The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

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

Financial Accounting and Reporting-II

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 Ajwa Limited (AL) is engaged in the business of manufacturing and trading of consumer goods. On 1 July 2021, AL launched its own website for online sale of its products. The website was developed internally which met the criteria for recognition as an intangible asset on 1 May 2021. Directly attributable costs incurred for the website are as follows:

	***Incurred in 2021**	**Rs. in million**
Defining hardware and software specifications	January to March	0.5
Salaries and general overheads	January to June	6.0
Development of the content	May to June	7.0
Registering website with search engines	June	1.0
Annual fees for website hosting	June	0.6
Employees training costs	June to July	1.5
Discount offers for logging on the website	July to August	2.0

All costs were incurred evenly throughout the mentioned period.

Required:
Compute the cost of the website for initial measurement. Also discuss the reason(s) for not inclusion of any of the above costs in the computation. **(07)**

Q.2 Retained earnings column extracted from the draft statement of changes in equity of Zahidi Limited (ZL) for the year ended 31 December 2020, is as follows:

	Retained earnings Rs. in million
Balance as at 31 December 2018	351
Final cash dividend for the year 2018	(15)
Total comprehensive income for the year 2019	68
Balance as at 31 December 2019	404
Total comprehensive income for the year 2020	82
Balance as at 31 December 2020	**486**

On 1 January 2018, ZL had acquired a building at cost of Rs. 200 million and had rented it out on the same day for three years. On 31 December 2020, the tenant vacated the building and ZL decided to transfer its head office to such building.

The finance manager was considering the reporting implications of change in use of the building. He came to know that the building has erroneously been reported as property, plant and equipment since inception and was being depreciated on straight line basis over 20 years. The fair value of the building has increased by 10% in each year since acquisition.

ZL follows cost model for property, plant and equipment and fair value model for investment property.

Required:
Prepare the following extracts from ZL's financial statements for the year ended 31 December 2020 in accordance with IFRSs:

(a) Correction of error note **(05)**
(b) Retained earnings column as would appear in the statement of changes in equity. **(03)**
(Show comparative figures)

Q.3 Rabbi Limited (RL) has made the following investments for the first time:

(a) RL purchased 1 million ordinary shares of Kholas Limited at the fair value of Rs. 23 per share. RL also incurred transaction cost of Rs. 0.5 million. RL considers this investment as a strategic equity investment and not held for trading.

(b) RL also purchased 1 million bonds of Barhi Limited having face value of Rs. 100 each at Rs. 95. These bonds are redeemable in five years' time. RL also incurred transaction cost of Rs. 0.8 million. RL intends to hold the bonds till maturity in order to collect contractual cash flows.

Required:
In respect of each of the above investments, discuss the possible classification option(s) available to RL for accounting purposes. Also compute the amount at which these investments would be initially recognised under each option. **(08)**

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

(i) ICAP code of ethics applies to:

(a) Members only
(b) Members and students only
(c) Members, students and affiliates only
(d) Members, students, affiliates and employees of member firms **(01)**

(ii) A Limited, an unlisted company, is the parent of B Limited, a listed company. Which schedule of the Companies Act, 2017 would apply to the financial statements of A Limited and B Limited for disclosures?

	A Limited	**B Limited**
(a)	Fifth	Fourth
(b)	Fourth	Fifth
(c)	Fourth	Fourth
(d)	Fifth	Fifth

(01)

(iii) Which of the following is **NOT** a primary indicator for determining functional currency of an entity?

(a) Currency of the country whose competitive forces and regulations mainly determine the sale prices of its goods and services
(b) Currency in which funds from financing activities are generated
(c) Currency that mainly influences sales prices for goods and services
(d) Currency that mainly influences labor, material and other costs **(01)**

(iv) Which **two** of the following are the non-monetary items?

(a) Foreign currency trade payables
(b) Right of use assets
(c) Advance to suppliers
(d) Lease liabilities **(01)**

(v) Which **two** of the following treatments for recognition of government grant related to biological asset measured at its fair value less cost to sell are correct?

