The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

6 March 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.

Section A

Q.1 With reference to IAS 41, identify whether each of the following statements is **TRUE** or **FALSE**:

(i) Both fish farming and ocean fishing are agricultural activities.
(ii) IAS 41 does not apply on bearer plant; however, it applies on produce growing on bearer plant.
(iii) A biological asset should initially be measured at cost of purchase.
(iv) A biological asset should subsequently be measured at fair value.
(v) The gain or loss on subsequent re-measurement of a biological asset should be taken to profit and loss account.
(vi) Commission to brokers as well as advertising cost would be classified as cost to sell when valuing agricultural produce upon harvest.
(vii) All government grants related to biological assets are accounted for under IAS 41.
(viii) Once wool is extracted from the sheep, subsequent processing of wool into carpets is accounted for under IAS 2. **(08)**

Q.2 **For the purpose of this question, assume that the date today is 1 February 2021.**

You are finance manager of Tibet Limited (TL). You are finalizing the financial statements of TL for the year ended 31 December 2020. The Chief Executive of TL has sent you the following email:

> 2020 was a tough year for TL due to COVID-19. The net profit of TL is expectedly very low as compared to previous years. However, I have identified the following matters which may improve TL's net profit for 2020:
>
> (i) On 25 January 2021, Government has enacted amendments in the income tax laws to reduce the rate of income tax for companies by 10% for 3 years including 2020.
>
> (ii) The exchange rate has risen from Rs. 150 per USD as on 31 December 2020 to Rs. 162 per USD. TL has significant receivables in USD due to export sales.
>
> (iii) A major local customer has settled his full balance after receiving bank loan last week. At year-end, the customer was facing financial difficulty and therefore TL had provided 40% of his balance as doubtful receivable.
>
> (iv) In December 2020, Government has announced a compensation scheme for entities which have not terminated any employee in 2020. Under the scheme, these entities would be reimbursed 25% of salaries expense of 2020. TL would initiate the process of obtaining the reimbursement after completion of audit. The reimbursement might take few months.

Required:
Discuss how each of the above matters would affect TL's net profit for the year ended 31 December 2020. Support your answer with justifications. **(08)**
(Discussion on disclosure requirements is not required)

Q.3 Dove Limited (DL) commenced development of a new product on 1 January 2020. In this regard, following expenditures have been incurred:

Description	Incurred in	Rs. in million
Evaluation of possible alternatives	January 2020	2
Pre-production prototypes	February and March 2020	17
Pilot plant	April to July 2020	40
Fee to register legal rights	August 2020	15
Cost of manufacturing samples	August to October 2020	*32
Brand building cost	October to December 2020	16

**NRV of Rs. 20 million*

DL has also incurred directly attributable salaries and overheads of Rs. 5 million and Rs. 1.5 million respectively in each month over the development period of new product.

The recognition criteria for capitalization of internally generated intangible asset was met on 1 April 2020 and commercial production of the product was commenced from 1 November 2020.

Required:
Compute the cost of the new product for initial measurement. Also discuss the reason(s) for ignoring any of the above expenditures in the computation. **(08)**

Q.4 Capri Ice, a notable ice cream parlour, enters into a contract with Yardley Limited (YL) to use a space in a shopping mall owned by YL for a period of five years. The contract specifies the dimensions of space and location. However, YL has discretion to relocate the space to any other floor to accommodate other customers who would be conducting promotional events and activities in the mall.

Required:
Discuss whether the contract between Capri Ice and Yardley Limited constitute lease or not. **(03)**

Section B

Q.5 (a) On 1 January 2020, Dettol Limited (DL) acquired a machine on lease from Lifebuoy Leasing Limited (LLL) for 3 years. The first annual instalment amounting to Rs. 35 million was paid on 1 January 2020 and all subsequent annual instalments are payable on 1 January subject to increase of 10% each year.

DL incurred initial direct cost of Rs. 5 million. As an incentive to DL for entering into the lease, LLL reimbursed Rs. 2 million.

