares having nominal value of Rs. 1,000 million.

The fair value of each share of PL and FL on acquisition date was Rs. 16 and Rs. 12 respectively. Retained earnings of PL and FL on the acquisition date were Rs. 1,671 million and Rs. 506.5 million respectively.

At acquisition date, fair value of FL's net assets was equal to their book value except a brand which had not been recognised by FL. The fair value of the brand is assessed at Rs. 90 million. PL estimates that benefit would be obtained from the brand for the next 10 years.

(ii) The incomes and expenses of FL had accrued evenly during the year except investment income. The investment income is exempt from tax and had been recognised in August 2017 and received in September 2017.

(iii) On 1 January 2018 PL sold a manufacturing plant having carrying value of Rs. 42 million to FL against cash consideration of Rs. 30 million. The plant had a remaining useful life of 6 years on the date of disposal.

(iv) On 1 February 2018 FL delivered goods having sale price of Rs. 100 million to PL on 'sale or return basis'. 40% of these goods were returned on 1 May 2018 and the remaining were accepted by PL. 20% of the goods accepted were included in the closing inventory of PL. FL earned a profit of 33.33% on cost.

(v) Both companies paid interim cash dividend at the rate of 5% in May 2018.

(vi) An impairment test carried out at year end has indicated that goodwill of FL has been impaired by 10%.

(vii) PL measures the non-controlling interest at its fair value.

Required:

(a) Prepare consolidated statement of profit or loss for the year ended 30 June 2018. **(13)**

(b) Compute the amounts of consolidated retained earnings and non-controlling interest as would appear in the consolidated statement of financial position as at 30 June 2018. **(04)**

Q.5 Apple Limited (AL) is in the process of finalizing its consolidated financial statements for the year ended 30 June 2018. Following information pertains to the Group's intangible assets:

(i) As on 30 June 2017, revalued amount of AL's license and related revaluation surplus were Rs. 450 million and Rs. 30 million respectively.

(ii) On 1 July 2017 AL acquired entire shareholding of Mango Limited (ML) for Rs. 1,950 million. Fair values of net assets appearing in ML's books on acquisition date are given below:

	Rs. in million
Software (Rs. 100 million each)	200
Other net assets	1,545

In respect of acquisition of ML, following information is also available:

- Till acquisition date, ML had incurred research & development cost of Rs. 80 million on product 'ABC'. ML had not recognised this as an asset because criteria for recognition of the internally generated intangible asset was met on 1 July 2017. On this date, AL estimated that the fair value of research and development work on ABC was Rs. 95 million.
- On acquisition date, fair value of ML's customer list was assessed at Rs. 20 million.

(iii) ML incurred following expenditures on this project from 1 July 2017 till ABC's launching date i.e. 1 May 2018.

	Rs. in million
Market research	5
Product design	12
Cost of pilot plant (not for commercial production)	48
Refinement of product before commercial production	6
Training of production staff	8
Testing of pre-production	4
Production and launching of product	105
	188

(iv) As on 1 July 2017, the fair value of AL's own customer list was assessed at Rs. 35 million.

(v) As on 1 July 2017, remaining useful life of all intangible assets except goodwill was 10 years.

(vi) On 31 March 2018, ML sold one of its software for Rs. 110 million.

(vii) Group follows the revaluation model for license whereas cost model is used for other intangible assets.

(viii) As on 30 June 2018:

- fair value of licence was assessed at Rs. 350 million.
- goodwill of ML has been impaired by 20%.

Required:
Prepare a note on intangible assets, for inclusion in AL's consolidated financial statements for the year ended 30 June 2018 in accordance with the requirements of IFRSs.
('Total' column is not required) **(14)**

Q.6 Orange Limited (OL) is in the process of finalizing its financial statements for the year ended 30 June 2018. The following information has been gathered for preparing the disclosures related to taxation:

(i) Profit before tax for the year ended 30 June 2018 was Rs. 508 million.
(ii) Accounting depreciation for the year exceeds tax deprecation by Rs. 45 million.
(iii) During the year, OL sold a machine whose accounting WDV exceeded tax WDV by Rs. 15 million.
(iv) OL carries trademark of Rs. 90 million having indefinite useful life which was acquired on 1 July 2015. Tax authorities allow its amortization over 10 years on straight line basis.
(v) OL sells goods with a 1-year warranty and it is estimated that warranty expenses are 2% of annual sales. Actual payments during the year related to warranty claims were Rs. 54 million. Of these, Rs. 38 million pertain to goods sold during the previous year. Sales for the year ended 30 June 2018 was Rs. 1,750 million. Under the tax laws, these expenses are allowed on payment basis.
(vi) During the year, OL expensed out payments of Rs. 17.5 million related to restructuring of one of its business segments. As per tax laws, these expenses are to be allowed as tax expense over a period of 5 years from 2018 to 2022.
(vii) Expenses include:
- accruals of Rs. 26 million which will be allowed for tax purpose on payment basis.
- cash donations of Rs. 5 million which are not allowed as tax expense.

(viii) Other income includes:
- commission receivable of Rs. 12 million.
- dividend receivable of Rs. 35 million.

Both incomes were taxable on receipt basis at 30% up to 30 June 2018. With effect from 1 July 2018 commission income is exempt from tax whereas dividend income is taxable at 10% on receipt basis.

(ix) On 30 June 2018, OL received advance rent of Rs. 16 million. Rent income is taxable on receipt basis.
(x) Net deferred tax liability as on 1 July 2017 arose on account of:

	Rs. in million
Property, plant and equipment	34.5
Trademark	5.4
Provision for warranty	(14.7)
	25.2

(xi) Applicable tax rate is 30% except stated otherwise.

Required:
(a) Prepare a note on taxation for inclusion in OL's financial statements for the year ended 30 June 2018 including a reconciliation to explain the relationship between tax expense and accounting profit. **(11)**
(b) Compute the deferred tax liability/asset in respect of each temporary difference. **(07)**

(THE END)