Certificate in Accounting and Finance Stage Examination

The Institute of Chartered Accountants of Pakistan

4 September 2023
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 The following balances have been extracted from the statement of financial position of Uchhali Limited (UL) as on 31 December 2022:

	2022	2021
	---- Rs. in million ----	
Investment property	420	-
Inventories	840	780
Interest receivable	65	80
Accumulated losses	460	390
Accrued expenses	232	250

Additional information:

(i) UL has only one investment property, which was purchased during 2022 at a cost of Rs. 450 million. The fair value of the property as on 31 December 2022 amounted to Rs. 610 million. UL follows cost model for accounting purposes.

Under tax laws, capital gain on investment property is taxable at the time of sale, while depreciation is not allowed.

(ii) Inventories imported during the year 2022 amounted to Rs. 660 million, of which 40% remained unsold as on 31 December 2022. Payment of imported inventories resulted in a foreign exchange loss of Rs. 100 million.

Under tax laws, the foreign exchange loss is considered as the part of cost of inventories.

(iii) Interest income for the year 2022 amounted to Rs. 120 million, of which Rs. 65 million was receivable as on 31 December 2022.

Under tax laws, interest income was taxable on an accrual basis in 2021. However, with effect from 1 January 2022, interest is taxable on a receipt basis.

(iv) Accrued expenses include payables for penalties of Rs. 42 million (2021: Rs. 6 million). During the year, UL also paid penalties of Rs. 56 million.

Under tax laws, penalties are not deductible; however, other expenses are allowed on payment basis.

(v) UL has unused tax losses amounting to Rs. 550 million as on 31 December 2022.

(vi) It is expected that, after three years, sufficient taxable profits will be earned to utilise the benefit of unused losses and deductible temporary differences.

(vii) The applicable tax rates are as follows:

	*2023 and onwards	2022 and before
Interest income	20%	15%
All other incomes	30%	25%

***Enacted before 31 December 2022**

Required:

Compute the deferred tax liability or asset that should be recognized in UL‘s statement of financial position as on 31 December 2022. **(10)**

Q.2 Drigh Limited (DL), a listed company, has seven components. The following information is available about the components:

Components	Revenues			Profit/(loss)	Total assets
	External	Inter-segment	Total		
	---------- Rs. in million ----------				
A	2,600	200	2,800	(300)	700
B	-	600	600	(45)	135
C	1,600	-	1,600	(580)	150
D	1,550	113	1,663	475	613
E	575	-	575	58	162
F	500	75	575	60	300
G	125	-	125	13	150
	6,950	**988**	**7,938**	**(319)**	**2,210**

Additional information:

(i) Operating results of all the above components are reviewed by DL's CEO. He is of the view that all components need to be presented separately in the DL's financial statements as per IFRS 8.

(ii) Components A and G exhibit similar long-term financial performance because they have similar economic characteristics while other components do not have similar economic characteristics.

(iii) Component F earns revenues that are only incidental to the activities of DL and supports components C and D.

Required:
Keeping in view the CEO's point of view, discuss how the above components should be presented in the note of 'Operating Segments' in accordance with IFRS 8.
(Preparation of note is not required) **(08)**

Q.3 The following information pertains to three independent contracts:

(i) Alpha entered into a contract with Beta to provide administrative support services to Beta for a period of one year. These services encompass data entry, scheduling departmental meetings and tasks, and so on, to help Beta focus on its core operations. Alpha is not entitled to any amount if the one year period is not completed.

(ii) Gamma is developing a residential society comprising identical villas. Delta entered into contract with Gamma to buy one of the villas. The control of the villa will be transferred to Delta once the entire society is complete.

The contract specifically mentions that no customized modification will be made during the construction by Gamma. Delta is required to make payments in proportion to the work done. In case of termination by Delta, Gamma is liable to return the amount paid by Delta once the villa is sold to another party.

(iii) Eta entered into a contract with Theta to develop a software for Theta. The software will be designed specifically to meet Theta's operational needs and will not be usable for any other customer. The contract states that Theta will pay 50% of the total contract price upfront and the remaining 50% upon completion of work. Theta does not have the right to terminate the contract unless Eta fails to perform.

