



## Financial Accounting and Reporting-II

### 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 On 1 July 2021, Nonagon Leasing (NL) leased a machine to Decagon Limited (DL). Details are as follows:

- (i) The non-cancellable lease term is five years during which annual instalment of Rs. 6 million is payable by DL in arrears.
- (ii) DL has an option to extend the lease term by one year by paying Rs. 4 million at start of sixth year. It is reasonably certain that DL will exercise this option.
- (iii) NL estimates the residual value of the machine at the end of lease term to be Rs. 10 million out of which DL has guaranteed Rs. 8 million. DL expects that the machine will have market value of Rs. 5 million at the end of lease term.
- (iv) NL incurred initial direct cost of Rs. 1 million.
- (v) The rate of interest implicit in the lease is 11% per annum.
- (vi) The useful life of the machine is eight years.

### **Required:**

Prepare note(s) for inclusion in the financial statements of NL for the year ended 30 June 2022.

(09)

Q.2 The following transactions pertain to Sphere Limited (SL) for the year ended 30 June 2022:

- (i) On 1 July 2021, SL acquired a license against cash consideration of Rs. 50 million. SL incurred cost of Rs. 3 million which includes refundable taxes of Rs. 1 million for transferring the title to its name.

The license is valid for five years but is renewable every five years at a significant cost of Rs. 40 million. SL intends to renew the license only once and then sell the license at the end of ten years.

SL estimates that residual value of the license would be Rs. 12 million and Rs. 9 million at the end of five years and ten years respectively.

- (ii) On 1 July 2021, SL decided to develop a website for advertising and promotion of its products. SL believes that website would enhance the brand value of the products and would also be used for providing general information about SL to the public.

On 1 September 2021, SL internally initiated development of the website which was completed on 31 January 2022. Directly attributable costs incurred by SL for developing website were as follows:

- Rs. 2 million for planning the website in September 2021.
- Rs. 7 million for acquisition of the web servers in October 2021.
- Rs. 3 million for content development equally in November and December 2021.
- Rs. 1 million for annual website hosting fees (valid till 31 January 2023) paid in January 2022.

**Required:**

Discuss how the above transactions should be dealt with in the SL's books for the year ended 30 June 2022, in accordance with the IFRSs.

**(08)**

- Q.3 Arrow Limited (AL) was incorporated on 1 January 2018 with an authorised capital of 90 million ordinary shares of Rs. 10 each. Details of ordinary shares issued on different dates are as follows:

Issued in	Shares (in million)	Issue price (Rs. per share)	Consideration
January 2018	20	10	Cash
April 2019	15	12	Plant & machinery
October 2019	7	-	Bonus issue
March 2020	5	18	Cash
February 2021	10	-	Bonus issue
June 2021	8	25	Plant & machinery
November 2021	6	27	Cash

**Required:**

Prepare note(s) on 'Share capital' for inclusion in the financial statements of AL for the year ended 31 December 2021. (*Show comparative figures*)

**(07)**

- Q.4 For the purpose of this question, assume that the date today is 31 August 2022.

Financial statements of Cone Motors Limited (CML) for the year ended 31 July 2022 are under preparation. Following matters are under consideration:

- (i) CML is concerned with the impact of rupee devaluation as its significant cost of production is incurred in USD. Between 15 June 2022 to 31 July 2022, rupee devalued from Rs. 200 to Rs. 240 per USD. At year-end, CML has following foreign currency balances appearing in its books:

- Trade payables to foreign suppliers amounting to Rs. 638 million (representing USD 3.1 million) which would be settled within next two months.
- Advances to other foreign suppliers amounting to Rs. 654 million (representing USD 3 million) against which the raw materials would be delivered within next three months.

CML's management is of the view that above balances do not need retranslation at year-end as loss of one will net off with gain of other. Further, rupee has started appreciating since 15 August 2022 and is trading at Rs. 208 per USD on 31 August 2022.

