Certificate in Accounting and Finance Stage Examination

The Institute of
Chartered Accountants
of Pakistan

8 September 2021
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-I

Instructions to examinees:
(i) Answer all **EIGHT** questions.
(ii) Answer in **black** pen only.
(iii) Multiple Choice Questions must be answered in answer script only.

Section A

Q.1 Following amounts have been extracted from the financial statements of Lithops Limited:

	2020	**2019**
	----- Rs. in million -----	
Sales	500	450
Cost of sales	378	300
Trade receivables	95	80
Trade payables	72	60
Inventory	93	75
Cash at bank	12	16

All sales and purchases are made on credit.

Required:
(a) Calculate working capital cycle days for 2020. ***(Assume a 360 day year)*** **(04)**
(b) Suggest **four** possible measures that can be taken to reduce working capital cycle days. **(03)**

Q.2 The draft financial statements of Barbary Cement Limited (BCL) for the year ended 31 December 2020 include a plant having a carrying value of Rs. 400 million. Due to technological change, the remaining useful life of the plant has been reduced to 4 years.

Following information has been gathered for impairment testing of the plant:

(i) Inflows from sale of product to be manufactured by the plant for the year 2021 are estimated at Rs. 200 million. These inflows are subject to 10% decrease in each subsequent year due to declining demand.
(ii) Outflows from operational cost for 2021 are estimated at Rs. 80 million. These outflow would increase by 5% in each subsequent year despite decline in demand due to inflation and increase in plant's wear and tear.
(iii) BCL's net profit is subject to income tax of 20%.
(iv) Depreciation on plant is calculated using straight line method.
(v) The plant's net disposal proceeds at the end of the useful life is estimated at Rs. 100 million.
(vi) Pre-tax and post-tax discount rates are 12% and 9.6% per annum respectively.
(vii) A technologically advanced plant with similar capacity can be purchased at Rs. 350 million. BCL has received an offer to buy the existing plant for Rs. 250 million. BCL will have to incur shipping cost of Rs. 7 million, to dispatch the existing plant to the purchaser.

Required:
Compute the impairment loss to be recognised as at 31 December 2020. **(07)**

Q.3 On 1 August 2021, Succulent Limited started its manufacturing business. Following information related to its manufacturing activities for the month of August is available:

(i) Raw materials of Rs. 2.5 million (including 20% indirect material) were acquired, out of which 40% is still unpaid.
(ii) Total factory payroll for the month amounted to Rs. 4 million, out of which 10% is still unpaid. 20% of the payroll relates to the indirect labor.
(iii) Other manufacturing overheads were Rs. 3.6 million which included depreciation of Rs. 0.9 million.
(iv) Manufacturing overheads are applied at the rate of 150% of direct labor.
(v) Cost of physical inventory at month end was as follows:

	Rs. in million
Direct material	0.6
Indirect material	0.1
Work in process	1.0

Required:
Prepare necessary journal entries in order to record the production and inventory cost in a manufacturing environment. ***(Narrations are not required)*** **(08)**

Q.4 Select the most appropriate answer(s) from the options available for each of the following Multiple Choice Questions.

(i) An asset was purchased on 1 January 2017 for Rs. 100 million with useful life of 6 years and residual value of Rs. 10 million. On 1 January 2020, it is revalued to Rs. 120 million with remaining useful life of 3 years and expected residual value of Rs. 15 million. How much excess depreciation will be charged for the year ended 31 December 2020?

(a) Rs. 15 million (b) Rs. 35 million
(c) Rs. 20 million (d) Rs. 25 million **(01)**

(ii) A company used to pay its salesman a salary of Rs. 35,000 per month plus 2% commission based on sales. Now he is promoted as assistant manager sales with a salary of Rs. 50,000 per month plus commission of Rs. 100,000 if sales are Rs. 5 million, Rs. 200,000 if sales are Rs. 10 million and so on.

Salesman's commission is the example of:

	Before promotion	After promotion
(a)	Fixed cost	Variable cost
(b)	Variable cost	Fixed cost
(c)	Stepped cost	Variable cost
(d)	Variable cost	Stepped cost

(02)

(iii) When items of property, plant and equipment are stated at revalued amounts, which of the following disclosures shall be made?

(a) Any restrictions on the distribution of the revaluation surplus to shareholders
(b) The carrying amount of temporarily idle property, plant and equipment
(c) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use
(d) All of the above **(01)**

(iv) Which of the following concepts measures profit in terms of an increase in the productive capacity of an entity?

(a) Physical capital maintenance
(b) Historical cost accounting
(c) Financial capital maintenance (money terms)
(d) Financial capital maintenance (real terms) **(01)**

(v) Which of the following should be included in the initial cost of investment property?

