The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

13 September 2022
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-I

Instructions to examinees:

(i) Answer all **NINE** questions.
(ii) Answer in **black** pen only.
(iii) Multiple Choice Questions must be answered in answer script only.

Section A

Q.1 Consider the following statements with reference to 'Conceptual framework for financial reporting':

(i) Physical capital maintenance measures profit in terms of increase in the productive capacity of an entity.
(ii) In times of rising prices, profits will be overstated and assets will be understated when financial statements are prepared on the basis of historical cost.
(iii) Income represents all increases in assets or decreases in liabilities that result in increase in equity.
(iv) To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, relevant and verifiable.
(v) In value in use method, assets are measured at the amount that would be paid to purchase the same or a similar asset currently.
(vi) Current cost and fair value are exit values.
(vii) Requirements of a standard overrides the requirements of conceptual framework.
(viii) Financial capital maintenance is likely to be the most relevant to investors as they are interested in maximizing the return on their investment and purchasing power.

Required:
Identify whether each of the above statements is **TRUE** or **FALSE**. Give reasons for statements identified as **FALSE**. **(07)**

Q.2 Discuss how the following should be dealt with in the current year's financial statements of relevant entities in accordance with IAS 20.

(a) Xero Limited (XL) received a government grant to setup a plant in an under-developed rural area three years ago. One of the conditions of the grant was that XL will maintain a minimum of 200 employees during the next five years. However, due to worsening economic conditions, XL failed to maintain 200 employees and the full grant became repayable immediately in the current year.

XL has been presenting the grant in statement of financial position by deducting the grant in arriving at the carrying value of the plant. **(04)**

(b) One Limited received a loan from government in the current year at an interest rate of 5% per annum. The prevailing market interest rate is 12% per annum. The only condition attached to the loan is that it should be used for acquisition of textile machinery. **(03)**

Q.3 Oracle Family Club (OFC) was formed in January 2021. The following information is available in respect of the first year of operations:

Receipt and payment account for the year ended 31 December 2021

Receipts	Rs. in '000	Payments	Rs. in '000
Subscriptions for:		Salaries	640
▪ 2021	2,800	Rent	990
▪ 2022	1,360	Equipment	2,560
Joining fees	2,100	10% Fixed deposit	2,020
Canteen sales	720	Construction of building	1,500
Life-time memberships	1,840	Canteen purchases	700
		Closing balance	410
	8,820		**8,820**

Income and expenditure account for the year ended 31 December 2021

Expenditures	Rs. in '000	Incomes	Rs. in '000
Salaries	700	Subscription	3,450
Rent	760	Interest on fixed deposit	150
Depreciation of equipment	200	Life-time memberships	360
Surplus	2,330	Profit from canteen	30
	3,990		**3,990**

Additional information:

(i) OFC also operates a canteen. All sales and purchases of canteen are made for cash.
(ii) Salary of canteen's salesman amounted to Rs. 90,000 is included in payments.

Required:
Prepare OFC's statement of financial position as on 31 December 2021. **(10)**

Q.4 During the review of accounting records and financial statements for the year ended 30 June 2022 of Tally Traders, following errors were highlighted:

(i) Sales included an outstanding balance of Rs. 500,000 for which a customer would need to pay Rs. 485,000 only if payment is made within 30 days. The customer is expected to pay within 30 days.

(ii) An item was included in closing inventory at its net realizable value of Rs. 490,000. However, the item had a cost of Rs. 450,000.

Periodic inventory method is used to record the inventory transactions.

(iii) A sub-total of Rs. 234,000 was carried forward in the purchase day book as Rs. 432,000.

Control accounts are not maintained for Debtors and Creditors.

(iv) A credit note issued to a customer of Rs. 128,000 was recorded as credit note received from supplier.

(v) An office machine costing Rs. 3,540,000 with a carrying value of Rs. 2,040,000 as on 1 July 2021 was disposed of on 28 February 2022 for Rs. 1,860,000. The sale proceeds were credited to accumulated depreciation account and full year's depreciation was provided on the machine.

Office machines are depreciated at 10% per annum using reducing balance method.

Required:
Prepare journal entries to correct the above errors. ***(Narrations are not required)*** **(08)**

Q.5 On 1 March 2017, Zarmoney Limited imported an automatic plant for Rs. 130 million. The commissioning of the plant was completed on 1 January 2018 at a cost of Rs. 10 million. The economic life of the plant was estimated as 12 years and useful life of the plant was estimated as 8 years. The plant is being depreciated at 20% per annum using reducing balance method.

