The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

7 March 2022
3 hours – 100 marks
Additional reading time – 15 minutes

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 January 2020, Grateful Industries Limited (GIL) completed installation of a plant which will be required to be dismantled at the end of its ten years' useful life. GIL paid Rs. 2,000 million for the plant. On 1 January 2020, it was estimated that the cost of dismantling would amount to Rs. 200 million. Applicable discount rate was 10% per annum when initial estimate of dismantling costs was made.

The fair value of the plant as on 31 December 2020 was assessed at Rs. 1,845 million (including dismantling cost).

Estimates of dismantling cost and applicable discount rate were reviewed as at 31 December 2021 and were revised to Rs. 150 million and 12% per annum respectively.

GIL has a policy to subsequently measure plant using the revaluation model and depreciation is provided on straight line basis.

Required:
Prepare accounting entries in the books of GIL, for the year ended 31 December 2021 in accordance with IFRSs. **(08)**

Q.2 On 1 November 2021, Excitement Limited (EL) entered into a contract with Pride Limited (PL) to manufacture and sell 100 units of a specialized machine at a total consideration of Rs. 300 million. The machines will be delivered in lots of 20 units at the end of each quarter. PL has paid 10% non-refundable consideration in advance while the remaining consideration will be paid in five equal instalments, only after delivery of each lot and not before.

The sales team of EL worked hard and spent 1600 hours costing Rs. 4 million for preparing proposal for the contract. The team was also rewarded with a bonus of Rs. 6 million upon obtaining the contract. Upto year ended 31 December 2021, EL had manufactured 15 units of the machine to be delivered on 31 January 2022.

EL's CFO, a chartered accountant, has suggested that revenue for 15 units should be recognized in 2021 as the machines are of specialized nature and have no alternate use for EL. Further, the sales team cost of Rs. 10 million should be taken to statement of profit or loss in 2021 as this has been fully recovered through 10% advance received from PL.

Required:
(a) Analyse the treatments suggested by the CFO in respect of the above contract. **(07)**
(b) Briefly explain how CFO may be in breach of the fundamental principles of Code of Ethics for Chartered Accountants and how he should respond. **(02)**

Q.3 Draft financial statements of Determined Limited (DL) for the year ended 31 December 2021 show the following amounts:

	Rs. in '000
Total assets	43,500
Total liabilities	12,300
Net profit for the year	4,573

While reviewing the draft financial statements, following issues were identified:

(i) DL has classified investment in Jubilant Limited (JL) as an investment in associate and accounted for using equity method despite having no significant influence over JL.

On 1 February 2021, DL purchased 40,000 shares of JL representing 15% shareholdings at Rs. 80 per share. On 30 September 2021, JL announced interim cash dividend of Rs. 5 per share. JL reported net profit of Rs. 2.4 million for the year ended 31 December 2021. The fair value of each share of JL was Rs. 70 as on 31 December 2021.

(ii) Transaction cost incurred on bonds issued by DL was recorded as an asset and being amortized over five years. Further, half of interest to be paid on 30 June 2022 has been accrued.

On 1 July 2021, DL issued 6,000 bonds of Rs. 1,000 each at a discount of Rs. 50 each with maturity in five years. The transaction cost associated with the issuance of these bonds was Rs. 20 per bond. The coupon interest rate is 11% per annum payable annually on 30 June. The approximate effective interest rate was 13% per annum. Bonds are subsequently measured at amortized cost.

Required:
Determine the revised amounts of total assets, total liabilities and net profit, after incorporating the required corrections. **(07)**

Q.4 The following transactions pertain to Amused Limited (AL):

(i) In 2020, AL started development of a new product. The recognition criteria for capitalization of internally generated intangible asset was met on 1 January 2021. On this date, AL started development of a plant which completed in 3 months. It is pilot plant for testing the new product and is not of a scale economically feasible for commercial production. AL incurred cost of Rs. 3 million and Rs. 7 million on design and construction of plant respectively. AL expects to operate the plant for two years till end of development phase. During 2021, AL incurred Rs. 5 million in operating the pilot plant.

(ii) On 1 March 2021, AL acquired a patent with indefinite life in exchange of its old equipment and cash consideration of Rs. 25 million. The fair values of the patent and equipment were assessed at Rs. 57 million and Rs. 35 million respectively. On the date of exchange, the equipment had a carrying value of Rs. 30 million. AL believes that its future cash flows will change as a result of this exchange. AL incurred cost of Rs. 2 million for transferring the title of the patent to its name.

(iii) On 1 June 2021, the government granted a license to AL free of cost to import raw material upto 10 tons from international market for its intended use. The license is non-transferable. There are no further conditions attached by the government. The fair value of the license is Rs. 50 million.

