The Institute of
Chartered Accountants
of Pakistan

Certificate in Accounting and Finance Stage Examination

14 March 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 Following information relating to Akkadian Limited (AL) has been gathered for the purpose of calculating earnings per share:

(i) Outstanding ordinary, preference and potential shares of AL as at 1 January 2021:
- 6 million ordinary shares having par value of Rs. 10 each.
- 2 million irredeemable preference shares having par value of Rs. 20 each carrying cumulative dividend of 14% per annum.
- 3 million share options for ordinary shares having exercise price of Rs. 36 each.

(ii) On 1 September 2021, AL announced 40% right shares to its ordinary shareholders at Rs. 18 per share. The entitlement date of right shares was 1 October 2021. The market price per share immediately before the announcement date and entitlement date were Rs. 30 and Rs. 32 respectively.

(iii) The average market price of ordinary shares during the years 2021 and 2022 were Rs. 30 and Rs. 45 per share respectively.

(iv) Profits for the years 2021 and 2022 amounted to Rs. 24 million and Rs. 34 million respectively.

(v) No dividend was declared in the years 2021 and 2022.

(vi) Share options were not exercised in the years 2021 and 2022.

Required:
Compute AL's basic and diluted earnings per share to be disclosed in the statement of profit or loss for the years ended 31 December 2021 and 2022. **(10)**

Q.2 Discuss how the following should be dealt with in the financial statements of relevant entities according to IAS 20:

(a) A government grant of Rs. 25 million was received by an entity in 2022 for the damage to its head office building caused by the flood in December 2021. As a result of damage, an impairment loss of Rs. 21 million was recognised in 2021. **(02)**

(b) A manufacturing entity established a plant in an area with high illiteracy rate and received a government grant of Rs. 40 million. The grant received was equivalent to two years' salaries of the 50 local persons employed by the entity. The grant is repayable in full if the number of these employees falls below 50 at any time during the next five years. It is highly probable that the entity will comply with the condition attached to the grant. **(03)**

(c) Government built an alternate road to the industrial zone, in which an entity's factory is situated. The new road has reduced the distance to the market and would result in an annual saving of transportation costs of Rs. 3 million for the entity. **(03)**

Q.3 You are working as the finance manager of Hittite Limited (HL). A new CFO has joined HL and has recommended changes to accounting policies related to assets to improve HL's financial ratios in the next financial statements. The CFO has suggested the following changes to the policies:

(i) Subsequent measurement of investment property from cost model to fair value model.
(ii) Subsequent measurement of property, plant and equipment from cost model to revaluation model.
(iii) Cost formula for inventory from weighted average to FIFO method.

You may assume that:

- fair values / cost / prices of all assets would increase over the time.
- the maximum possible amount from the revaluation surplus to retained earnings would be transferred on an annual basis.
- periodic inventory system is followed by HL.

Required:
State the effect (increase, decrease, no effect) of each of the above changes on the ratios in the next financial statements. ***(Note: Use the following format)***

Ratios	Change in policy of		
	investment property	**property, plant and equipment**	**inventory**
Net profit to sales ratio			
Return on assets			
Return on capital employed			
Debt equity ratio			
Current ratio			

(10)

Q.4 On 1 July 2019, Sumerian Limited (SL) purchased a manufacturing plant for Rs. 570 million. The plant is being depreciated at a rate of 15% per annum using the reducing balance method. On 31 December 2021, the remaining life of the plant was estimated at 4 years resulting in an increase of 5% in depreciation rate.

SL carried out impairment testing of the plant on 31 December 2021 and also on 31 December 2022 using the following estimates:

	31 Dec 2021	**31 Dec 2022**
	----- Rs. in million -----	
Annual inflows from the sale of product	245	263
Annual outflows for operations	167	174
Annual interest on loan obtained for plant acquisition	14	14
Net sales proceeds at the end of useful life in current condition	142	140
Additional sale proceeds at the end of useful life if plant is modified at cost of Rs. 50 million	125	125
Current fair value less cost to sell	300	280
Applicable discount rate	12%	10%

Required:
Calculate the carrying value of the manufacturing plant as at 31 December 2021 and 2022. **(08)**

Q.5 On 1 March 2022, Inca Empire Limited (IEL) commenced business with a capital of Rs. 60,000 which was used to purchase two items of inventory. Details of their cost and sales for the year ended 28 February 2023 are as follows:

	Cost	Sale
	----------- Rupees -----------	
Product A	25,000	55,000
Product B	35,000	70,000

Additional information:

(i) General inflation during the year is 8%.
(ii) Inflation specific to product A during the year is 12%.
(iii) Replacement cost of the product B at the end of the year is Rs. 45,000.

