The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

6 March 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 Zinc Limited (ZL) has entered into the following transactions:

(i) On 1 January 2022, ZL purchased 1.5 million bonds of Copper Limited having face value of Rs. 100 each at a premium of Rs. 5 each with maturity of five years. The transaction cost associated with the purchase of these bonds was Rs. 2 each. The coupon interest rate is 13% per annum payable annually on 31 December while the effective interest rate was approximately 11.1% per annum. The investment was classified at fair value through other comprehensive income. At 31 December 2022, the bonds were quoted at Rs. 103 each on stock exchange.

(ii) On 1 July 2022, ZL issued 2 million 10% redeemable preference shares having face value of Rs. 100 each at a discount of Rs. 10 each. The transaction cost associated with the issuance of these shares was Rs. 3 million. ZL measured preference shares at fair value through profit or loss. At 31 December 2022, the shares were quoted at Rs. 80 each on stock exchange and ZL has estimated that 70% reduction in the fair value is due to drop in ZL's credit rating. No dividend was declared during 2022 in respect of these shares.

Required:
Prepare journal entries in the books of ZL for the year ended 31 December 2022 in accordance with IFRSs. **(08)**

Q.2 You have recently joined as Finance Manager of Mercury Limited (ML) and have been asked by the CFO to prepare a power point presentation on ML's financial statements for the half-year ended 31 December 2022 for the board of directors' meeting. These financial statements were finalised by the CFO who is a chartered accountant.

While preparing the presentation, you have noted that a five storey building purchased in July 2022 by ML was entirely classified as an investment property. ML uses the ground and first floors for its administrative purposes while remaining three floors were rented out to different tenants and will be sold in future. Further, on 31 December 2022, the fair value increase of Rs. 150 million for the entire building has been taken to the statement of profit or loss which has ensured that the required interest cover as per bank loan covenants has been met.

The CFO is of the view that IFRSs allow such application as ML only uses less than 50% of the building for its own use. He further explained that non-compliance of loan covenants should be avoided at any cost as the bank loan would become immediately payable upon non-compliance. This would create significant financial difficulties for ML which may even result in closure of business.

Required:
Briefly explain how CFO may be in breach of the fundamental principles of ICAP's Code of Ethics for Chartered Accountants. Also state the potential threats that you may face in the above circumstances and how you should respond. **(08)**

Q.3 Fluorine Limited (FL), a manufacturer of ships, has entered into the following contracts during the year ended 31 December 2022:

(i) On 1 January 2022, FL entered into a contract with Alpha Limited (AL) to construct a cruise ship for Rs. 400 million to be delivered on 31 December 2023 i.e. the date on which control of the ship would be transferred to AL. As per the contract, 90% of agreed amount was paid immediately by AL and the balance will be paid on delivery.

Till 31 December 2022, only 40% of the construction of the ship was completed at a cost of Rs. 150 million.

(ii) On 1 April 2022, FL entered into a contract with Beta Limited (BL) to sell three fishing boats for Rs. 50 million per boat. The amount was received on 1 April 2022 but the boats were delivered on 1 May 2022. As per the contract, if BL purchases more than six boats before 31 December 2022, FL will retrospectively reduce the price to Rs. 48 million per boat. At the inception of the contract, FL expected that BL would meet the threshold for the discount.

On 1 November 2022, BL purchased two additional boats on the same price of Rs. 50 million per boat for which the payment was made in January 2023.

Despite FL's expectation, no further order was placed by BL till 31 December 2022.

(iii) On 1 November 2022, FL sold a luxury yacht to Gamma Limited (GL) for Rs. 100 million on cash. FL also provided GL with a Rs. 5 million discount voucher for any interior design work on yacht within six months. There is 80% likelihood that GL will award the work of interior design within six months and will avail the discount. However, no interior design work was awarded till 31 December 2022. FL normally sells such luxury yachts for Rs. 100 million without any discount voucher for interior design work.

Discount rate of 15% per annum may be used wherever required.

Required:
Prepare journal entries in FL's books to record the above information for the year ended 31 December 2022 in accordance with IFRSs. ***(No marks will be awarded on entries without dates)*** **(09)**

Q.4 On 1 January 2020, Uranium Limited (UL) completed installation of a manufacturing plant which will be required to be dismantled at the end of its eight years' useful life. UL paid Rs. 3,000 million for the plant. On 1 January 2020, it was estimated that the cost of dismantling would amount to Rs. 500 million. Applicable discount rate at the time of initial estimate of dismantling cost was 10% per annum.

Estimates of dismantling cost and applicable discount rate were reviewed as at 31 December 2021 and were revised to Rs. 475 million and 15% per annum respectively.