Required:
Analyze whether the revenue should be recognized over time in each of the above contracts in accordance with IFRS 15. **(08)**

Q.4 You have been working as an accountant at Satpara Limited (SL), a listed company. SL is considering to grant interest free long term loans to few directors for the purpose of building houses, which will be recovered in instalments from salaries over five years. Further, a Pakistan-based related party has also requested a long term loan from SL for business expansion, with repayment expected after three years. You have pointed out that providing such loans would require additional disclosures as per Fourth schedule to the Companies Act, 2017. CFO has asked you to prepare an illustrative note disclosing the above, which would be included in the upcoming annual financial statements of SL if these loans are granted.

Required:
Prepare the note as required by the CFO. **(06)**
(You may assume necessary details or numbers)

Q.5 On 1 January 2022, Namal Leasing Limited (NLL) leased a manufacturing plant to Haleji Limited (HL). Details are as follows:

(i) The non-cancellable lease term is five years during which annual instalment of Rs. 60 million is payable by HL in arrears.
(ii) The interest rate implicit in the lease is 16% per annum.
(iii) NLL incurred an initial direct cost of Rs. 4 million for arranging the lease.
(iv) The estimated residual value of the plant at the end of the lease is Rs. 125 million, of which Rs. 90 million has been guaranteed by HL.

The following information is also available:

(i) NLL's profit before tax for the year after all adjustments was Rs. 350 million.
(ii) Applicable tax rate is 30%
(iii) Tax authorities treat each lease as an operating lease.

Required:
Prepare the relevant extracts from NLL's statement of profit or loss for the year ended 31 December 2022, and the statement of financial position as on that date. **(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 statements is/are correct?

(I) All public interest companies must follow the requirements of the Fourth schedule to the Companies Act, 2017.
(II) IAS 1 requires entities to show an analysis of expenses based on both nature as well as functions within the entity.

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

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

Which of the following statements is/are correct in this regard?

(I) On initial recognition, the investment can be recognised at Rs. 23 million or Rs. 23.5 million depending on classification.
(II) On subsequent measurement, the investment must be carried at fair value only.

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

(iii) On 1 July 2022, a company issued 5% debentures with a par value of Rs. 15 million for Rs. 20 million, incurring issue costs of Rs. 0.5 million. The debentures are redeemable at a premium, giving them an effective interest rate of 8% per annum.

What expense should be recorded in relation to the debentures for the year ended 30 June 2023?

(a) Rs. 2,400,000 (b) Rs. 1,600,000 (c) Rs. 975,000 (d) Rs. 1,560,000 **(01)**

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

(I) In case of sale of goods by parent to associate, the unrealised profit is eliminated in full.
(II) In case of sale of goods by associate to parent, amount payable to associate would be presented in the consolidated statement of financial position.

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

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

(I) Acceptance of a significant gift would result in familiarity threat to fundamental principles.
(II) Commercial pressure from outside the employing organization would result in self-review threat to fundamental principles.

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

(vi) A Pakistan based company purchased a piece of land in Saudi Arabia for SAR 10 million on 1 August 2022. Details of payments on various dates are as follows:

Date	Amount	Exchange rate
1 May 2022	SAR 3 million	1 SAR = Rs. 65
1 August 2022	SAR 5 million	1 SAR = Rs. 74
1 October 2022	SAR 2 million	1 SAR = Rs. 78

At what amount, should this piece of land be recognised?

(a) Rs. 713 million (b) Rs. 721 million
(c) Rs. 740 million (d) Rs. 780 million **(01)**

(vii) Which of the following statements is correct in the light of IAS 21?

(a) 'Investment in debt securities' is a monetary item while 'Refund liability' is a non-monetary item
(b) 'Advance from customers' is a monetary item while 'Biological assets' is a non-monetary item
(c) 'Deferred government grant' is a monetary item while 'Deferred tax asset' is a non-monetary item
(d) 'Lease liability' is a monetary item while 'Right-of-use asset' is a non-monetary item **(01)**

(viii) Ansoo Limited (AL) owns a property that has been rented to its subsidiary which uses it as sales office. How should the above property be classified by AL in separate and consolidated financial statements?