- (ii) At year-end, certain orders against which the customers have paid full amount in advance are still undelivered. These orders were booked at old prices but production cost of these vehicles have increased enormously due to fluctuation in exchange rates and inflation in local market.

CML can cancel these orders by refunding the full amount alongwith additional penalty of Rs. 85 million but would result in loss of reputation and goodwill in the market. Therefore, CML is considering to fulfil these orders on their delivery dates in October 2022 which would result in loss of Rs. 150 million.

CML's management is of the view that loss on these orders is a future loss and does not need to be accounted for at year-end.

**Required:**

Comment on the CML's management view about the impact of above matters in the financial statements for the year ended 31 July 2022, in accordance with the IFRSs.

**(08)**

Q.5 While reviewing the draft financial statements of Hexagon Industries (HI) for the year ended 30 June 2022, following mistakes were identified:

- (i) Investment in bonds of Oval Limited (OL) was accounted for as a financial asset subsequently measured at fair value through profit or loss instead of measuring the investment at amortised cost.

On 1 July 2021, HI purchased 1 million bonds of OL of Rs. 100 each at a discount of Rs. 5 each with maturity in three years. Transaction cost of Rs. 2 million was also incurred on purchase of these bonds. The coupon interest rate is 12% per annum payable annually on 30 June while the approximate effective interest rate was 13.28% per annum. The fair value of each bond of OL was Rs. 99 on 30 June 2022.

- (ii) HI has accounted for investment in shares of Kite Limited (KL) as a financial asset subsequently measured at fair value through other comprehensive income instead of applying its policy of equity method for investment in associates.

On 1 September 2021, HI purchased 500,000 shares (par value at Rs. 10 each) of KL representing 20% shareholdings at Rs. 60 per share. On 30 April 2022, KL paid interim cash dividend of Rs. 3 per share. KL reported net profit of Rs. 15 million for the year ended 30 June 2022. The fair value of each share of KL was Rs. 67 on 30 June 2022.

**Required:**

Prepare correcting entries in the books of HI for the year ended 30 June 2022.

**(08)**

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

- (i) Which of the following accounting framework and schedule of the Companies Act, 2017 applies to a non-listed public sector company?

- (a) IFRS and Fifth schedule
- (b) IFRS and Fourth schedule
- (c) Revised AFRS for SSEs and Fifth schedule
- (d) Revised AFRS for SSEs and Fourth schedule

**(01)**

- (ii) Which **TWO** of the following situations might create a self-interest threat?

- (a) Profit/incentive based compensation
- (b) Reviewing self-prepared reports
- (c) Fear of losing job
- (d) Accepting gift of significant value

**(01)**

- (iii) Which of the following statements are correct?

- (I) Self-interest threat arise if a chartered accountant promotes a client's position to the point that the accountant's objectivity is compromised.
- (II) Professional behaviour means members should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgements.

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

**(01)**

- (iv) Nasir is working as a director of Rectangle Limited (RL). He is aware of the profit in RL's draft financial statements which would increase share price of RL upon public announcement. He has suggested his friend to purchase shares of RL.

Which of the following fundamental principles of ICAP's code of ethics has been breached by Nasir?

- (a) Integrity
- (b) Confidentiality
- (c) Objectivity
- (d) Professional competence and due care (01)

- (v) Which of the following statements are correct in the context of IFRS 8?

- (I) Two or more operating segments may be aggregated into a single operating segment.
- (II) An operating segment not fulfilling 10% quantitative threshold may still be a reportable segment.

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

- (vi) As per IFRS 8, which **TWO** of the following disclosures apply to all entities including those entities that have a single reportable segment?

- (a) Extent of reliance on major customers
- (b) Extent of reliance on major suppliers where quantitative threshold is met
- (c) All liabilities payable in Pakistan and in all foreign countries
- (d) Non-current assets located in Pakistan and in all foreign countries (01)

- (vii) Which of the following is **NOT** required to be measured at fair value less costs to sell even if fair value is measurable?

