The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examinations

11 March 2017
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 The following information pertains to the financial statements of Home Dynamics Limited (HDL), a listed company, for the year ended 31 December 2016:

(i) Profit after tax for the year:

	Rs. in million
Profit from continuing operations – net of tax	765
Profit from discontinued operations – net of tax	155
Profit after tax	920

(ii) Shareholders' equity as on 1 January 2016 comprised of:

- 10 million ordinary shares of Rs. 10 each, having market value of Rs. 25 each.
- 4 million cumulative preference shares of Rs. 10 each entitled to a cumulative dividend at 10%.

(iii) On 31 March 2016, HDL announced 40% right shares to its ordinary shareholders at Rs. 25 per share. The entitlement date of right shares was 31 May 2016. The market price per share immediately before the announcement date and entitlement date was Rs. 28 and Rs. 32 respectively.

(iv) On 2 August 2016, HDL announced 20% bonus issue. The entitlement date of bonus shares was 31 August 2016.

(v) On 1 February 2017, the board of directors announced 20% cash dividend and 10% bonus issue being the final dividend to the ordinary shareholders and 10% cash dividend for preference shareholders.

Required:
Calculate basic earnings per share for inclusion in HDL's financial statements for the year ended 31 December 2016. Show all relevant calculations. **(10)**

Q.2 Atif is a chartered accountant and has been working as Manager – Accounts in an unlisted public company MNZ Limited.

While preparing the financial statements for the year ended 31 December 2016, CFO of MNZ who is also a chartered accountant informed Atif that the directors are considering to have the company listed on Pakistan Stock Exchange.

Consequently, CFO wants to show higher profit and has asked Atif to identify areas where book adjustments can be made. He has also informed that if MNZ is able to list the shares at a price of Rs. 35 or more, all managerial staff would be given an additional bonus this year.

Required:
Briefly explain how the CFO is in breach of the fundamental principles of ICAP's code of ethics. Also state the potential threats that Atif may face under the above circumstances and how he should respond. **(08)**

Q.3 BB Limited (BBL) produces a single product in two factories A and B. Factory A produces the required components which are assembled in factory B. The finished product is then sent to distributors for sale.

Following information is available for the purpose of impairment testing:

(i) BBL uses cost model for subsequent measurement of property, plant and equipment.

(ii) The book value and fair value less cost to sell of BBL's tangible assets as on 31 December 2016 were as follows:

	Book value		**Fair value less cost to sell**	
	Factory A	**Factory B**	**Factory A**	**Factory B**
	-------------------- Rs. in million --------------------			
Building	1,850	3,600	1,800	4,200
Plant	1,125	2,700	1,300	1,600
Equipment	690	1,350	460	1,480
Other assets	240	510	130	280

(iii) Goodwill appearing in the books is Rs. 100 million.

(iv) Expected cash flows of BBL in next three years are as follows:

	2017	**2018**	**2019**
	------- Rs. in million -------		
Net operating cash inflows	1,650	2,450	2,900
Estimated sale proceeds of all assets	-	-	8,200
Costs of disposing the above assets	-	-	283

(v) Pre-tax discount rate of BBL is 9%.

Required:

(a) Identify the cash generating unit for BB Limited. **(02)**

(b) Determine the carrying amount of each asset to be included in BBL's financial statements for the year ended 31 December 2016 in accordance with International Financial Reporting Standards. ***(Ignore tax implications)*** **(10)**

Q.4 On 1 January 2016 Maisum Limited (ML) entered into a sale and lease back agreement with Bachat Bank in respect of a machine. The details of machine sold and leased back are as under:

	Rs. in million
Carrying value	85
Sale price to the lessor	95
Fair market value	120

The terms of lease agreement are as follows:

Lease term	4 years
Annual rentals (payable in advance)	Rs. 21 million
Implicit interest rate	9%

The transfer of machine by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale.

Required:

(a) Prepare journal entry in the books of ML to record the above transaction on 1 January 2016. **(07)**

(b) Prepare relevant extracts from the statements of financial position and comprehensive income and related notes for inclusion in ML's financial statements, for the year ended 31 December 2016. **(10)**

Q.5 The draft summarized statements of financial position of Golden Limited (GL) and its subsidiary Silver Limited (SL) as at 31 December 2016 are as follows:

	GL	SL
	---------- Rs. in million ----------	
Building	1,600	500
Plant & machinery	1,465	690
Investment in SL	327	-
Current assets	2,068	780
	5,460	**1,970**
Share capital (Rs. 10 each)	980	450
Share premium	730	150
Retained earnings	3,150	210
	4,860	810
Liabilities	600	1,160
	5,460	**1,970**

(i) GL acquired 60% of the shares of SL on 1 April 2016 at following consideration:

- Issuance of 20 million ordinary shares at premium of Rs. 2 each;
- Cash amounting to Rs. 87 million, which includes consultancy charges of Rs. 10 million and legal expenses of Rs. 5 million.