Required:
Prepare the statement of profit or loss and the statement of financial position (equity portion only) of IEL according to the concept of 'Physical Capital Maintenance'. **(04)**

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

(i) Alpha Limited made a profit before tax of Rs. 80,000 in the year just ended after charging depreciation of Rs. 75,000. There was a gain of Rs. 25,000 on disposals of property, plant and equipment. Net working capital excluding cash increased by Rs. 19,000. Income tax paid during the year was Rs. 24,000.

What is the amount of cash generated from operations?

(a) Rs. 87,000 (b) Rs. 111,000 (c) Rs. 125,000 (d) Rs. 148,000 **(02)**

(ii) A company's cash balances have increased from last year. Which of the following events could account for this?

(a) Delayed payments by debtors
(b) Shortening of the credit period by the creditors
(c) Acquisition of a long-term loan at high interest rate
(d) A decrease in final dividend proposed by the directors **(01)**

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

(I) Statement of cash flows is useful in assessing the ability of the entity to generate cash and cash equivalents.
(II) Historical cash flows are often a fairly reliable indicator of the amount, timing and certainty of the future cash flows.

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

(iv) An entity reported a positive earnings per share in previous year. Which of the following would result in increase in earnings per share of previous year due to restatement?

(a) Right issue (b) Bonus issue
(c) Share split (d) Share consolidation **(01)**

(v) Quick and current ratios of a business as on 31 December were 1:1 and 1.25:1. If inventories at that date amounted to Rs. 45 million, then current liabilities were:

(a) Rs. 144 million (b) Rs. 225 million
(c) Rs. 180 million (d) Rs. 135 million **(01)**

(vi) After the preparation of the draft financial statements, it was discovered that inventory items lost in a fire incident were ignored altogether. If the entity follows periodic inventory system, what would be the effect of the correction?

	Gross profit	Net profit
(a)	Increase	No impact
(b)	Decrease	Decrease
(c)	No impact	No impact
(d)	Increase	Decrease

(01)

(vii) Which of the following falls under the definition of investment property?

(a) Owner occupied property awaiting disposal
(b) Property occupied by an employee
(c) Land held for undetermined use
(d) Property held for future development and subsequent use as owner-occupied property **(01)**

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

(I) Earnings per share amounts should not be presented if they are negative i.e. losses per share.
(II) Earnings per share amounts calculated for discontinued operations must be presented on the face of the statement of profit or loss.

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

(ix) Which **TWO** of the following may appear in the operating cash flows?

(a) Increase in depreciation expense
(b) Interest received
(c) Dividend paid
(d) Sale proceeds from disposal of property, plant and equipment **(01)**

Section B

Q.7 Roman Limited (RL) has extracted the following information for the purpose of preparation of statement of changes in equity for the year ended 31 December 2022:

	2022 Draft	2021 Audited	2020 Audited
	--------- Rs. in million	---------	
Net profit	285	195	177
Revaluation surplus arising during the year	-	115	(78)
Transfer of incremental depreciation	30	26	28

Additional information:

(i) On 1 February 2021, a bonus issue of 10% was made as final dividend for 2020.
(ii) On 15 May 2021, RL issued right shares for Rs. 20 per share. Right shares were issued in a proportion of 1 right share for every 4 ordinary shares held. Transaction cost of Rs. 0.5 per share was also incurred.
(iii) On 1 May 2022, an item of property, plant and equipment was disposed of at its carrying value. An amount of Rs. 75 million was remaining in the revaluation surplus account in respect of this item's previous revaluations.
(iv) On 1 July 2022, 50 million irredeemable preference shares having par value Rs. 10 each were issued at Rs. 15 per share.
(v) In October 2022, an interim 5% cash dividend on all shares was made.

(vi) The revalued amount of RL's head office building was determined as Rs. 400 million as on 31 December 2021. However, revaluation was not incorporated as the change in revalued amount was considered to be temporary by RL's management. The head office building had a carrying value of Rs. 350 million on 31 December 2021 and had a remaining useful life of 10 years. A revaluation loss of Rs. 24 million was recorded on 31 December 2019 on its previous revaluation.

