The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

7 September 2019
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Section A

Q.1 Copper Limited (CL) entered into following transactions during the year ended 30 June 2019:

(i) On 1 October 2018, CL imported a machine from China for USD 250,000 against 60% advance payment which was made on 1 July 2018. The remaining payment was made on 1 April 2019.

(ii) On 1 January 2019, CL sold goods to a Dubai based company for USD 40,000 on credit. CL received 25% amount on 1 April 2019, however, the remaining amount is still outstanding.

Following exchange rates are available:

Date	1 Jul 2018	1 Oct 2018	1 Jan 2019	1 Apr 2019	30 Jun 2019	Average
1 USD	Rs. 121	Rs. 124	Rs. 137	Rs. 140	Rs. 163	Rs. 135

Required:
Prepare journal entries in CL's books to record the above transactions for the year ended 30 June 2019. **(08)**

Q.2 Diamond Limited, a listed company, has six operating segments. These segments do not have similar economic characteristics. Following segment wise information is available:

Segments	**Revenue**			**Profit/(loss)**	**Total assets**
	External	**Inter-segment**	**Total**		
	Rs. in '000				
A	-	24,000	24,000	(1,800)	5,400
B	184,000	8,000	192,000	(12,000)	48,000
C	22,000	4,500	26,500	19,000	4,500
D	24,000	-	24,000	(23,200)	6,000
E	23,000	-	23,000	2,300	6,500
F	25,000	3,000	28,000	2,900	18,000
	278,000	**39,500**	**317,500**	**(12,800)**	**88,400**

Required:
Identify the reportable segments under IFRSs alongwith brief justification. **(07)**

Q.3 On 1 July 2018, Gypsum Limited purchased 5,000 debentures issued by Iron Limited at par value of Rs. 100 each. The transaction cost associated with the acquisition of the debentures was Rs. 24,000. The coupon interest rate is 11% per annum payable annually on 30 June. On 1 July 2018, the effective interest rate was worked out at 9.5% per annum whereas the market interest rate on similar debentures was 11% per annum.

As on 30 June 2019, the debentures were quoted on Pakistan Stock Exchange at Rs. 96 each.

Required:
Prepare journal entries for the year ended 30 June 2019 if the investment in debentures is subsequently measured at:

(a) amortized cost **(03)**
(b) fair value through profit or loss **(03)**

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

(i) Which of the following does **NOT** give rise to deferred tax?

(a) Difference between accounting depreciation and tax depreciation
(b) Expenses charged in the statement of profit or loss but not allowable in tax
(c) Revaluation of a non-current asset but not allowable in tax
(d) Unused tax losses **(01)**

(ii) Which **TWO** of the following are examples, where carrying amount is always equal to tax base?

(a) Accrued expenses that have already been deducted in determining the current tax
(b) Allowance for bad debts where tax relief is granted when the debt is written-off
(c) Accrued income that will never be taxable
(d) Capitalized development costs which are allowable in tax upon payment **(02)**

(iii) The following information relates to a building of Jet Limited (JL).

- At 1 January 2018, the carrying amount of the building exceeded its tax base by Rs. 1,275,000.
- In 2018, JL claimed tax depreciation of Rs. 750,000 and charged accounting depreciation of Rs. 675,000.
- As at 31 December 2018, JL increased the carrying amount of the building by Rs. 375,000 on account of revaluation. Revaluation is not allowed in tax.
- Applicable tax rate is 32%.

The deferred tax liability as at 31 December 2018 in respect of building is:

(a) Rs. 384,000 (b) Rs. 432,000
(c) Rs. 504,000 (d) Rs. 552,000 **(02)**

(iv) IAS 41 is applied to agricultural produce:

(a) before the harvest (b) at the point of harvest
(c) after the harvest (d) before, during and after the harvest **(01)**

(v) Disclosure requirements of IAS 8 in respect of change in accounting policy are **NOT** applicable in case of :

(a) change in method for inventory valuation from FIFO to weighted average
(b) initial adoption of revaluation model for property, plant and equipment
(c) change in revenue recognition policy
(d) none of the above **(01)**

(vi) Which of the following is **NOT** a characteristic of ‘small sized company’ under the Companies Act, 2017?

(a) A private company
(b) Paid-up capital upto Rs. 10 million
(c) Total assets upto Rs. 100 million
(d) Employees not more than 250 **(01)**

(vii) Which of the following should **NOT** be included in the initial cost of a right of use asset?

(a) Amount of initial measurement of the lease liability
(b) Present value of estimated cost of dismantling the asset at the end of lease period
(c) Payments made to the lessor before commencement of the lease
(d) Gross lease rentals payable under the lease agreement **(01)**

(viii) Wood Leasing Limited has leased certain equipment on 1 July 2018. In this respect, following information is available:

	Rs. in million
Fair value of equipment	67.00
Amount received on 1 July 2018	5.50
Four annual instalments payable in arrears	20.00
Guaranteed residual value on expiry of the lease	10.00

Useful life of the equipment is estimated at 5 years. Implicit rate in the lease is 16%.

