Certificate in Accounting and Finance Stage Examination

The Institute of
Chartered Accountants
of Pakistan

12 September 2023
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 The retained earnings column, extracted from the draft statement of changes in equity of Puffer Limited (PL) for the year ended 31 December 2022, is as follows:

	Rs. in million
Balance as at 31 December 2020	928
Final cash dividend @ 10% for the year 2020	(114)
Profit for the year 2021	258
Balance as at 31 December 2021	1,072
Profit for the year 2022	328
Balance as at 31 December 2022	**1,400**

The following changes have not been incorporated into the draft financial statements of PL:

(i) PL has decided to change the method for valuation of inventory from 'first-in, first-out' (FIFO) to the weighted average. The value of inventory under each method has been determined as follows:

	FIFO	Weighted average
	------- Rs. in million -------	
As at 31 December 2020	438	460
As at 31 December 2021	560	520
As at 31 December 2022	601	618

(ii) In view of increasing bad debts, PL has decided to double the provision for doubtful receivables. The balance of provision for doubtful receivables prior to this change were as follows:

	Rs. in million
As at 31 December 2020	15
As at 31 December 2021	19
As at 31 December 2022	23

(iii) PL has also decided to recognise all borrowing costs incurred in a year as an expense. Previously, borrowing costs related to qualifying assets were capitalised as part of the cost of that asset. Total borrowing costs incurred during the years 2022 and 2021 amounted to Rs. 87 million and Rs. 95 million, respectively. Of these, Rs. 53 million and Rs. 38 million were capitalised in the cost of head office building in 2022 and 2021, respectively. The construction of the building is expected to complete in 2023.

Required:
(a) Briefly discuss how the above changes should be incorporated in PL's financial statements. **(03)**
(b) Prepare the retained earnings column as would appear in PL's statement of changes in equity for the year ended 31 December 2022, in accordance with IFRSs. **(06)**

Q.2 During the review of accounting records and financial statements of Jelly Traders (JT) for the year ended 30 June 2023, the following errors were highlighted:

(i) A payment of Rs. 90,000 to a supplier was recorded as purchase of inventory on cash.

(ii) Inventory withdrawn by owner for personal use was recorded as a credit sale for Rs. 460,000.

(iii) Inventory returned by a customer, with a selling price of Rs. 540,000, were debited to inventory and credited to receivables at the selling price.

(iv) On 1 November 2022, an item of equipment was sold for Rs. 90,000. The disposal was not recorded, and the amount received was credited to depreciation expense. On 1 July 2022, the equipment had a written down value of Rs. 120,000, while its original cost was Rs. 250,000.

(v) A cheque issued for one year's rent from 1 May 2023 to 30 April 2024, amounting to Rs. 240,000, was dishonoured due to a mistake in the name of the party. No entry was made upon the return of the cheque, and a new cheque was issued by JT after the year-end.

Other information:

- JT uses the perpetual inventory method. JT makes a profit of 25% on sales.
- All fixed assets are depreciated at a rate of 20% using the reducing balance method.

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

Q.3 The following information pertains to Ray Limited (RL):

(i) The profit for the year ended 31 December 2022 amounted to Rs. 84 million (2021: loss of Rs. 60 million).

(ii) The outstanding weighted average number of ordinary shares was 15 million during the years 2022 and 2021.

(iii) On 1 January 2021, 2 million convertible bonds having a par value of Rs. 100 each were issued. The bonds carry interest @ 20% per annum, payable on 31 December each year. Each bond is convertible into 3 ordinary shares if converted after three years, or 4 ordinary shares if converted after five years.

(iv) On 1 January 2021, 12 million share warrants were issued, which can be exercised after two years at an exercise price of Rs. 21 per share. The average market price of each of RL's share during the years 2022 and 2021 was Rs. 28 and Rs. 21, respectively.

(v) On 1 January 2022, 6 million 16% cumulative irredeemable preference shares having a par value of Rs. 10 each were issued. Every 3 preference shares are convertible into 1 ordinary share after four years.

(vi) Applicable tax rate is 30%.

Required:
Compute RL's diluted earnings per share for the years ended 31 December 2021 and 2022. **(10)**

Q.4 You are the accountant of Betta Limited (BL). BL has commenced construction of a manufacturing plant to expand its production line, which will take two years to complete. The cost of the plant will be financed through a new loan specifically obtained for this purpose. Remaining cost will be financed through the existing borrowings.

You have pointed out that a portion of borrowing costs needs to be capitalised in the cost of plant. The management is interested in determining the estimated borrowing costs that will be capitalised in the future and has requested you to prepare a working.