The fair value of the plant including dismantling cost as at 31 December 2022 was assessed at Rs. 1,900 million.

UL has a policy to subsequently measure plant using the revaluation model and provide depreciation on straight line basis.

Required:
Prepare relevant extracts from UL's statement of profit or loss and other comprehensive income for the year ended 31 December 2022 and statement of financial position on that date. ***(Show comparative figures)*** **(09)**

Q.5 Ahmed, a foreign qualified accountant, has recently returned to Pakistan and has joined a newly incorporated company Radium Limited (RL), a subsidiary of a listed company. Ahmed has been entrusted with preparing the notes on 'Property, plant and equipment' in the financial statements of RL for the year ended 28 February 2023. While preparing the notes, Ahmed has complied with all the disclosure requirements of IAS 16, however, he is unaware of additional disclosures required by the Companies Act, 2017.

Required:
List down the disclosure requirements related to 'Fixed Assets' as provided in the fourth schedule of the Companies Act, 2017. **(06)**

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

(i) As per IFRS 8, an operating segment is identified as newly reportable segment in the current year that was not required to be reported separately in prior years. Which of the following is the correct way of reporting this newly reportable segment?

(a) It shall be reported separately in current year and comparative information shall be restated
(b) It shall be reported separately in current year and comparative information shall not be restated
(c) It shall not be reported separately in current year to ensure consistency with comparative information
(d) It shall be reported only when the criteria is met for two consecutive years **(01)**

(ii) According to Companies Act, 2017, analysis of expenses in the statement of profit or loss require to be presented using:

(a) nature of expenses only
(b) function of expenses only
(c) function of expenses with additional information on nature
(d) nature of expenses with additional information on function **(01)**

(iii) Which of the following statements under the Companies Act, 2017 is/are correct?

(I) The classification of a company shall be based on the current year's audited financial statements.
(II) The classification of a company can be changed where it does not fall under the previous criteria for two consecutive years.

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

(iv) Two or more contracts with the same customer can be combined as a single contract if it meets certain criteria. Which of the following is **NOT** the criteria as specified in IFRS 15?

(a) The contracts are negotiated as a package with a single commercial objective
(b) The amount of consideration to be paid in one contract depends on the price of the other contract
(c) The goods are regularly sold separately and the customers generally can benefit from the goods on its own
(d) The goods promised in the contracts are a single performance obligation **(01)**

(v) A company exchanged an intangible asset having fair value and carrying value of Rs. 15 million and Rs. 13.6 million respectively with a new intangible asset having a fair value of Rs. 18 million. An amount of Rs. 3.2 million was also paid in cash. If this transaction lacks commercial substance, the cost of intangible asset acquired would be measured at:

(a) Rs. 15.0 million (b) Rs. 16.8 million
(c) Rs. 18.0 million (d) Rs. 18.2 million **(01)**

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

(I) An entity can have only one presentation currency.
(II) Any currency other than functional currency of the entity is foreign currency.

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

(vii) Government grant related to a biological asset measured at its cost less any accumulated depreciation is accounted for under:

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

(viii) Which **TWO** of the following elements are **NOT** included within the definition of control?

(a) Power to participate in the financial and operating policies of the investee
(b) Power over the investee to affect the amount of the investor's returns
(c) Exposure or rights to variable returns from its involvement with the investee
(d) Holding the majority of shares in investee's share capital **(01)**

(ix) Which **TWO** of the following costs related to development of a website may be capitalized?

(a) Defining hardware and software specifications
(b) Stress testing
(c) Evaluating alternative products and suppliers
(d) Graphical design development **(01)**

(x) Which **TWO** of the following are the adjusting events?

(a) A company made an out of court settlement with a customer after reporting date, for a case that was lodged before the reporting date
(b) A decline in the fair value of investments between the end of the reporting period and the date when the financial statements are authorized for issue
(c) A company made a provision for damages in respect of a pending suit, which was decided by the court after the reporting date with the same amount of damages
(d) Directors approved the plan to close down the major segment before the reporting date but the announcement to public was made after the reporting date **(01)**

Section B

Q.7 Gold Limited (GL) is a dealer of specialized engines. GL acquires each engine from a manufacturer at a cost of Rs. 58 million and sells it for Rs. 71 million on cash. The estimated economic life of an engine is five years.

On 1 January 2022, Lead Limited (LL) leased an engine from GL on four years lease term. The first annual instalment of Rs. 16 million was paid on 1 January 2022 and all subsequent annual instalments are payable on 1 January subject to increase of Rs. 2 million in each year. LL incurred initial direct cost of Rs. 4 million, out of which GL reimbursed Rs. 1.5 million. GL estimates the residual value of the engine at the end of lease term to be Rs. 5 million. However, LL has guaranteed an additional amount of Rs. 3 million at the end of lease term.