- (a) Biological assets at initial recognition
- (b) Biological assets at the end of each reporting period
- (c) Agricultural produce at the point of harvest
- (d) Agricultural produce at the end of each reporting period (01)

- (viii) Which of the following statements are correct in the context of IFRS 16?

- (I) When the supplier has a substantive right of substitution, then the contract does not constitute a lease.
- (II) When consideration for use of an asset is paid in terms of goods and services (other than cash), then the contract does not constitute a lease.

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

- (ix) On 1 January 2021, a herd of 20 animals of 1-year old was recorded at Rs. 800,000. On 1 July 2021, 10 animals of 1.5 years old were purchased for Rs. 50,000 each. On 31 December 2021, the fair value less costs to sell of 1-year and 2-year animals were Rs. 60,000 and Rs. 70,000 respectively. Calculate the amount that will be taken to profit or loss for the year ended 31 December 2021.

- (a) Rs. 500,000
- (b) Rs. 1,000,000
- (c) Rs. 1,300,000
- (d) Rs. 800,000 (02)

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**Section B**


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Q.7 Following are the summarized statements of financial position of Heptagon Limited (HL) and Ellipse Limited (EL) as at 30 June 2022:

	HL	EL
	--- Rs. in million ---	
Property, plant and equipment	1,820	840
Investment property	650	-
Investment in Octagon Limited – at cost	100	-
Inventories	490	330
Other current assets	360	260
	<b>3,420</b>	<b>1,430</b>
Share capital (Rs. 10 per share)	1,400	650
Share premium	750	200
Retained earnings	820	340
Liabilities	450	240
	<b>3,420</b>	<b>1,430</b>

**Additional information:**

- (i) On 1 January 2022, HL acquired 60% shareholdings in EL at the following consideration which has not been recorded in HL's books:
  - One share in HL was given for every three shares in EL. At acquisition date, the fair values of each share of HL and EL were Rs. 54 and Rs. 17 respectively.
  - Cash payment of Rs. 5 per share shall also be paid two years later provided that profits of EL exceed a certain benchmark. The fair value of this conditional payment at acquisition date was estimated at Rs. 143 million which has increased to Rs. 150 million on 30 June 2022.
- (ii) At acquisition date, EL's retained earnings were Rs. 300 million and carrying values of EL's net assets were equal to their fair values except land which was carried at Rs. 50 million. The land had a fair value and value in use estimated at Rs. 80 million and Rs. 70 million respectively. The group follows cost model for subsequent measurement of all property, plant and equipment.
- (iii) On 1 January 2022, HL purchased an investment property with useful life of thirty years for Rs. 600 million and rented out to EL on same date for Rs. 4 million per month till 31 December 2022. The property was carried in HL's books at fair value of Rs. 650 million on 30 June 2022. Rent for the month of June 2022 was unpaid at 30 June 2022.
- (iv) An impairment test carried out at 30 June 2022 indicated that goodwill of EL has been impaired by Rs. 15 million. The management believes that the impairment arose due to temporary adverse economic conditions.
- (v) On 1 July 2021, HL acquired 6 million shares representing 30% shareholdings in Octagon Limited (OL). On that date, fair value of each share of OL was Rs. 16.
- (vi) During the year ended 30 June 2022, OL reported net profit of Rs. 60 million and paid total dividend of Rs. 20 million. HL recorded its share of OL's dividend as other income.
- (vii) During the year, OL made sales of Rs. 50 million to HL at 20% above cost. 60% of these goods were sold by HL during the year. As at 30 June 2022, OL has receivable with HL of Rs. 25 million.
- (viii) HL values non-controlling interest at the acquisition date at its fair value.

**Required:**

Prepare HL's consolidated statement of financial position as at 30 June 2022 in accordance with the IFRSs.

Q.8 Rhombus Limited (RL), a supplier of high quality office equipment, has entered into following two contracts during the year ended 31 August 2022:

- (i) On 1 July 2022, RL entered into a contract with Trapezoid Limited (TL) to sell 50 laptops at a total consideration of Rs. 10 million. 50% laptops would be delivered on 20 July 2022 and balance on 15 August 2022. RL was unconditionally entitled to receive full payment upon delivery of first lot of 25 laptops, however, TL paid full amount on 31 July 2022.