What amount of net investment in lease will be presented in **non-current** assets as at 30 June 2019?

(a) Rs. 57.72 million (b) Rs. 46.96 million
(c) Rs. 51.34 million (d) Rs. 39.55 million **(02)**

Section B

Q.5 Coal Limited (CL) is preparing its financial statements for the year ended 30 June 2019. Following information is available:

(i) On 1 January 2019, CL acquired a machine on lease from a bank. Fair value of machine on acquisition was Rs. 70 million. CL incurred initial direct cost of Rs. 5 million and received lease incentives of Rs. 2 million.

The terms agreed with the bank are as follows:

- The lease term and useful life are 4 years and 10 years respectively.
- Instalment of Rs. 17 million is to be paid annually in advance on 1 January.
- The rate implicit in the lease is 15.096% per annum.
- At the end of the lease term, CL has an option to purchase the machine at its estimated fair value of Rs. 25 million. It is not reasonably certain that CL will exercise this option. **(07)**

(ii) During the year, it was discovered that due to some calculation error in excel sheet, fair value of CL's office building was taken incorrectly as Rs. 460 million instead of Rs. 360 million. Resultantly, the building was recorded based on incorrect revaluation amount in CL's financial statements for the year ended 30 June 2017.

This building was acquired on 1 July 2015 for Rs. 500 million and then revalued for the first time on 30 June 2017.

CL follows revaluation model for subsequent measurement of its building classified as property, plant and equipment and charges depreciation over its useful life of 10 years using straight line method. CL accounts for revaluation on net replacement value method and transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.

As on 30 June 2019, the revalued amount of building has been determined at Rs. 320 million. **(09)**

Required:
Prepare extracts from CL's statement of financial position and related notes to the financial statements for the year ended 30 June 2019 alongwith comparative figures for the above.
(Note on Property, plant and equipment is not required)

Q.6 The following balances are extracted from the records of Golden Limited (GL), Silver Limited (SL) and Bronze Limited (BL) for the year ended 30 June 2019:

	GL	SL	BL
	---------- Rs. in million ----------		
Sales	2,500	2,050	1,000
Cost of sales	1,550	1,150	590
Operating expenses	810	520	288
Other income	350	180	50
Finance cost	90	60	35
Surplus arising on revaluation of property, plant and equipment during the year	60	-	20
Investment in SL - at cost	1,400	-	-
Investment in BL - at cost	2,500	-	-
Retained earnings as at 30 June 2019	8,000	3,500	2,200

Additional information:

(i) Details of GL's investments are as follows:

Date of investment	Holding %	Investee	Share capital (Rs. 10 each) of investee	Retained earnings of investee
			---------- Rs. in million ----------	
1 Jan 17	35%	BL	5,000	1,800
1 Jul 18	70%	SL	6,000	3,000

(ii) Cost of investment in SL includes professional fee of Rs. 20 million incurred on acquisition of SL.

(iii) The following considerations relating to acquisition of SL's shares are still unrecorded:

- Issuance of 175 million ordinary shares of GL.
- Cash payment of Rs. 1,000 million after three years.

On the date of investment, the market price of shares of GL and SL were Rs. 20 and Rs. 17 respectively. Applicable discount rate is 12%.

(iv) At the date of acquisition of SL, carrying values of its net assets were equal to fair value except the following:

- an internally developed software by SL which had a fair value of Rs. 150 million. The cost of Rs. 120 million incurred by SL on development had been expensed out by SL since the software did not meet the criteria for capitalization during development. At acquisition date, the software had a remaining useful life of 5 years.
- a contingent liability of Rs. 90 million as disclosed in financial statements of SL which had an estimated fair value of Rs. 60 million. Subsequent to acquisition, the liability has been recognised by SL in its books at Rs. 40 million.

(v) Following inter-company sales at cost plus 15% were made during the year ended 30 June 2019:

	Sales	Included in buyer's closing stock-in-trade
	------------- Rs. in million -------------	
SL to GL	506	138
GL to BL	161	69

(vi) On 1 January 2019, GL granted loans of Rs. 150 million and Rs. 130 million to SL and BL respectively, at interest rate of 12% per annum.

(vii) GL and BL follow revaluation model whereas SL follows cost model for subsequent measurement of property, plant and equipment. If SL had adopted the revaluation model, SL would have recorded revaluation surplus of Rs. 35 million for the year ended 30 June 2019.

(viii) GL measures non-controlling interest at the acquisition date at its fair value.