Required:
Explain how each of the above transactions should be accounted for in the financial statements of AL for the year ended 31 December 2021, in accordance with the requirements of IFRSs. **(09)**

Q.5 Calm Limited (CL) is a listed company and engaged in manufacturing of textile products. Following disclosures have been extracted from CL's draft financial statements for the year ended 31 December 2021:

16 - Long term loans and advances – secured

	2021	2020
	----- Rs. in '000 -----	
Loans and advances – considered good:		
Directors	89,600	95,100
Executives and other employees	81,900	87,600
	171,500	**182,700**
Reconciliation		
Balance at 1 January	88,500	92,300
Disbursements	18,700	22,400
Repayments	(25,300)	(27,100)
Balance at 31 December	**81,900**	**87,600**

29 - Remuneration of Chief Executive, Directors and Executives

The aggregate amounts charged in these financial statements are given below:

	Chief Executive	Directors & Executives
	----- Rs. in '000 -----	
Managerial remuneration including bonuses	28,320	70,150
House rent and other allowances	17,700	38,975
Contribution to retirement benefit plans	1,888	3,680
	47,908	**112,805**

Executives are also entitled for other benefits.

Required:

Prepare list of errors and omissions in the above disclosures. **(07)**

(Redrafting of disclosures is not required)

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

(i) Government grants related to 'Bearer plants' are accounted for under:

(a) IAS 41
(b) IAS 20
(c) IAS 16
(d) IAS 41 and IAS 20 **(01)**

(ii) With regards to accounting regulation in Pakistan, the Institute of Chartered Accountants of Pakistan is responsible for:

(a) establishing accounting rules that must be followed by the companies in Pakistan.
(b) recommending accounting standards to the Securities and Exchange Commission of Pakistan for notification.
(c) issuing notification in the official gazette in respect of accounting standards to be applicable in Pakistan.
(d) approving accounting standards applicable in Pakistan. **(01)**

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

(I) Ocean fishing is an agricultural activity.
(II) Biological assets are never depreciated.

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

(iv) As per IAS 21, non-monetary items carried at fair value are retranslated at the exchange rate prevailing:

(a) at year-end
(b) during the year i.e. average rate
(c) at the date when fair value was determined
(d) at acquisition date **(01)**

(v) Which **TWO** of the following are non-adjusting events?

(a) Directors approved the plan to close down the major segment before year-end but announcement to public was made after year-end.
(b) A company made an out of court settlement with a customer after year-end, for defective products supplied before year-end.
(c) The discovery of fraud after year-end which shows that financial statements are incorrect.
(d) A change in income tax rate announced after year-end. **(02)**

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

(I) An investment in equity instruments of another entity cannot be classified as subsequently measured at amortized cost.
(II) An investment in debt instruments of another entity cannot be classified as subsequently measured at fair value through other comprehensive income.

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

(vii) Which of the following statements is/are correct under IAS 21?

(I) Exchange differences on retranslation of all items are taken to profit or loss.
(II) Dividend received on foreign investments are recognized at average exchange rate for the year.

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

(viii) On 1 January 2022, a company entered into a non-cancellable contract with its client to implement a software by 30 June 2022. As per contract, client was required to pay 10% advance on 31 January 2022. The client paid the advance on 15 February 2022. How will company record transaction on 31 January 2022?

	Debit	**Credit**
(a)	Accounts receivable	Contract liability
(b)	Contract asset	Revenue
(c)	Accounts receivable	Revenue
(d)	No entry	

(01)

(ix) An operating segment has just started operations but has not earned any revenues yet. Which of the following statements is correct?

(a) It may be a reportable segment if quantitative threshold is met.
(b) It is a reportable segment even if quantitative threshold is not met.
(c) It is not a reportable segment even if quantitative threshold is met.
(d) It will be a reportable segment only after earning revenues. **(01)**

Section B

Q.7 Following information has been gathered for preparing the disclosures related to taxation of Surprise Limited (SL) for the year ended 31 December 2021:

(i) Accounting profit before tax for the year amounted to Rs. 130 million.

(ii) Tax depreciation exceeds accounting depreciation by Rs. 9 million and revaluation loss recognized against revaluation surplus is Rs. 6 million. Under tax laws, revaluation has no effect.

(iii) Interest income exceeds interest receipt by Rs. 12 million while commission receipt exceeds commission income by Rs. 15 million. Under tax laws, both are taxable on receipt basis.

(iv) Out of total donations of Rs. 5 million, only 60% are allowable in tax.

(v) Development cost of Rs. 25 million incurred in 2021 has been expensed out. Under tax laws, development cost are amortized at the rate of 28% per annum on reducing balance basis.

(vi) Capital work in progress as at 31 December 2021 includes borrowing cost of Rs. 8 million incurred in 2021. Under tax laws, borrowing cost is allowed in the year in which it is incurred.

(vii) On 1 January 2021, SL acquired shares in Funny Limited (FL) for Rs. 70 million. The investment in FL was subsequently measured at fair value through profit or loss. During the year, SL received Rs. 4 million as dividend from FL. At year-end, a gain of Rs. 10 million was recognized as fair value adjustment. Under tax laws, capital gain is taxable at 15% at the time of sale while dividend received is taxable at 10%. The intention of SL for holding investment in FL is to take benefit in the form of capital gain.