Due to declining demand for the product manufactured from this plant, an impairment test was carried out at 31 December 2021. Following information has been gathered for impairment testing of the plant:

(i) The current selling price of a similar plant in the local market is Rs. 50 million. The present decommissioning cost of the plant is estimated at Rs. 2 million.

(ii) The plant's net disposal proceeds at the end of the useful life is estimated at Rs. 4 million.

(iii) The current market risk-free rate of interest is 8% per annum, however, an investor would ask additional return of 2% for bearing the uncertainty inherent in such a plant.

(iv) A junior accountant has calculated following net cash flows from operating the plant:

Year	2022	2023	2024	2025
Net cash inflow (Rs. in million)	11	7	3	1

However, a review of accountant's working has revealed the following:

- Depreciation of the plant has been included as an outflow in each year.
- Tax payments of Rs. 2 million has been included as an outflow in each year.
- Inflows from plant in 2022 include receipts from sale of existing inventory amounting to Rs. 3 million

Required:
Compute the impairment loss (if any) in the value of the plant to be recognised on 31 December 2021. ***(Show all necessary workings)*** **(08)**

Q.6 Select the most appropriate answer(s) from the options available for each of the following Multiple Choice Questions.

(i) Which of the following is **NOT** a limitation of ratio analysis?

(a) Use of different accounting policies and estimates
(b) Use of different formulas for calculating ratios
(c) Different inflation rates in different years
(d) Companies pursuing different strategies **(01)**

(ii) If the existing current ratio of a company is more than 1, what would be the impact of a credit purchase of inventory on the current ratio?

(a) Current ratio would increase
(b) Current ratio would decrease
(c) Current ratio would decrease but would remain higher than 1
(d) Current ratio would remain same **(01)**

(iii) Which of the following statements are correct?

(I) Giving incentives to customer to pay on time would result in decrease in debtor's turnover in times.
(II) If all debtors pay their debts within the credit period, the average collection period would be Nil.

(a) Only (I) is correct (b) Only (II) is correct
(c) Both are correct (d) None is correct **(01)**

(iv) Which **TWO** of the following would improve gearing ratio of a company?

(a) Issuance of shares at discount
(b) Repayment of a bank loan
(c) Issuance of bonus shares
(d) Disposal of a land at its carrying value **(01)**

(v) Which of the following changes would be considered as change in accounting policy?

(I) Changing the subsequent measurement model for property, plant and equipment from cost model to revaluation model.
(II) Changing the inventory valuation method from FIFO to Weighted average.

(a) Only (I) is change in accounting policy
(b) Only (II) is change in accounting policy
(c) Both are change in accounting policy
(d) None is change in accounting policy **(01)**

(vi) On 1 January 2021, a company borrowed Rs. 20 million @ 9% per annum for the purpose of constructing an asset. The company started construction on 1 February 2021 and paid Rs. 8 million on 1 March 2021 and Rs. 12 million on 1 July 2021. The asset was ready to use on 1 September 2021. Surplus funds were invested @ 6% per annum.

The borrowing cost that can be capitalized is:

(a) Rs. 660,000 (b) Rs. 710,000
(c) Rs. 900,000 (d) Rs. 1,050,000 **(02)**

(vii) Which of the following statements are correct?

(I) Investment income on the temporary investment of unused funds of general borrowings is taken to profit or loss.
(II) Capitalisation of borrowing cost always commences as soon as construction of a qualifying asset begins.

(a) Only (I) is correct (b) Only (II) is correct
(c) Both are correct (d) None is correct **(01)**

(viii) Which **TWO** of the following would be shown as a deduction from the column of retained earnings in statement of changes in equity?

(a) Transfer of incremental depreciation
(b) Issuance of shares at discount
(c) Cash dividend
(d) Transfer to general reserves **(01)**

(ix) Which **TWO** of the following situations would require prior year adjustment as per IAS 8?

(a) Changing the depreciation method from straight line basis to the reducing balance basis in respect of a building held for the last 10 years.
(b) Changing the measurement model for Investment property from cost model to fair value model.
(c) Incorporating the effects of a material understatement found in last year closing inventories due to incorrect formula in excel sheet.
(d) Adopting the requirements of IAS 20 for a government grant received by an entity for the first time. **(01)**

Section B

Q.7 Following is the statement of financial position of Quicken Limited (QL) as at 30 June 2022:

	2022	2021		2022	2021
	Rs. in million			Rs. in million	
Share capital	480	400	Land and building	748	526
Revaluation surplus	135	-	Vehicles	118	96
Retained earnings	337	325	Inventories	365	444
Long-term loan	335	460	Trade and other receivables	212	185
Trade and other payables	160	142	Cash and bank balances	73	111
Advance from customers	69	35			
	1,516	**1,362**		**1,516**	**1,362**

Additional information:

(i) During the year, land and building were revalued for the first time, resulting in a surplus of Rs. 150 million and incremental depreciation of Rs. 15 million.