	Separate	Consolidated
(a)	Property, plant and equipment	Property, plant and equipment
(b)	Investment property	Property, plant and equipment
(c)	Property, plant and equipment	Investment property
(d)	Investment property	Investment property

(01)

(ix) Asghar Limited (AL) is currently negotiating the acquisition of Basker Limited (BL). Mr. Karim ACA, besides being CFO of AL, is part of the team negotiating the acquisition of BL. After becoming aware of the potential acquisition, Karim purchased 2 million shares of BL in the name of his son.

Which **TWO** of the following fundamental principles of ICAP's code of ethics is Mr. Karim is in breach of?

(a) Confidentiality (b) Objectivity
(c) Professional behaviour (d) Professional competence **(01)**

(x) Which **TWO** of the following assets require the application of IAS 41?

(a) Animals kept by zoo for earning ticket revenue
(b) Parrots kept by a restaurant to attract more customers
(c) Birds kept for sale by a pet shop
(d) Hens kept by a poultry farm **(01)**

Section B

Q.7 **For the purpose of this question, assume that the date today is 1 September 2023.**

Jahlar Cosmetics Limited (JCL) is currently in the process of finalising its financial statements for the year ended 30 June 2023.

In May 2023, JCL was on the verge of launching an innovative line of beauty products. However, the launch was cancelled due to alarming reports that employees involved in internal testing of the new cosmetics experienced adverse skin reactions, ranging from minor irritations to serious allergic responses. The situation worsened as news of these reactions spread through media outlets, highlighting potential risks, damaging JCL's reputation, and causing public doubt.

As a result of the above, JCL has incurred a net loss for the first time. Additionally, JCL has encountered the following matters:

(i) In July 2023, affected employees filed a lawsuit against JCL for damages. Legal advisors anticipate that these suits could result in potential liability of Rs. 120 million. However, due to legal complexities, the actual payout remains uncertain. The legal advisors estimate a 70% likelihood of incurring the full liability and a 30% likelihood of incurring only half the amount.

(ii) In June 2023, the JCL's board of directors approved a detailed restructuring plan involving the reduction of operations in two cities due to high cost and low profitability. The plan was announced and communicated to the employees in the same month. The implementation of this plan will span over a six-months period, resulting in employee redundancies, lease termination charges, and retraining cost amounting to Rs. 150 million, Rs. 24 million and Rs. 18 million, respectively. Further, an expected disposal of assets is projected to generate a gain of Rs. 18 million.

(iii) As of 30 June 2023, JCL was in breach of one of the loan covenants related to revenue target, which would have led to the entire long term loan becoming payable immediately. However, JCL contacted the banks and obtained a waiver from them for compliance with the given covenant on 26 July 2023.

(iv) JCL plans to raise finance from the issuance of bonds in October 2023. Due to the challenges, it is estimated that the bond issuance will yield Rs. 100 million less than the original estimates. Further, the interest rates would need to be increased by 2% per annum to make the issue possible. This additional interest would result in an annual loss of Rs. 14 million, which has a present value of Rs. 70 million.

Required:
Discuss the effect of the above matters on JCL's financial statements for the year ended 30 June 2023. **(13)**

Q.8 Following balances have been extracted from the records of Baghsar Limited (BL), Rawal Limited (RL), and Tarbela Limited (TL) for the year ended 30 June 2023:

	BL	RL	TL
	-------- Rs. in million --------		
Sales	3,900	2,480	1,900
Cost of sales	1,980	1,660	810
Operating expenses	500	620	415
Other income	420	100	90
Finance cost	150	60	95
Revaluation surplus arising during the year	120	300	90

Additional information:

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

Date of investment	Holding%	Investee	Share capital (Rs. 10 each) of investee	Retained earnings of investee	Revaluation surplus
			------------- Rs. in million -------------		
1 Oct 2022	75%	RL	6,000	(1,650)	450
1 Jul 2022	30%	TL	1,000	1,400	270

(ii) BL acquired the shareholding in RL at the following consideration:

- Immediate cash payment of Rs. 2,600 million. This amount was recorded as investment in BL's books, and includes Rs. 120 million incurred as a valuation fee.
- Further cash payments of Rs. 2 per share and Rs. 1.5 per share to be paid on 30 September 2024 and 30 September 2025, respectively. This has not been recorded in BL's books.