(a) Cost incurred on opening ceremony to celebrate completion of property
(b) Operating losses incurred before the property achieves the planned level of occupancy
(c) Abnormal waste of materials incurred in construction of property
(d) Property transfer taxes **(01)**

(vi) An entity purchased an investment property on 1 January 2018 for Rs. 35 million. The property had an estimated useful life of 35 years with no residual value. At 31 December 2020, the property had a fair value of Rs. 42 million. On 1 January 2021, the property was sold for net proceeds of Rs. 40 million. Calculate the profit or loss on disposal under both the cost and fair value models.

	Cost model	**Fair value model**
(a)	Gain of Rs. 2 million	Gain of Rs. 2 million
(b)	Gain of Rs. 8 million	Loss of Rs. 2 million
(c)	Gain of Rs. 7 million	Loss of Rs. 2 million
(d)	Gain of Rs. 8 million	Gain of Rs. 5 million

(02)

(vii) Which of the following is not considered as transaction with owners with reference to statement of changes in equity?

(a) Issuance of shares at par
(b) Issuance of shares at premium
(c) Profit for the year
(d) Bonus issue of shares **(01)**

(viii) Which **two** of the following factors could cause a company's gross profit percentage on sales to be above the expected level?

(a) Over-statement of closing inventories
(b) Sales were higher than expected
(c) Inclusion of disposal proceeds of non-current assets in sales
(d) Decrease in carriage charges borne by the company on goods sent to customers **(01)**

Section B

Q.5 Financial statements of Parodia Motors Limited (PML) for the year ended 30 June 2021 are under preparation. While reviewing revenues from contract with customers, following matters have been identified:

(i) On 1 November 2020, PML sold Car-A to Alpha Limited (AL) for Rs. 5 million. As per the contract, Rs. 1 million would be paid immediately and the balance would be paid after 2 years. The accountant has recognized revenue to the extent of the cost of Car-A i.e. Rs. 3.5 million and remaining revenue would be recognized upon receipt of balance from AL.

(ii) On 1 January 2021, PML entered into six months' contract with Beta Limited (BL) to sell Car-B for Rs. 3.5 million per unit. As per the contract, if BL purchases more than 10 units during the contract period, the price will be retrospectively reduced to Rs. 3.4 million per unit. At the inception of the contract, PML concluded that BL will meet the threshold for the discount. BL purchased 11^{th} unit of Car-B on 28 June 2021 for which no revenue has been recorded. BL has made payments of all units except 11^{th} unit which will be settled in July 2021.

(iii) On 1 February 2021, PML sold Car-C to Gamma Limited (GL) for Rs. 3 million and recognized the entire amount as revenue. PML also provided GL a Rs. 0.2 million discount voucher for any future purchases of spare parts within one year. There is 80% likelihood that GL will redeem the discount voucher and will purchase spare parts within one year. By the end of the year, no spare parts were purchased by GL. PML normally sells Car-C for Rs. 3 million with no discount voucher.

(iv) On 20 February 2021, PML sold Car-D to Delta Limited (DL) with one-year free maintenance services at a lumpsum payment of Rs. 3.6 million. Payment was made on 1 March 2021 upon delivery of Car-D to DL. The revenue of Rs. 1.2 million (i.e. 4/12 of Rs. 3.6 million) has been recognized. PML normally sells Car-D and annual maintenance services separately for Rs. 3.5 million and Rs. 0.3 million respectively.

Discount rate of 12% per annum may be used wherever required.

Required:
Prepare correcting entries for the year ended 30 June 2021 in accordance with IFRS 15 'Revenue from Contracts with Customers'. **(16)**

Q.6 Following are the extracts from the financial statements of Saguaro Limited (SL) for the year ended 30 June 2021:

Statement of financial position as on 30 June 2021

Assets	2021	2020	Equity & liabilities	2021	2020
	Rs. in million			Rs. in million	
Operating fixed assets	820	848	Share capital (Rs. 10 each)	700	500
Accumulated depreciation	(300)	(262)	Share discount	(40)	-
Capital work in progress	84	-	Retained earnings	220	315
Inventories	274	245	Long-term loans	175	210
Trade receivables	177	204	Trade payables	180	130
Insurance claim	-	31	Accrued expenses	48	43
Advance to supplier	78	60	Current portion of long-term loans	43	40
Cash and bank balances	193	112			
	1,326	**1,238**		**1,326**	**1,238**

Statement of profit or loss for the year ended 30 June 2021

	Rs. in million
Sales	757
Cost of sales	(485)
Gross profit	272
Operating expenses	(310)
Gain on disposal of equipment	17
Loss before interest	**(21)**

Other information:
(i) SL declared a final dividend of 10% on 30 September 2020 which was paid in December 2020.
(ii) 20 million shares were issued in May 2021.
(iii) Insurance claim was related to plant and machinery destroyed in April 2020. The plant had cost and book value of Rs. 63 million and Rs. 42 million respectively.
(iv) During the year, SL disposed of equipment having cost and net book value of Rs. 75 million and Rs. 35 million respectively.
(v) Current portion of long-term loans include accrued interest of Rs. 5 million. (2020: Rs. 1 million)
(vi) Trade payables include an amount of Rs. 14 million payable against capital work in progress.