(a) An unconditional grant is recognised in profit or loss when, and only when the grant becomes receivables
(b) An unconditional grant is recognised in profit or loss only when, and only when the grant is received
(c) A conditional grant is recognised in profit or loss when, and only when the conditions attaching to the grant are met
(d) A conditional grant is recognised in profit or loss when, and only when the grant is received **(02)**

(vi) Operating segments of an entity have reported following profit or loss for the year:

	A	**B**	**C**	**D**	**E**	**Total**
Profit / (loss) **(Rs. in million)**	100	25	(40)	35	(50)	70

For the purpose of determining reportable operating segments, the quantitative threshold of 10% would be applied on the amount of:

(a) Rs. 70 million (b) Rs. 90 million
(c) Rs. 100 million (d) Rs. 160 million **(01)**

(vii) An entity acquired a patent for a period of ten years at cost of Rs. 90 million. The patent can be further renewed for another five years at renewal cost of Rs. 1 million. The entity estimated that expected period of cash inflows is twelve years from acquisition date. The useful life of patent in years is:

(a) Five (b) Ten (c) Twelve (d) Fifteen **(01)**

(viii) Which **two** of the following events after the balance sheet date would normally require adjustment in the amounts recognised in the financial statements in accordance with IAS 10?

(a) Determination of the cost of assets purchased before the balance sheet date
(b) Announcement of changes in tax rates
(c) Declaration of dividend on ordinary shares
(d) Bankruptcy of a customer with outstanding amount at the balance sheet date **(02)**

Section B

Q.5 Following are the summarized statements of financial position of Safawi Limited (SL) and Khudri Limited (KL) as at 30 June 2021:

	SL	KL
	--- Rs. in million ---	
Property, plant and equipment	2,390	1,210
Intangible assets	525	135
Investment in Anbara Limited – at cost	540	-
Inventories	1,200	600
Other current assets	1,485	445
	6,140	**2,390**
Share capital (Rs. 10 per share)	2,500	1,000
Share premium	1,040	-
Retained earnings	1,280	1,200
Liabilities	1,320	190
	6,140	**2,390**

Additional information:

(i) On 1 October 2020, SL acquired 80% shareholdings in KL through share exchange of one share in SL for every share in KL. At acquisition date, KL's retained earnings were Rs. 1,000 million and the fair values of each share of SL and KL were Rs. 25 and Rs. 23 respectively. Shares issued by SL have not been recorded in the books.

(ii) On acquisition date, carrying values of KL's net assets were equal to their fair values except the following:

- Inventories were carried at Rs. 240 million and had a fair value of Rs. 340 million. 60% of these were sold during the year ended 30 June 2021.
- Land was carried at nil value and had a fair value of Rs. 50 million. The land was allotted unconditionally to KL by the government free of cost in 2018 when its fair value was Rs. 40 million.

(iii) On 1 January 2021, SL disposed of a software license to KL for Rs. 120 million. Its carrying value and remaining useful life at that date was Rs. 90 million and 3 years respectively.

(iv) Due to temporary adverse economic conditions, an impairment test carried out at 30 June 2021 indicated that goodwill has been impaired by Rs. 60 million.

(v) On 1 July 2020, SL acquired 3 million shares of Anbara Limited (AL) representing 25% shareholdings. On that date, AL's retained earnings and fair value of each share were Rs. 2,400 million and Rs. 172 respectively.

(vi) During the year ended 30 June 2021, AL reported net loss of Rs. 280 million and other comprehensive income of Rs. 60 million.

(vii) On 1 July 2020, SL disposed of machinery to AL for Rs. 200 million at a gain of 100%. The remaining useful life of the machinery at the time of disposal was 5 years.

(viii) An impairment test carried out at year end has indicated that investment in AL has been impaired by Rs. 130 million.

(ix) SL values non-controlling interest on the acquisition date at its fair value.

Required:
Prepare SL's consolidated statement of financial position as at 30 June 2021 in accordance with the requirements of IFRSs. **(18)**

Q.6 Sagahi Autos Limited (SAL) is a dealer of specialized vehicles. SAL acquires each unit of vehicle 'Alpha' from manufacturer at a cost of Rs. 26 million and sells it for Rs. 30 million. The estimated economic life of Alpha is five years.

Few prospective customers did not have adequate funds to purchase Alpha on cash. Therefore, SAL entered into the following arrangements during the year ended 31 December 2020:

(i) On 1 January 2020, SAL leased Alpha to Haris for a non-cancellable period of four years. The rate of interest implicit in the lease is 10% per annum. The payment is to be made in four equal annual instalments payable on 31 December each year. The residual value at the end of four years is estimated at Rs. 5 million which is guaranteed by a third party related to SAL.

(ii) On 1 April 2020, SAL leased Alpha to Yasir for a non-cancellable period of three years. The rate of interest implicit in the lease is 18% per annum. Annual instalment of Rs. 10 million is to be paid in advance. At the end of the lease term, Yasir has an option to purchase Alpha at Rs. 7.14 million. It is reasonably certain that Yasir will exercise this option.