The market value of each share of GL and SL on acquisition date was Rs. 25 and Rs. 11 respectively. At acquisition date, retained earnings of SL were Rs. 100 million.

(ii) The following table sets out those items whose fair value on the acquisition date was different from their book value. These values have not been incorporated in SL's books of account.

	Book value	Fair value
	---------Rs. in million---------	
Building	250	170
Inventory	112	62
Provision for bad debts	(15)	(24)

(iii) Upon acquisition of SL, a contract for management services was also signed under which GL would provide various management services to SL at an annual fee of Rs. 50 million from the date of acquisition. The payment would be made in two equal instalments payable in arrears on 1 April and 1 October.

(iv) On 30 September 2016, GL acquired a plant from SL in exchange of a building which was currently not in use of GL. The details of plant and building are as follows:

	Cost	Accumulated depreciation	*Exchange price
	------------------ Rs. in million -----------------------		
Building	240	130	120
Plant	200	80	120
** Equivalent to fair value*			

Both companies follow cost model for subsequent measurement of property, plant and equipment and charge depreciation on building and plant at 5% and 20% respectively on cost.

(v) SL paid an interim cash dividend of 10% on 31 July 2016.

(vi) GL values non-controlling interest at the acquisition date at its fair value.

Required:

Prepare a consolidated statement of financial position as at 31 December 2016 in accordance with the requirements of International Financial Reporting Standards. **(17)**

Q.6 The following trial balance pertains to Hadi Limited (HL) for the year ended 31 December 2016:

Description	Debit	Credit
	------- Rs. in '000	-------
Capital work-in-progress	145,000	
Plant and machinery – at cost	305,000	
Trade receivables	61,400	
Stock-in-trade	79,600	
Cash and bank	33,444	
Cost of sales	78,664	
Administrative expenses	37,636	
Ordinary share capital (Rs. 10 each)		241,000
Retained earnings		69,050
Accumulated depreciation – Plant and machinery		53,250
Trade payables		60,912
10% long term loan		75,000
Provision for warranty		10,000
Provision for bad debts		5,000
Deferred tax liability		25,125
Sales		201,407
	740,744	**740,744**

While finalizing the financial statements of HL from the above trial balance, the following issues have been noted:

(i) No depreciation has been charged in the current year. Depreciation is provided at 10% per annum using the straight line method.

(ii) A machine which was purchased on 1 January 2015 for Rs. 25 million was traded-in, on 1 July 2016 for a new and more sophisticated machine. The disposal was not recorded and the new machine was capitalized at Rs. 15 million being the net amount paid to supplier. The trade-in allowance amounted to Rs. 20 million.

(iii) Taxation authorities allow initial and normal depreciation at 25% and 15% respectively using reducing balance method. No tax depreciation is allowed in the year of disposal. The tax written down value of the plant and machinery as on 1 January 2016 was Rs. 153 million.

(iv) HL maintains a provision for doubtful debts at 6% of trade receivables. On 1 February 2017, a customer owing Rs. 10 million at year-end was declared bankrupt. HL estimates that 20% of the amount would be received on liquidation.

(v) The long term loan of Rs. 75 million was obtained on 1 January 2016, to finance the capital work-in-progress. HL capitalizes the finance cost on such loan in accordance with IAS-23 'Borrowing cost'. However, the financial charges are admissible as an expense, under the tax laws.

(vi) HL sells goods with a 1-year warranty and it is estimated that warranty expenses are 3% of annual sales. Actual payments during the year, against warranty claims of the products sold during current and previous years were Rs. 2.5 million and Rs. 8 million respectively. These have been debited to administrative expenses.

(vii) On 1 January 2016, HL started research and development work for a new product. On 1 May 2016, the recognition criteria for capitalization of internally generated asset was met. The product was launched on 1 November 2016.

HL incurred Rs. 20 million from commencement of research and development work till launching of the product and charged it to cost of goods sold. It is estimated that the useful life of this new product will be 20 years. It may be assumed that all costs accrued evenly over the period.

On 31 December 2016, the recoverable amount of the development expenditure was Rs. 10 million. For tax purposes, research and development costs are allowed to be amortized over 10 years.

(viii) Applicable tax rate is 30%.

Required:

(a) Prepare statement of comprehensive income for the year ended 31 December 2016 in accordance with the requirements of International Financial Reporting Standards. **(11)**

(b) Compute the current and deferred tax expenses for the year ended 31 December 2016. **(15)**

Q.7 Karim Limited (KL) bought a special purpose engineering plant on 1 January 2015 at a cost of Rs. 1,755 million inclusive of sales tax @ 17% (refundable).

KL is required to decommission the plant after a period of 2 years. Decommissioning cost is estimated at Rs. 300 million. The applicable discount rate is 11%.

KL uses the cost model for subsequent measurement of its property, plant and equipment. Plant is being depreciated using the straight line method over its useful life.

Required:

Prepare journal entries to record the above transactions for the years 2015 and 2016. **(10)**

(THE END)