(iii) At the date of acquisition, carrying values of RL's net assets were equal to their fair values, with the following exceptions:

- The brand, an intangible asset, had a carrying value of Rs. 160 million and a fair value of Rs. 256 million. The remaining useful life of the brand on acquisition date is estimated at four years. The recoverable amount of the brand as on 30 June 2023 was estimated at Rs. 178 million.
- A building with a carrying value of Rs. 900 million had a fair value of Rs. 1,200 million. The building is depreciated using a 5% straight-line method. RL revalued the building to its fair value on 2 October 2022 in its books.

(iv) The fair value of RL's share was Rs. 8.5 per share on the acquisition date.

(v) Subsequent to the acquisition date, BL sold goods to RL at a sale price of Rs. 500 million, generating a profit of Rs. 160 million. 80% of these goods were sold by RL to its customers at a profit of Rs. 150 million before 30 June 2023.

(vi) BL acquired the shareholding in TL by transferring BL's land having a carrying value of Rs. 690 million and a fair value of Rs. 932 million on that date. The investment in TL was recorded at the carrying value of land.

(vii) TL paid a dividend of Rs. 5 per share on 1 June 2023. BL recorded the dividend as other income.

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

(ix) Income and expenses of all companies accrued evenly during the year unless stated otherwise.

(x) A discount rate of 17% per annum may be used wherever required.

Required:

Prepare BL's consolidated statement of profit or loss and other comprehensive income for the year ended 30 June 2023. **(18)**

Q.9 The following information pertains to the intangible assets of Hadero Limited (HL):

(i) On 1 May 2022, HL acquired an eight year license at a cost of Rs. 174 million. HL plans to use the license for six years. Licenses are traded in an active market. As on 31 December 2022, the fair value of a new license valid for eight years is Rs. 192 million, while older licenses sell at a fair value of new license value less Rs. 2 million for each month the license has already been used.

(ii) On 1 July 2022, HL acquired operation management software at a cost of Rs. 410 million. HL also incurred a cost of Rs. 20 million for consulting charges to select and evaluate the appropriate software in alignment with HL's needs.

HL expects that indefinite life can be achieved if HL incurs future expenditures to enhance its performance standards by integrating 'artificial intelligence' into this software. Without such expenditures, the software is projected to become technologically obsolete in five years.

After the acquisition of the new software, the existing software would henceforth serve limited purposes. The existing software was acquired for Rs. 240 million, and as on 31 December 2021, Rs. 126 million had been amortized, based on a useful life of ten years.

On 31 December 2022, HL has estimated the value in use of the existing software to be Rs. 58 million. This valuation has been computed using cash flows projected over the revised remaining useful life of two years.

(iii) During the year 2022, it was discovered that the entire cost of Rs. 1,050 million incurred on 'product development' has been recorded as intangible asset without considering the following pertinent facts:

- The product development was commenced on 1 August 2021. Up till the launch date of 1 October 2022, the following directly attributable costs were incurred:

	Rs. in million
Staff salary	150
Equipment (having useful life of five years)	420
Consumables	160
Consultant fee	320
Total	**1,050**

- The recognition criteria for capitalization of internally generated intangible assets was met on 1 February 2022. All costs have been incurred evenly during the period except the equipment which was purchased specifically for this product development on 1 September 2021. The useful life of the developed product is estimated at eight years.

(iv) HL uses the revaluation model for the subsequent measurement of its intangible assets, wherever possible, and accounts for revaluation using the net replacement value method. Depreciation and amortisation are charged using the straight line basis.

Required:
Prepare the notes on 'Intangible assets' and 'Correction of error' for inclusion in HL's financial statements for the year ended 31 December 2022, in accordance with the requirements of IFRSs. **(19)**

(THE END)