Required:
List the information (key dates, amounts, etc.) that you will need to gather in order to calculate the estimated borrowing costs to be capitalised. **(06)**

Q.5 Shark Limited (SL) established a desalination plant at a total cost of Rs. 300 million in a coastal area to provide clean drinking water. The plant started commercial production on 1 January 2019 and had an estimated useful life and residual value of six years and Rs. 30 million, respectively.

On 1 January 2020, SL received a government grant of Rs. 160 million towards the cost of the plant. The sanction letter stated that SL should also operate the plant for atleast 300 days in each of the next three years. At inception, there was a reasonable assurance that condition of the grant shall be complied with. SL recorded the grant as deferred income.

In 2022, the plant was not operated for 120 days. Owing to this, the government issued a notice to SL for repayment of Rs. 100 million. Accordingly, the amount was repaid by SL immediately.

Required:
Prepare relevant extracts from SL's statement of profit or loss for the year ended 31 December 2022, and statement of financial position as at that date.
(Show comparative figures) **(07)**

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

(i) Which **TWO** of the following characteristics are considered fundamental qualitative characteristics according to the IASB's conceptual framework for financial reporting?

(a) Timeliness (b) Faithful representation
(c) Relevance (d) Comparability **(01)**

(ii) Which **TWO** of the following properties owned by a company would be classified as investment properties?

(a) Property occupied by an employee paying market rent
(b) Land held by a company for undetermined future use
(c) Machinery held for short-term sale in the ordinary course of business
(d) Building held by a company for long-term capital appreciation **(01)**

(iii) When there is no balance in the share premium account, transaction costs relating to issue of shares are debited to:

(a) profit or loss (b) share capital
(c) revaluation surplus (d) retained earnings **(01)**

(iv) Which of the following is a self-balancing set of accounts that reports all unrestricted revenue and restricted contributions for which no corresponding restricted fund is presented?

(a) General fund (b) Restricted fund
(c) Endowment fund (d) Balancing fund **(01)**

(v) Annual membership subscription income of Rs. 1,800,000 was shown in the statement of income and expenditure. Out of this, Rs. 300,000 was receivable at the year-end. During the year, an amount of Rs. 400,000 was received pertaining to the previous year. Calculate the total amount of subscription received during the year.

(a) Rs. 1,100,000 (b) Rs. 1,700,000 (c) Rs. 1,900,000 (d) Rs. 2,500,000 **(01)**

(vi) Which of the following is a specific reserve created out of retained earnings to ensure that dividends remain stable irrespective of changes in earnings?

(a) General reserve (b) Dividend equalization reserve
(c) Revenue reserve (d) Capital reserve **(01)**

(vii) A non-profit organisation earns income on funds that are externally restricted to be held for endowment. How should such income be recognised under the deferral method?

(a) Recognise revenue in the current year immediately
(b) Defer and recognise revenue over the years
(c) Recognise direct increase in the statement of changes in net assets
(d) Deduct from the related capital asset **(01)**

(viii) Which of the following statements is/are correct?

(I) It is always necessary to determine both an asset's fair value less costs of disposal and its value in use.
(II) An entity shall estimate the recoverable amount of the asset at each year-end.

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

(ix) The carrying value of a plant at 30 June 2023 is Rs. 26 million. The fair value of the plant is estimated at Rs. 25 million, while its disposal costs are estimated to be Rs. 3 million. The plant's cash flows for the next five years are estimated to be Rs. 7 million per annum. The pre-tax and post-tax discount rates per annum are 16% and 12%, respectively.

What is the approximate recoverable amount of the plant in the above case?

(a) Rs. 3 million (b) Rs. 23 million (c) Rs. 25 million (d) Rs. 26 million **(02)**

Section B

Q.7 The following is the statement of financial position of Dolphin Limited (DL) as at 30 June 2023:

Equity & liabilities	2023	2022	Assets	2023	2022
	Rs. in million			Rs. in million	
Share capital	16,000	13,000	Property, plant and equipment	13,835	14,300
Share premium	1,120	-	Capital work-in-progress	3,485	2,500
Retained earnings	10,150	10,800	Investment properties	1,820	1,950
Long-term loan	3,275	3,540	Inventories	7,450	5,000
Trade and other payables	1,485	935	Trade receivables - net	3,588	4,085
Accrued interest	140	195	Advance tax	36	-
Dividend payable	260	140	Cash and bank balances	2,216	1,010
Tax payable	-	235			
	32,430	**28,845**		**32,430**	**28,845**

Additional information:

(i) The interest payment for the year amounted to Rs. 700 million, of which Rs. 300 million has been capitalised in capital work-in-progress.