(vii) Share capital and reserves as at 1 January:

	2021	2020
	------ Rs. in million ------	
Ordinary share capital (Rs. 10 each)	800	800
Retained earnings	715	510
Revaluation surplus	399	505

Required:
Prepare RL's statement of changes in equity for the year ended 31 December 2022 along with comparative figures. ***(Column for total is not required)*** **(15)**

Q.8 Aztec Sports Club (ASC) was formed on 1 January 2021 when a founding member sold a piece of land to ASC having fair value of Rs. 4,000,000 for the purpose of establishing a sports club, for Rs. 1,000,000 only. The following information is available for the preparation of financial statements of ASC for the year ended 31 December 2022:

(i) Balances of some assets and liabilities as on 1 January 2022:

	Rs. in '000
Cash and bank balances	223
Fixed assets (other than land)	6,450
Prepaid insurance	274
Accrued other expenditures	865

(ii) Payments made during the year:

	Rs. in '000
Fixed assets (on 1 May 2022)	6,000
Annual insurance (valid till 31 March 2023)	1,404
Other expenditures	2,788

(iii) Annual membership fee for the years 2021, 2022 and 2023 was Rs. 8,000, Rs. 10,000 and Rs. 12,000 respectively. However, members joining in second half of year are charged only half fee for that year. Each member is required to pay the membership fee for the current year and the next year at the time of admission. The numbers of members admitted during the years 2021 and 2022 are as follows:

2021		2022	
1st half	2nd half	1st half	2nd half
150	270	220	105

(iv) Contributions received during the year:
- A member contributed Rs. 1,400,000 for the purchase of a tractor for ground's maintenance. The tractor will be purchased in the year 2023.
- Another member contributed Rs. 1,100,000 without specifying any restriction.

(v) On 1 April 2021, an area was given on rent for operating a canteen in the club at an annual rent of Rs. 840,000. However, to facilitate the tenant for setting up the canteen, it was agreed that the rent for 2 years will be paid in 2023.

(vi) On 1 September 2022, some fixed assets having book value of Rs. 3,000,000 on 1 January 2022 were disposed of for Rs. 3,300,000.

(vii) Depreciation is charged on all fixed assets (other than land) using reducing balance method at a rate of 20% per annum.

Required:
Prepare the following using the deferral method:

(a) Statement of income and expenditure for the year ended 31 December 2022 **(09)**
(b) Statement of financial position as at 31 December 2022 **(09)**

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

(i) On 1 July 2019, ML acquired a warehouse at a cost of Rs. 300 million and was immediately given on rent to a third party. On 1 January 2022, ML commenced the development work on its warehouse with a view to put it in own use. The development work was completed on 31 March 2022 at a cost of Rs. 50 million. ML started using the warehouse for its inventory on 1 May 2022. Fair value of the warehouse on various dates are as follows:

	31 Dec 2020	31 Dec 2021	31 Mar 2022	31 Dec 2022
Rs. in million	316	344	352	366

Depreciation is charged on warehouse at a rate of 10% per annum using the reducing balance method.

(ii) On 1 January 2020, ML purchased a heavy duty vehicle for Rs. 360 million. On purchase date, the vehicle had an estimated useful life and residual value of 5 years and Rs. 72 million respectively.

During 2022, ML has decided to change the depreciation method for vehicles from reducing balance to straight line.

(iii) On 1 June 2021, ML started construction of an office building. The building was available for use on 1 October 2022 and was immediately put into use. Details of the construction costs incurred are as under:

Payment date	Rs. in million	Sources (See below)
1 May 2021	140	**A**
1 January 2022	*100	**A & B**
1 April 2022	70	**C**
1 August 2022	160	**D**
	470	

**The bill from the contractor was received on 1 December 2021.*

These payments were financed through the following sources:

(A) A short term loan of Rs. 200 million obtained on 1 April 2021 from Bank A at the rate of 16% per annum. The surplus funds available from the loan were invested in a saving account at 10% per annum. On 1 March 2022, ML repaid the loan using the proceeds received from a right issue of shares.
(B) Excess cash available with ML in current bank accounts.
(C) Withdrawals from its short term investments earning a profit of 12% per annum.
(D) Withdrawals from a running finance facility from Bank B carrying interest at 14% per annum. The facility is also used for working capital needs.

Depreciation is charged on office building using straight line method over the estimated useful life of 20 years.

Additional information:
- Cost model is used for subsequent measurement of all property, plant and equipment.
- Fair value model is used for subsequent measurement of all investment properties.

Required:
Prepare relevant extracts **(including comparative figures)** from ML's statement of profit or loss for the year ended 31 December 2022 and statement of financial position as on that date. **(17)**

(THE END)