LLL has incorporated an implicit rate of 11% per annum which is not known to DL.

The residual value of the machine at the end of 3 years is estimated at Rs. 30 million, out of which DL has guaranteed Rs. 20 million.

DL is also obliged to incur decommissioning cost of Rs. 4 million at the end of the lease term.

Discount rate of 12% may be assumed wherever required but not given.

Required:
Prepare relevant extracts from **DL**'s statement of profit or loss for the year ended 31 December 2020 and statement of financial position as on that date. **(09)**

(b) Using the information given in part (a) above, prepare note(s) for inclusion in the financial statements of Lifebuoy Leasing Limited (LLL) for the year ended 31 December 2020. **(08)**

Q.6 Safeguard Limited (SL) is listed on Pakistan Stock Exchange and has registered office in Lahore. SL is engaged in the manufacture of polyester and soda ash. Production plants are located in Lahore and Karachi. Following is the SL's draft statement of financial position as on 31 December 2020:

Equity and liabilities	Rs. in million	Assets	Rs. in million
Share capital (Rs. 10 each)	5,000	Property, plant and equipment	4,520
Reserves	2,050	Loan to employees	330
Long term liabilities	1,440	Trade and other receivables	3,265
Trade and other payables	1,610	Stock-in-trade	2,250
Bank overdraft	265		
	10,365		**10,365**

Additional information:

(i) Authorised share capital consists of 900 million shares of Rs. 10 each.

(ii) 130 million shares were issued at premium of Rs. 5 as consideration for purchase of building and plant. Remaining shares were allotted at par for consideration paid in cash.

(iii) Reserves include revaluation surplus on property, plant and equipment of Rs. 190 million.

(iv) Long term liabilities comprise of:

- loan from bank of Rs. 1,100 million, out of which Rs. 250 million is payable on 30 November 2021.
- long term deposit of Rs. 340 million from dealers.

(v) Trade and other payables include unpaid dividend of Rs. 18 million.

(vi) Loan to employees include loans to directors of Rs. 140 million. All of these loans are interest free house financing for 10 years as per company's policy. 30% of the amount was disbursed during the year. Repayment will start after two years.

(vii) Bank overdraft is net of cash in hand of Rs. 30 million.

(viii) SL has two operating segments on the basis of geographical locations. Information for 2020 extracted from reports to the segment controllers is as follows:

	North	South
	---- Rs. in million ----	
Sales	1,950	1,300
Cost of goods sold	(1,640)	(840)
Gross profit	310	460
Expenses	(175)	(390)
Profit	**135**	**70**

(ix) Assets, other income and expenses of Rs. 300 million, Rs. 40 million and Rs. 74 million respectively cannot be allocated to any segment.

(x) Assets and liabilities of North and South were in the ratio of 4:3.

(xi) North's sales include sales of Rs. 50 million to South at a profit of Rs. 5 million.

Required:

Prepare the revised statement of financial position as at 31 December 2020 along with the relevant notes showing possible disclosures as required under the IFRSs and the Companies Act, 2017. ***(Comparative figures and note on accounting policies are not required)*** **(20)**

Q.7 Following are the summarized statements of financial position of Himaliya Limited (HL) and Method Limited (ML) as on 31 December 2020:

	HL	ML
	--- Rs. in million ---	
Property, plant and equipment	2,400	1,750
Investments	4,320	-
Inventories	1,050	700
Trade receivables	840	525
Cash and bank balances	210	175
	8,820	**3,150**
Share capital (Rs. 10 per share)	4,700	1,400
Share premium	720	-
Retained earnings	2,210	1,190
Liabilities	1,190	560
	8,820	**3,150**

Additional information:

(i) On 1 April 2020, HL acquired 90% shareholdings in ML at Rs. 2,220 million which was recorded as cost of investment by HL. It includes professional fee of Rs. 30 million for advice on acquisition of ML. At acquisition date, ML's retained earnings were Rs. 700 million.

