The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

8 September 2018
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 Orange Limited (OL) is in the process of finalizing its financial statements for the year ended 30 June 2018. The following information has been gathered for preparing the disclosures related to taxation:

(i) Profit before tax for the year ended 30 June 2018 was Rs. 508 million.
(ii) Accounting depreciation for the year exceeds tax deprecation by Rs. 45 million.
(iii) During the year, OL sold a machine whose accounting WDV exceeded tax WDV by Rs. 15 million.
(iv) OL carries trademark of Rs. 90 million having indefinite useful life which was acquired on 1 July 2015. Tax authorities allow its amortization over 10 years on straight line basis.
(v) OL sells goods with a 1-year warranty and it is estimated that warranty expenses are 2% of annual sales. Actual payments during the year related to warranty claims were Rs. 54 million. Of these, Rs. 38 million pertain to goods sold during the previous year. Sales for the year ended 30 June 2018 was Rs. 1,750 million. Under the tax laws, these expenses are allowed on payment basis.
(vi) During the year, OL expensed out payments of Rs. 17.5 million related to restructuring of one of its business segments. As per tax laws, these expenses are to be allowed as tax expense over a period of 5 years from 2018 to 2022.
(vii) Expenses include:

- accruals of Rs. 26 million which will be allowed for tax purpose on payment basis.
- cash donations of Rs. 5 million which are not allowed as tax expense.

(viii) Other income includes:

- commission receivable of Rs. 12 million.
- dividend receivable of Rs. 35 million.

Both incomes were taxable on receipt basis at 30% up to 30 June 2018. With effect from 1 July 2018 commission income is exempt from tax whereas dividend income is taxable at 10% on receipt basis.

(ix) On 30 June 2018, OL received advance rent of Rs. 16 million. Rent income is taxable on receipt basis.
(x) Net deferred tax liability as on 1 July 2017 arose on account of:

	Rs. in million
Property, plant and equipment	34.5
Trademark	5.4
Provision for warranty	(14.7)
	25.2

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

Required:
(a) Prepare a note on taxation for inclusion in OL's financial statements for the year ended 30 June 2018 including a reconciliation to explain the relationship between tax expense and accounting profit. **(11)**
(b) Compute the deferred tax liability/asset in respect of each temporary difference. **(07)**
(Comparative figures are not required)

Q.2 Following is the draft statement of financial position of Papaya Limited (PL) as on 30 June 2018:

Assets	2018	2017	Equity & liabilities	2018	2017
	Rs. in million			Rs. in million	
Property, plant & equipment	47,400	40,600	Share capital	9,000	6,000
Deferred tax	250	-	Retained earnings	29,045	22,590
Stock-in-trade	5,100	4,500	Revaluation surplus	3,625	2,500
Trade receivables	5,330	4,780	Loans and borrowing	11,888	14,200
Cash and bank balances	7,758	5,620	Lease liabilities	950	800
			Deferred tax	-	1,300
			Provision for dismantling	210	190
			Trade and other payables	7,050	6,550
			Interest payable	270	370
			Income tax payable	3,800	1,000
	65,838	**55,500**		**65,838**	**55,500**

Additional information:

(i) Depreciation expense for the year was Rs. 2,450 million.

(ii) Interest expense for the year was Rs. 1,200 million which included Rs. 20 million on unwinding of discount related to provision for dismantling.

(iii) Tax expense for the year was Rs. 4,500 million.

(iv) During the year, the board declared an interim cash dividend of Rs. 600 million and interim bonus in proportion of 1 share for every 3 shares held. Subsequently, a right issue was also made.

(v) During the year, PL recognised revaluation surplus of Rs. 1,600 million related to its land.

(vi) Each year incremental depreciation is transferred from revaluation surplus to retained earnings.

(vii) A plant having original cost of Rs. 2,000 million and carrying value of Rs. 1,200 million was completely destroyed by fire. The insurance claim amounting to Rs. 800 million was received.

(viii) On 1 July 2017, machinery having fair value of Rs. 245 million were acquired on a non-cancellable lease of five years. Rentals of Rs. 62 million are to be paid annually in advance. PL's incremental borrowing rate is 12.08%.

(ix) Trade and other payables include an amount of Rs. 700 million payable against purchase of machinery.

Required:
Prepare PL's statement of cash flows for the year ended 30 June 2018 in accordance with the requirements of IFRSs using indirect method. **(15)**

Q.3 Baqir, ACA is working as Finance Manager at Kiwi Limited (KL), a listed company, and reports to Shahid, FCA who is the Chief Financial Officer of the company.

Before the date of authorization for issuance of KL's financial statements for the year ended 30 June 2018, Zahoor (a mutual friend of Baqir and Shahid) informed Baqir that Shahid has recommended him to purchase KL's shares as higher EPS is expected this year. Zahoor also sought Baqir's advice on this matter.

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

Q.4 Apple Limited (AL) is in the process of finalizing its consolidated financial statements for the year ended 30 June 2018. Following information pertains to the Group's intangible assets:

(i) As on 30 June 2017, revalued amount of AL's license and related revaluation surplus were Rs. 450 million and Rs. 30 million respectively.

(ii) On 1 July 2017 AL acquired entire shareholding of Mango Limited (ML) for Rs. 1,950 million. Fair values of net assets appearing in ML's books on acquisition date are given below:

	Rs. in million
Software (Rs. 100 million each)	200
Other net assets	1,545

In respect of acquisition of ML, following information is also available:

- Till acquisition date, ML had incurred research & development cost of Rs. 80 million on product 'ABC'. ML had not recognised this as an asset because criteria for recognition of the internally generated intangible asset was met on 1 July 2017. On this date, AL estimated that the fair value of research and development work on ABC was Rs. 95 million.
- On acquisition date, fair value of ML's customer list was assessed at Rs. 20 million.