(iii) On 1 August 2020, SAL leased Alpha to Faisal for a non-cancellable period of one and a half years. Quarterly instalment of Rs. 3 million is to be paid in arrears. SAL will dispose this unit of Alpha at the end of two years at an estimated residual value of Rs. 11 million.

Direct cost of Rs. 1 million was incurred by SAL for each of the above arrangements. Market rate of interest is 15% per annum.

Required:
Prepare journal entries for each of above lease transactions in the books of SAL for the year ended 31 December 2020. **(16)**

Q.7 Following information has been gathered for preparing the disclosures related to taxation of Mabroom Limited (ML) for the year ended 31 December 2020:

(i) Accounting profit before tax for the year amounted to Rs. 50 million.

(ii) Accounting amortization exceeded tax amortization by Rs. 20 million (2019: Rs. 12 million). As at 31 December 2020, carrying values of intangible assets exceeded their tax base by Rs. 145 million.

(iii) During the year, ML incurred advertising cost of Rs. 12 million. This cost is to be allowed as tax deduction over 3 years from 2020 to 2022.

(iv) During the year, entertainment expenses amounting to Rs. 10 million pertaining to year ended 31 December 2018 were disallowed. Similar entertainment expenses for the current year were amounted to Rs. 7 million.

(v) Provision for warranty as at 31 December 2020 was Rs. 23 million (2019: Rs. 18 million). Under tax laws, warranty expense is allowed on payment basis.

(vi) During the year, ML recorded dividend income of Rs. 6 million out of which Rs. 2 million was not received till 31 December 2020. Under tax laws, dividend is taxable on receipt basis at the rate of 15%.

(vii) On 1 April 2020, a manufacturing plant was acquired on lease for a period of 4 years at an annual lease rental of Rs. 40 million, payable in arrears. Interest rate implicit in the lease is 10% per annum. Under tax laws, all lease rentals are allowed on payment basis.

(viii) Applicable tax rate (other than dividend income) is 35% for 2020 and prior years. However, this rate has been reduced by 5% for 2021 and future years through Finance Act enacted on 20 December 2020.

Required:

(a) Prepare a note on taxation for inclusion in ML's financial statements for the year ended 31 December 2020 and a reconciliation to explain the relationship between the tax expense and accounting profit. **(11)**

(b) Compute deferred tax liability/asset in respect of each temporary difference as at 31 December 2020 and 2019. **(07)**

Q.8 **For the purpose of this question, assume that the date today is 1 August 2021.**

On 1 January 2021, Holwah Automobiles Limited (HAL) launched vehicle with the brand name of 'Deluxe'. In March 2021, reports were circulated in social media that carbon emissions from Deluxe exceed the regulatory limits. In May 2021, HAL announced to halt the sales of Deluxe upon receiving an inquiry from regulatory authority.

On 1 June 2021, HAL announced that:

- high emissions were confirmed in those batches of Deluxe which were produced from March 2021 and onwards due to defect in assembling of emission kit.
- customers can get the defect fixed from the authorized dealers free of cost from 1 July 2021.
- sales of Deluxe will also resume from 1 July 2021.

The senior management has summarized the following financial implications of the above matter:

(i) On 10 June 2021, a penalty of Rs. 20 million was imposed by the regulatory authority. On 25 July 2021, an additional penalty of Rs. 2 million was imposed due to non-payment of penalty within 40 days. HAL has decided to challenge the additional penalty on the relevant forum.

(ii) Defect in the existing inventory of Deluxe will be fixed by HAL at its factory in the month of August 2021. The rework cost will be Rs. 15 million and loss of profit due to temporary suspension of production will be Rs. 30 million.

(iii) Defect in all vehicles sold during March to May 2021 will be fixed by the authorized dealers in July and August 2021. The cost will be re-imbursed to dealers at the end of each month on the basis of actual number of vehicles fixed. Though HAL is legally bound to fix the defect in all vehicles which will cost approximately Rs. 50 million, management estimates that only 85% of customers will get their vehicle fixed.

(iv) Market value of internally generated brand of Deluxe would reduce by Rs. 150 million.

(v) Value in use of the production line of Deluxe would reduce by Rs. 80 million.

(vi) In June 2021, the regulatory authority has introduced new emission protocol to ensure that the emissions are within the limits and needs to be complied by 30 September 2021. The new protocol will require modification in the existing production line at a cost of Rs. 100 million.

Required:

In the context of relevant IFRSs, discuss how the above financial implications should be dealt with in the financial statements of HAL for the year ended 30 June 2021. **(15)**

(THE END)