(viii) Deferred tax liability/(asset) in respect of temporary differences for SL as at 31 December 2020 was as follows:

	Rs. in million
Property, plant and equipment	18
Interest receivable	3
Unearned commission	(9)
	12

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

(x) Unused assessed tax losses were Rs. 50 million till 31 December 2020. However, deferred tax asset was recognized only to the extent of Rs. 12 million (i.e. on tax losses of Rs. 40 million) due to limited availability of expected future taxable profits.

Required:

(a) Prepare a note on taxation for inclusion in SL's financial statements for the year ended 31 December 2021 and a reconciliation to explain the relationship between the tax expense and accounting profit. **(10)**

(b) Compute deferred tax liability/asset in respect of each temporary difference as at 31 December 2021. **(07)**

Q.8 Following balances are extracted from the records of Happiness Limited (HL), Satisfied Limited (SL) and Furious Limited (FL) for the year ended 31 December 2021:

	HL	SL	FL
	-------- Rs. in million --------		
Sales	4,100	2,250	2,100
Cost of sales	2,880	1,125	1,365
Operating expenses	800	550	303
Other income	414	216	95
Gain/(loss) on re-measurement of investment in listed securities	195	(80)	20
Finance cost	-	50	35
Surplus arising on revaluation of property, plant and equipment for the year	-	-	*100

***The revaluation was performed on 31 December 2021**

Additional information:

(i) Details of HL'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 July 20	75%	SL	1,500	1,200
1 March 21	30%	FL	1,000	950

(ii) Following was the consideration for acquisition of SL's shares:

- Immediate payment of Rs. 1,700 million and another payment of Rs. 843 million after 3 years.
- An amount of Rs. 500 million payable on 1 May 2021 that was contingent upon the post-acquisition performance of SL. Fair value of this consideration was estimated at Rs. 290 million on acquisition date as well as on 31 December 2020. However, due to improvement in business conditions in 2021, the target was achieved and full amount was paid. HL has included the full payment in cost of investment in SL.

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

- An in-process development project for a software had a fair value of Rs. 180 million. The cost of Rs. 140 million incurred before acquisition by SL on development had been expensed out in SL's books since the project did not meet the criteria for capitalization. After acquisition, SL incurred further Rs. 20 million which resulted in completion of project on 1 January 2021. The software has a useful life of 4 years.
- Fair value of inventory was higher than its carrying value by Rs. 200 million. 50% and 10% of the inventory were included in the inventory of SL at 31 December 2020 and 2021 respectively.

(iv) HL has designated its investment in listed securities as subsequently measured at fair value through profit or loss whereas SL and FL irrevocably elected their respective investments at initial recognition on 1 June 2021 as subsequently measured at fair value through other comprehensive income.

(v) SL paid cash dividend of 8% for the half year ended 30 June 2021. HL recorded its share as other income.

(vi) On 25 August 2021, FL delivered goods having sale price of Rs. 150 million at a markup of 20% to HL. 40% of these goods are included in the HL's inventory as at 31 December 2021.

(vii) An impairment test has indicated that goodwill of SL was impaired by 15% on 31 December 2021. There was no impairment in the previous year.

(viii) The income and expenses of all companies had accrued evenly during the year except stated otherwise.

(ix) HL measures non-controlling interest at the proportionate share of acquiree's identifiable net assets.

(x) Discount rate of 12% per annum may be used wherever required.

Required:
Prepare HL's consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2021. **(18)**

Q.9 Optimism Limited (OL) entered into following arrangements:

(i) On 1 January 2020, OL leased a machine from Fascinated Bank Limited (FBL). Details are as follows:

- The lease period is agreed as six years. However, the lease contains an option for OL to terminate the lease at the end of four years upon payment of Rs. 1 million. OL is reasonably certain to exercise this option due to anticipated technological changes.
- First annual instalment amounting to Rs. 12 million was paid on 1 January 2020 and all subsequent annual instalments are payable on 1 January subject to decrease of Rs. 2 million in each year.
- Market rate for similar transaction is 12% per annum but as an incentive to OL for entering into the lease, FBL has incorporated an implicit rate of 11% per annum which is known to OL.
- The fair value and useful life of the machine are Rs. 40 million and seven years respectively.
- OL incurred initial direct cost of Rs. 3 million.

(ii) On 1 May 2021, OL entered into an arrangement with Energetic Limited (EL) for the use of five photocopy machines for a non-cancellable period of three years. Semi-annual instalment of Rs. 2 million is to be paid in advance. As per agreement, EL has a substantive substitution right to replace the machines.

Required:

(a) Prepare relevant extracts (including comparative figures) from OL's statement of financial position, statement of profit or loss and notes to the financial statements for the year ended 31 December 2021. **(12)**

(b) Compute the unguaranteed residual value estimated by FBL at the end of six years if FBL had incurred Rs. 2 million of initial direct cost. ***(Assume that FBL is reasonably certain that OL will not exercise termination option)*** **(03)**

(THE END)