Required:

(a) Prepare GL's consolidated 'statement of profit or loss and other comprehensive income' for the year ended 30 June 2019. **(17)**

(b) Compute the amount of investment in associate as would appear in GL's consolidated statement of financial position as at 30 June 2019. **(03)**

Q.7 Turquoise Limited (TL) is in the process of finalizing its financial statements for the year ended 30 June 2019. Following matters are under consideration:

(i) On 10 July 2019, the owner of the adjacent building filed a case against TL claiming Rs. 50 million. The claim is made in respect of severe damage to his building during a fire incident in TL's head office in June 2019. He is of the view that TL was negligent in maintaining fire safety systems in its head office. According to TL's lawyers, there is 70% probability that TL would be found negligent and would need to pay 40% of the amount claimed. **(04)**

(ii) In May 2019, TL's board of directors decided to relocate its regional office from Multan to Lahore. In this respect, a detailed plan was approved by the management and a formal public announcement was made in June. TL has planned to complete the relocation by December 2019. The related costs have been estimated as under:

	Rs. in million
Redundancy payments	20
Costs of moving office equipment to Lahore	3
Compensation to employees agreeing to relocate	10
Salary of existing operation manager (responsible to supervise the relocation)	2

(04)

(iii) TL had 6,000 unsold units of product A as on 30 June 2019 acquired at Rs. 500 per unit. In June 2019, the selling price of product A has fallen to Rs. 350 per unit.

TL acquires product A under the contract in which TL has to buy 10,000 units of product A per month for Rs. 500 per unit. The contract is valid till 31 August 2019 and if TL decides to cancel the contract, then it must pay a cancellation penalty of Rs. 4 million. TL is of view that the market may not improve in near future. **(04)**

(iv) TL sells product B with a warranty of 12 months, though the manufacturer i.e. Sulphur Limited (SL) provides a warranty of 8 months only. Warranty services are provided by SL. However, TL is responsible if SL fails to honour its obligation for this warranty. If warranty claim arises within 8 months, SL does not charge any cost. However, SL charges Rs. 500, Rs. 1,000 and Rs. 2,500 for a minor, moderate and major defect respectively in each unit if the defect arises in the extended warranty period of 4 months offered by TL. The probability that a warranty claim in respect of a unit sold may arise, is as under:

Nature of defect	**First 8 months**	**Last 4 months**
Minor	12%	6%
Moderate	7%	10%
Major	4%	5%

During the year ended 30 June 2019, a total of 12,000 units of product B has been sold by TL and warranty cost of Rs. 1.2 million has been paid to SL in respect of these units. **(05)**

Required:
Discuss how the above issues should be dealt with in the financial statements of TL for the year ended 30 June 2019. Support your answers in the context of relevant IFRSs.

Q.8 Zinc Limited (ZL), a broadcasting company, uses revaluation model for subsequent measurement of its intangible assets, wherever possible. Following information pertains to ZL's intangible assets:

(i) On 1 January 2018, ZL bought an incomplete research and development project from Bee Tech at its fair value of Rs. 90 million. The purchase price was analysed as follows:

	Rs. in million
Research	30
Development	60

Subsequent expenditures incurred on this project are as follows:

	Rs. in million
Further research to identify possible markets	10
Development	48

Recognition criteria for capitalization of development was met on 1 March 2018. All costs are incurred evenly from 1 January 2018 till project completion date i.e. 31 August 2018. It is expected that newly developed technology will provide economic benefits to ZL for the next 10 years.

On 31 December 2018, ZL received an offer of Rs. 170 million for its developed technology.

(ii) On 31 December 2018, ZL launched its new website for online streaming of TV shows, movies and web series. The website's content is also used to advertise and promote ZL's products. The website was developed internally and met the criteria for recognition as an intangible asset. Directly attributable costs incurred for the website are as follows:

	Rs. in million
Undertaking feasibility studies	3
Evaluating alternative products	1
Acquisition of web servers	16
Acquisition cost of operating system of web servers	7
Registration of domain names	2
Stress testing to ensure that website operates in the intended manner	3
Designing the appearance of web pages	5
Development cost of new content related to:	
▪ online streaming	11
▪ advertising and promoting ZL's products	8
Advertising of the website	6

(iii) During 2018, the licensing authority intimated that broadcasting license of one of ZL's channels will not be further renewed.

ZL had obtained this license for indefinite period on 1 January 2012 by paying Rs. 150 million, subject to renewal fee of Rs. 0.3 million at every five years. Upto last year, this license was expected to contribute to ZL's cash inflows for indefinite period.

As on 31 December 2018, the recoverable amount of this license was assessed as Rs. 105 million.

Required:
In accordance with the requirements of IFRSs, prepare a note on intangible assets, for inclusion in ZL's financial statements for the year ended 31 December 2018 in respect of the above intangible assets. ***('Total' column is not required)*** **(15)**

(THE END)