On 7 August 2022, the contract was modified as TL ordered additional 30 laptops of Rs. 190,000 each for delivery on 25 August 2022. These 30 laptops are distinct but do not reflect the stand-alone selling price. It was agreed that TL would pay for 29 laptops only instead of 30 laptops. This discount has been given in compensation of minor defects identified in 25 laptops, delivered on 20 July 2022. TL settled the balance in September 2022 as per the terms of the contract.

All laptops were delivered as agreed.

(07)

- (ii) On 1 January 2022, RL entered into a contract with Crescent Limited (CL) for sale of 10 units of its state of the art 3D printers. The cost and stand-alone price of goods/services included in each unit of printer are as follows:

	Unit cost	Unit price
	---- Rs. in '000 ----	
Hardware	1,800	3,600
Printing software	720	
Software upgrade to next version	350	500
Maintenance support for 1 year	210	N/A

RL sells 3D printer hardware along with the software as hardware cannot be used without the printing software. The 3D printer remains functional without the software upgrade and the maintenance support. RL sells software upgrade upon release to all of its customers. However, RL does not provide maintenance support but went against its policy to provide it to CL.

Each unit of printer was sold to CL at an overall discounted price of Rs. 4 million. As per payment terms, CL paid 30% on 1 January 2022 while 50% was paid at the time of delivery of printers (hardware plus printing software) on 1 March 2022 and remaining 20% will be paid in February 2023.

At year-end, 80% work has been completed on the new version of the printing software which is expected to be released in October 2022.

(09)

**Required:**

Prepare necessary accounting entries for the year ended 31 August 2022 in accordance with the IFRSs. *(No marks will be awarded on entries without dates)*

Q.9 Following information has been gathered for preparing the disclosures related to taxation of Prism Limited (PL) for the year ended 31 December 2021:

- (i) Accounting profit before tax for the year after making all necessary adjustments was Rs. 105 million.
- (ii) On 1 July 2020, PL acquired an investment property for Rs. 50 million. The fair values of property as on 31 December 2020 and 2021 were Rs. 55 million and Rs. 65 million respectively. PL follows fair value model for accounting purposes.

Under tax laws, depreciation is allowed at 10% per annum on cost. Further, full year's tax depreciation is allowed in the year of purchase.

- (iii) On 1 January 2021, PL purchased a license having indefinite life from a foreign company at a cost of Rs. 116 million. Upon payment, PL recorded foreign exchange gain of Rs. 16 million.

Under tax laws, foreign exchange differences arising on payment are added to/deducted from the cost of asset while amortisation is allowed at 10% per annum.

- (iv) PL commissioned a new plant at a cost of Rs. 210 million which became operational on 1 January 2021. PL is also obliged to incur decommissioning cost of Rs. 40 million at the end of useful life of eight years. Applicable discount rate is 12% per annum.

Under tax laws, decommissioning cost is allowable deduction at the time of payment while depreciation on plant is allowed at 10% per annum.

- (v) On 1 May 2021, PL acquired 5% equity investment for Rs. 75 million. In October 2021, dividend of Rs. 8 million was received on this investment. As at 31 December 2021, PL recorded Rs. 15 million as gain for change in fair value which was taken to other comprehensive income.

Under tax laws, gain on investment is taxable at the time of sale while dividend income is exempt from tax.

- (vi) As on 31 December 2021, taxable temporary differences on other items amounted to Rs. 30 million (2020: Rs. 39 million). These differences have arisen due to items taken to profit or loss.

- (vii) The tax rate for the year is 35% (2020: 32%).

**Required:**

- (a) Prepare a note on taxation for inclusion in PL's financial statements for the year ended 31 December 2021 and a reconciliation to explain the relationship between the tax expense and accounting profit. (08)
- (b) Compute deferred tax liability/asset in respect of each temporary difference as at 31 December 2021 and 2020. (08)

**(THE END)**