Required:
Prepare SL's statement of cash flows for the year ended 30 June 2021. **(16)**

Q.7 Following information pertains to non-current assets of Bunny Ear Limited (BEL):

Land:
In January 2019, the government allotted a piece of land to BEL subject to the condition that BEL will establish a factory building on it. The land was recorded at its fair value of Rs. 100 million.

Factory building:
On 1 March 2019, BEL started construction of the factory building. The construction work was completed on 30 June 2020. Payments related to the construction of the factory were as follows:

Description	Date of payment	Rs. in million
1st bill of contractor	1-Mar-2019	130
2nd bill of contractor	1-Aug-2019	190
3rd bill of contractor	1-Jan-2020	180
Last bill of contractor	1-Jul-2020	100

The project was financed through:

(i) government grant of Rs. 200 million received on 1 February 2019. Unused funds from government grant were invested in a saving account @ 8% per annum.

(ii) withdrawals from the following running finance facilities obtained from Bank A and Bank B. The relevant details are:

	Bank A	Bank B
Obtained on	1 January 2019	1 January 2020
Markup rate	12%	14%
	-------- Rs. in million --------	
Balance on 31 December 2019	250	-
Markup for 2019	22	-
Balance on 31 December 2020	350	200
Average balance during 2020	300	150
Markup for 2020	36	21

Manufacturing plant:
The manufacturing plant was purchased on 1 August 2020 at cost of Rs. 420 million. Rs. 240 million was financed through an interest free loan from government. The loan will be forgiven if the plant is operated for atleast 4 years by BEL. Upon acquisition, there is a reasonable assurance that BEL will comply with this condition.

Other information:

- BEL uses cost model for subsequent measurement of property, plant and equipment.
- All government grants are recorded as deferred income and a part of it is transferred to income each year.
- Useful life of the factory building and manufacturing plant has been estimated at 25 years and 10 years respectively.

Required:
Prepare relevant extracts **(including comparative figures)** from BEL's statement of profit or loss for the year ended 31 December 2020 and statement of financial position as on that date.
(Notes to the financial statements are not required. Borrowing costs are to be calculated on the basis of number of months) **(16)**

Q.8 The accountant of Cereus Golf Club (CGC) was terminated on charges of fraud and you have been assigned the task of preparing the accounts for the year ended 31 December 2020. You have found that the proper books had not been maintained. The management of CGC has given you the following information:

(i) Cash and bank balances at 1 January 2020 amounted to Rs. 0.5 million and Rs. 2 million respectively. However, as on 31 December 2020, there was no cash balance and Rs. 4.2 million in the bank.

(ii) The members are required to pay 3 years' subscription in advance upon admission/renewal. Full year subscription is charged from members joining during the year. Number of subscriptions received are as under:

Year	No. of memberships	3 years' subscription per member
2018	100	Rs. 60,000
2019	140	Rs. 75,000
2020	160	Rs. 90,000

During 2020, 10 members were awarded membership on special permission but they had not paid the subscription till year-end.

After year-end, 5 more members informed that they had paid the 3 years' subscription amount in 2020. It was found out that the amount was misappropriated by the accountant.

(iii) CGC had received a donation of Rs. 8 million in 2019 to meet the repair and maintenance expenditure of its golf course. Out of total donation, the club has spent Rs. 2.2 million and Rs. 2.8 million in 2019 and 2020 respectively.

(iv) CGC started purchasing golf kits in 2020 for sales as well as for rent purposes. 20% of the purchases were unpaid at year-end. Two third of the golf kit purchases made in 2020 had been added to inventory of golf kits for sale and remaining had been added directly to golf kits for rent.

(v) Golf kits are sold for cash at cost plus 40%. Cost of closing inventory of golf kits for sale amounted to Rs. 1 million. It was decided to transfer half of these kits into golf kits for rent at 30% of their original cost.

(vi) Some of the receipts and payments during the year were as follows:

	Rupees
Rent of golf kits	650,000
Golf kits purchases	4,800,000
Annual insurance (paid till April 2021)	660,000
Salaries (including Rs. 350,000 for 2019)	2,800,000
Other expenses	2,320,000

(vii) CGC has a fidelity insurance policy and any cash deficiency upto a maximum of Rs. 2 million is recoverable under the policy.

(viii) Fixed assets at 1 January 2020 had a book value of Rs. 25 million. All fixed assets are to be depreciated at 15% per annum.

Required:

(a) Prepare income and expenditure account for the year ended 31 December 2020. **(11)**

(b) Prepare statement of financial position as on 31 December 2020. **(09)**

(THE END)