(ii) On acquisition date, carrying value of ML's net assets was equal to fair value except a brand which had not been recognized by ML. The fair value of the brand was assessed at Rs. 160 million. HL estimated that benefit would be obtained from the brand for the next 5 years.

(iii) Upon acquisition, HL had a plan to restructure ML at a cost of Rs. 80 million. Up to 31 December 2020, ML has incurred and recorded cost of Rs. 70 million for restructuring as per HL's plan.

(iv) On 1 January 2020, HL acquired 35% shareholdings in Pears Limited (PL) by investing Rs. 1,500 million. This investment is carried at cost on 31 December 2020. Details of PL's net asset on 31 December 2020 are as follows:

Assets and liabilities	Rs. in million
Property, plant and equipment	2,625
Inventories	1,190
Trade receivables	700
Cash and bank balances	595
Liabilities	(630)
Net assets	**4,480**

(v) During the year ended 31 December 2020, PL earned a net profit of Rs. 910 million.

(vi) PL paid dividend of Rs. 490 million for the half year ended 30 June 2020. HL recorded its share as other income.

(vii) Subsequent to investments made by HL in ML and PL, inter-company sales of goods are invoiced at a mark-up of 25%. The relevant details are as under:

	Rs. in million
ML's inventory on 31 December 2020 includes goods purchased from HL	50
HL's inventory on 31 December 2020 includes goods purchased from PL	120
Receivable from ML on 31 December 2020 as per HL's books	74
Payable to PL on 31 December 2020 as per HL's books	98

(viii) HL values non-controlling interest at the acquisition date at its fair value which was Rs. 240 million.

Required:

(a) Prepare HL's consolidated statement of financial position as at 31 December 2020 in accordance with the requirements of IFRSs. **(17)**

(b) List down the additional information having no effect in your working in (a) above. **(02)**

Q.8 Following information has been gathered for preparing the disclosures related to taxation of Lux Limited (LL) for the year ended 31 December 2020:

(i) Accounting profit before tax for the year amounted to Rs. 1,270 million.

(ii) Accounting depreciation exceeds tax depreciation by Rs. 100 million (2019: Rs. 150 million). Accounting depreciation also includes incremental depreciation of Rs. 40 million (2019: Rs. 60 million). As on 1 January 2019, carrying value of property, plant and equipment exceeded their tax base by Rs. 500 million.

(iii) Liabilities of LL as at 31 December 2020 include:

- balances of Rs. 100 million (2019: Rs. 70 million) which are outstanding for more than 3 years. As per tax laws, liabilities outstanding for more than 3 years are added to income and are subsequently allowed as expense on payment basis.
- unearned commission of Rs. 80 million (2019: Rs. 15 million). Commission is taxable on receipt basis.

(iv) Interest accrued as at 31 December 2020 amounted to Rs. 40 million (2019: Rs. 30 million). Interest income for the year is Rs. 55 million. Interest income is taxable at 20% on receipt basis.

(v) Expenses include payments of donations of Rs. 50 million (2019: Rs 80 million). Donation is allowable in tax by 200% of actual amount.

(vi) LL recorded an expense of Rs. 35 million (2019: nil) to bring an inventory item to its net realizable value. This adjustment is not allowable for tax purposes.

(vii) LL acquired 5% equity in Palmolive Limited for Rs. 425 million on 1 August 2020. The investment was classified at fair value through other comprehensive income. As at 31 December 2020, LL recorded Rs. 65 million as gain for change in fair value. As per tax laws, gain or loss on investment is taxable at the time of sale.

(viii) Applicable tax rate is 30% except stated otherwise.

Required:

(a) Prepare a note on taxation for inclusion in LL's financial statements for the year ended 31 December 2020 and a reconciliation to explain the relationship between the tax expense and accounting profit. **(09)**

(b) Compute deferred tax liability/asset in respect of each temporary difference as at 31 December 2020 and 2019. **(08)**

(THE END)