(ii) Depreciation on building charged to profit or loss amounted to Rs. 72 million.

(iii) During the year, vehicles having book value of Rs. 8 million were sold for Rs. 11 million received in cash. Further, sale proceeds of Rs. 6 million of another vehicle (book value Rs. 7 million) disposed of in May 2021 were received in August 2021.

(iv) Vehicles costing Rs. 51 million were purchased during the year of which Rs. 12 million is still unpaid.

(v) Inventories as at 30 June 2022 included work in process inventories of Rs. 96 million (2021: Rs. 80 million) which are not available for sale.

(vi) Interest on loan for the year amounted to Rs. 48 million of which Rs. 14 million was capitalised in the cost of a building constructed during the year.

(vii) Following dividends were announced for the year ended 30 June 2022 and 2021:

2022	20% interim bonus shares and 15% final cash dividend
2021	5% interim bonus shares and 10% final cash dividend

Required:

Prepare QL's statement of cash flows for the year ended 30 June 2022. **(15)**

Q.8 Peach Tree Limited (PTL) was incorporated on 1 July 2020. Following information has been extracted from its financial statements for the year ended 30 June 2022:

	2022	2021
	---- Rs. in million ----	
Net profit	250	210
Revaluation surplus arising during the year	30	50
Total comprehensive income	**280**	**260**

Details of shares and bonds issued by PTL since incorporation are as follows:

(i) On 1 July 2020, 50 million ordinary shares having par value of Rs. 10 each were issued at Rs. 14 each.

(ii) On 1 July 2020, 10 million 12% redeemable preference shares having par value of Rs. 50 each were issued at Rs. 64 each. Each preference share is convertible into 3 ordinary shares after 5 years.

(iii) On 1 February 2021, further 20 million ordinary shares having par value of Rs. 10 each were issued at prevailing market price of Rs. 16 each.

(iv) On 1 October 2021, 40% right shares were issued at a premium of Rs. 10 per share. The market price per share immediately before the entitlement date was Rs. 30 per share.

(v) On 1 November 2021, 3 million convertible bonds having par value of Rs. 100 each were issued. The bonds carry interest @ 10% per annum payable on 31 October each year. Each bond is convertible into 7 ordinary shares after 3 years.

Required:
Compute basic and diluted earnings per share to be disclosed in PTL's financial statements for the years ended 30 June 2021 and 2022. ***(Show comparative figures)*** **(15)**

Q.9 Following information pertains to non-current assets of GnuCash Limited (GL):

(i) GL purchased a manufacturing plant for Rs. 340 million on 1 January 2021. On that date, the plant had an estimated useful life and residual value of 13 years and Rs. 60 million respectively. The revalued amounts and residual value were as follows:

	Revalued amount	**Residual value**
	----------- Rs. in million -----------	
30 June 2021	304	54
30 June 2022	315	44

(ii) A warehouse owned by GL was given on rent on 1 January 2022. Previously, the warehouse was in use of GL.

The warehouse was acquired by GL on 1 July 2019 at a cost of Rs. 200 million and is being depreciated @ 10% per annum on reducing balance method.

Fair value of the warehouse on various dates are as follows:

	Rs. in million
1 January 2022	206
30 June 2022	214

Rentals earned for the year ended 30 June 2022 amounted to Rs. 10 million out of which Rs. 6 million is still outstanding.

(iii) GL acquired a property comprising of three similar showrooms at a total cost of Rs. 900 million on 1 October 2021. 40% of the cost of property is attributable to the value of land. Each of the showroom can be leased out separately and has a useful life of 15 years with no residual value.

GL is using one showroom for its own products while the other showrooms were held to be leased out. On 1 March 2022, the two showrooms were given on monthly rent of Rs. 4 million.

The fair value of each showroom is increasing by Rs. 3 million each month.

Other information:
- Cost model is used for subsequent measurement of all property, plant and equipment except for manufacturing plant for which revaluation model is used.
- Maximum possible amount is transferred from the revaluation surplus to retained earnings on an annual basis.
- Fair value model is used for subsequent measurement of all investment properties.

Required:
Prepare notes on 'Property, Plant and Equipment' and 'Investment Property', for inclusion in GL's financial statements for the year ended 30 June 2022.
(Comparative figures and column for total are not required) **(20)**

(THE END)