Market rate for similar transaction is 15% per annum. As an incentive to LL for entering into the lease, GL has incorporated an implicit rate of 10% per annum which is known to LL.

LL is also obliged to incur decommissioning cost of Rs. 9 million at the end of the lease term.

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

Required:
In accordance with IFRSs:

(a) prepare journal entries in the books of GL for the year ended **31 December 2022**. **(07)**
(b) prepare relevant extracts from LL's statement of profit or loss for the year ended **30 September 2022** and statement of financial position on that date. **(10)**

Q.8 Following are the summarized statements of financial position of Aluminium Limited (AL) and Silver Limited (SL) as at 31 December 2022:

	AL	SL
	----- Rs. in million -----	
Property, plant and equipment	1,160	960
Investment property	440	290
Investments - at cost	1,000	-
Inventories	365	190
Other current assets	295	270
	3,260	**1,710**
Share capital (Rs. 10 per share)	1,400	800
Share premium	550	-
Revaluation surplus	-	150
Retained earnings	618	445
Liabilities	692	315
	3,260	**1,710**

Additional information:

(i) On 1 January 2022, AL acquired a 70% shareholding in SL for the following consideration:

- Issuance of 20 million shares of AL after one month of acquisition. The market price of AL's shares at the date of acquisition was Rs. 25 each. However, market price increased to Rs. 27 each when shares were issued. The issuance of shares has been recorded in AL's books at Rs. 27 per share.
- Cash payment of Rs. 304 million after three years. The amount payable has been recorded in full i.e. at Rs. 304 million in AL's books.

(ii) At acquisition date, SL's retained earnings and revaluation surplus were Rs. 515 million and Rs. 105 million respectively. Further, carrying values of SL's net assets were equal to their fair values except an investment property whose fair value exceeded the carrying value by Rs. 160 million. The property had a remaining useful life of eight years. Both AL and SL subsequently measure investment properties using the cost model.

(iii) AL follows the cost model whereas SL follows the revaluation model for subsequent measurement of property, plant and equipment. If SL had adopted the cost model, SL would not have recorded revaluation surplus of Rs. 45 million on 31 December 2022.

(iv) During the year, SL made sales of Rs. 150 million to AL at 20% mark-up. 40% of these goods are included in AL's closing inventories.

(v) On 1 July 2022, AL acquired 5 million shares representing 25% shareholdings in Platinum Limited (PL) for Rs. 91 million. On acquisition date, the fair value of PL's share was Rs. 17 each. AL has nominated 1 director out of 5 directors on the board of PL.

(vi) During the six months ended 31 December 2022, PL reported net profit of Rs. 52 million. AL has recorded its share of dividend from PL amounting to Rs. 5 million as other income.

(vii) On 1 September 2022, AL sold a machine having carrying value of Rs. 60 million to PL for Rs. 108 million. The remaining useful life of the machine at the time of disposal was four years.

(viii) A fair value loss of Rs. 22 million needs to be recorded in respect of AL's remaining investments.

(ix) Discount rate of 15% per annum may be used wherever required.

(x) AL measures non-controlling interest at the proportionate share of SL's identifiable net assets.

Required:

In accordance with IFRSs, prepare AL's consolidated statement of financial position as at 31 December 2022. **(18)**

Q.9 The first year's financial statements of Titanium Limited (TL) for the year ended 31 December 2022 are under preparation. The following matters have been identified which may have implications of deferred tax:

(i) TL acquired an equity investment for Rs. 85 million which was subsequently measured at fair value through profit or loss. On 31 December 2022, TL recorded Rs. 20 million as gain for change in the fair value. Under the tax laws, gain on investment is taxable at the time of sale.

(ii) TL purchased factory building for Rs. 1,200 million in 2022 which was depreciated by Rs. 80 million. On 31 December 2022, the factory building was revalued at Rs. 1,260 million. Under the tax laws, depreciation at the rate of 10% per annum is allowed as a tax expense while revaluation does not affect taxable profit.

(iii) Development cost of Rs. 20 million incurred in 2022 has been expensed out. Under the tax laws, development cost is amortized over ten years.

(iv) TL received government grant of Rs 12 million related to an equipment. The grant is recognised as income over three years. Under the tax laws, the government grant is exempt from tax.

(v) TL incurred a tax loss of Rs. 260 million for the year ended 31 December 2022. Under the tax laws, all unused tax losses are adjustable from future profits within next six years.

Applicable tax rate is 35%.

Required:
Discuss how the deferred tax related to each of the above matters should be dealt with in TL's financial statements for the year ended 31 December 2022. **(15)**

(THE END)