(ii) The transfer from capital work-in-progress to property, plant and equipment amounted to Rs. 550 million.

(iii) An old machine costing Rs. 520 million with a book value of Rs. 350 million was traded-in for a new machine costing Rs. 600 million on payment of Rs. 200 million.

(iv) DL acquired an investment property costing Rs. 300 million, of which Rs. 125 million is still unpaid. DL applies fair value model for subsequent measurement of its investment properties.

(v) The provision for doubtful trade receivables at 30 June 2023 was estimated at 8% (2022: 5%).

(vi) During the year, DL issued 10% bonus shares. Subsequently, a right issue was also made.

(vii) The tax charge for the year amounted to Rs. 750 million at 30% of profit before tax.

(viii) DL classifies dividends and interest payments in a way that keeps 'cash flows from operating activities' higher.

Required:
Prepare DL's statement of cash flows for the year ended 30 June 2023. **(18)**

Q.8 Whale Limited (WL) is a growing business in the electronic items industry and operates two owned outlets. Below are the summarized financial statements of WL for 2023:

Statement of financial position as at 31 March 2023

Assets	Rs. in '000	Equity and liabilities	Rs. in '000
Fixed assets	52,514	Share capital	11,000
Inventory	11,528	Retained earnings	25,535
Trade receivables	6,874	Long-term loan	21,625
Cash	2,658	Trade payables	9,874
		Accrued expenses	5,540
	73,574		**73,574**

Statement of profit or loss for the year ended 31 March 2023

	Rs. in '000
Sales	67,851
Cost of sales	(47,528)
Gross profit	**20,323**
Selling and administrative expenses	(7,584)
Interest expenses	(5,147)
Net profit	**7,592**

Extracts from management reports:

(i) Ratios for the year ended 31 March 2022:

Gross profit margin	36.2%	Quick ratio	1.1 times
Operating profit margin	30.0%	Interest cover	17.5 times
Return on capital employed	51.7%	Asset turnover	1.7 times
Average time to pay	35 days	Inventory turnover	9.0 times

(ii) Key events during the year:

- A new outlet was inaugurated. The cost of purchasing the outlet was financed through another long-term loan from a bank. The sales prices at the new outlet are kept lower to attract customers.
- Despite an increase in sales promotional activities, the sales at the new outlet were below expectation but are expected to increase from next year.
- Inventory at the new outlet was build-up by utilising liquid funds available with WL and the extended credit facility from suppliers.
- The interest rate on existing bank loans has increased due to rise in the market interest rate.

Required:

(a) Compute WL's ratios for 2023 in comparison with 2022. **(06)**

(b) Keeping in view the key events during the year, provide possible reasons for the variation(s) in the ratios computed in (a) above. **(09)**

Q.9 The following information pertains to non-current assets of Trout Limited (TL):

(i) Details of the property, plant and equipment as at 1 January 2022 are as follows:

Assets	**Cost/revalued amount**	**Accumulated depreciation**	**Depreciation method**	**Rate/ life**	**Subsequent measurement**
	------- Rs. in million -------				
Equipment	360	110	Reducing balance	20%	Cost
Office building	280	56	Straight line	10 years*	Revaluation

**Remaining life at the date of last revaluation*

As at 1 January 2022, the revaluation surplus related to the office building amounted to Rs. 32 million. However, on 31 December 2022, due to a slump in the market, the building was again revalued by an independent valuer, and this time, the office building was valued at only Rs. 156 million.

(ii) On 1 July 2022, a new equipment was acquired by making payment of Rs. 50 million to the supplier. In addition, an old equipment was given in exchange to the supplier. The fair values of the old and new equipment were assessed at Rs. 60 million and Rs. 105 million, respectively. The old equipment had been acquired at a cost of Rs. 80 million on 1 July 2019.

(iii) On 1 January 2022, TL completed construction of the warehouse at a cost of Rs. 55 million for subsequent sale to customer. However, warehouse was given on rent at an annual rent of Rs. 8 million on 1 April 2022. The fair value of the warehouse on various dates are as follows:

	Rs. in million
1 January 2022	65
1 April 2022	73
31 December 2022	80

Other information:

- TL accounts for revaluation using the net replacement value method and transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.
- The fair value model is used for the subsequent measurement of all investment properties.

Required:
Prepare the notes on ‘Property, plant and equipment’ and ‘Investment property’ to be included in TL’s financial statements for the year ended 31 December 2022.
(Comparative figures and a column for the total are not required) **(17)**

(THE END)