(iii) ML incurred following expenditures on this project from 1 July 2017 till ABC's launching date i.e. 1 May 2018.

	Rs. in million
Market research	5
Product design	12
Cost of pilot plant (not for commercial production)	48
Refinement of product before commercial production	6
Training of production staff	8
Testing of pre-production	4
Production and launching of product	105
	188

(iv) As on 1 July 2017, the fair value of AL's own customer list was assessed at Rs. 35 million.

(v) As on 1 July 2017, remaining useful life of all intangible assets except goodwill was 10 years.

(vi) On 31 March 2018, ML sold one of its software for Rs. 110 million.

(vii) Group follows the revaluation model for license whereas cost model is used for other intangible assets.

(viii) As on 30 June 2018:

- fair value of licence was assessed at Rs. 350 million.
- goodwill of ML has been impaired by 20%.

Required:
Prepare a note on intangible assets, for inclusion in AL's consolidated financial statements for the year ended 30 June 2018 in accordance with the requirements of IFRSs.
('Total' column is not required) **(14)**

Q.5 Banana Limited (BL) is listed on Pakistan Stock Exchange and has registered office in Karachi. BL engages in manufacturing and marketing of fertilizers. It operates a manufacturing plant at Nawabshah.

Summarized trial balance of BL as at 30 June 2018 is given below:

Description	**Rs. in million**
Advance from customers	576
Cash and bank balances	831
Intangible assets	444
Investment in 3 months term deposit	500
Land and building – revaluation model	2,000
Long term deposits with utility companies	10
Long term investments	1,500
Ordinary share capital	6,000
Plant and equipment – cost model	3,086
Provision for doubtful receivables	80
Revaluation surplus on land and building	468
Running finance	800
Share premium	500
Stock-in-trade	2,670
Trade and other receivables	1,470
Trade payables	1,150
Un-appropriated profit	2,885
Unclaimed dividend	52

Additional information:

(i) Trade and other receivables include receivables from BL's associate i.e. Strawberry Limited (SL) and BL's subsidiary i.e. Pear Limited (PL) amounting to Rs. 50 million and Rs. 20 million respectively. Provision for doubtful receivables includes provision of Rs. 10 million against receivables from SL.

(ii) Bad debts of Rs. 35 million were written off during the year. These include an amount of Rs. 8 million receivable from SL.

(iii) Authorised share capital consists of 1 billion shares of Rs. 10 each.

(iv) 80 million shares were issued as bonus shares in the previous years whereas 20 million shares were issued as a consideration for purchase of building at market price of Rs. 15 per share. Remaining shares were allotted for consideration paid in cash.

(v) Guarantees issued by BL to Cherry Bank Limited against loans granted to BL's employees amounting to Rs. 16 million.

(vi) During the year, BL produced 3 million tonnes of urea operating at 75% production capacity. The shortfall was due to lower demand of product in the market.

(vii) Following decisions were taken by the board of directors in their meeting held on 16 August 2018:

- Cash dividend of Rs. 3 per share for the year ended 30 June 2018 was proposed.
- Financial statements for the year ended 30 June 2018 were approved.

Required:

(a) Formulate a note on accounting policy for property, plant and equipment measured under cost model. ***(Assume necessary details in this respect)*** **(03)**

(b) Prepare BL's statement of financial position as at 30 June 2018 along with the relevant notes showing possible disclosures as required under the IFRSs and the Companies Act, 2017. ***(Comparative figures and note on accounting polices are not required)*** **(14)**

Q.6 (a) Guava Leasing Limited (GLL), had leased a machinery to Honeyberry Limited (HL) on 1 July 2017 on the following terms:

(i) The non-cancellable lease period is 3.5 years. Each semi-annual lease instalment of Rs. 48 million is receivable in arrears.
(ii) The lease contains an option to extend the lease term by 1.5 years. Each semi-annual lease instalment in the extended period will be of Rs. 15 million, receivable in arrears. It is reasonably certain that HL will exercise this option.
(iii) The rate implicit in the lease is 10% per annum.
(iv) The useful life of machinery is 6 years.
(v) The unguaranteed residual value at the end of lease term is estimated at Rs. 20 million.

GLL incurred a direct cost of Rs. 10 million and general overheads of Rs. 0.5 million to complete the transaction.

Required:
Prepare note(s) for inclusion in GLL's financial statements, for the year ended 30 June 2018. **(09)**

(b) Property, plant and equipment as disclosed in the draft financial statements of Apricot Pakistan Limited (APL) for the year ended 30 June 2018 include a plant having a carrying value of Rs. 610 million. The performance of the plant has been deteriorating since last year which is affecting APL's sales.

Following information/estimates relate to the plant for the year ending 30 June 2019:

	Rs. in million
Inflows from sale of product under existing condition of the plant	250
Operational cost other than depreciation	25
Depreciation	170
Expenses to be paid in respect of 30 June 2018 accruals	8
Cost of increasing the plant's capacity	60
Additional inflows (net) expected from the upgrade	40
Interest on finance lease	30
Maintenance cost	15
Tax payment on profits	18

Cash flows from the plant are expected to decrease by 15% each year from 2020 and onward. The plant's residual value after its remaining useful life of 3 years is estimated at Rs. 100 million.

An offer has been received to buy the plant immediately for Rs. 570 million but APL has to incur the following costs.

	Rs. in million
Cost of delivery to the customer	45
Legal cost	10
Costs to re-organize the production process after disposal of plant	50

Applicable discount rate is 9%.

Required:
Calculate the amount of impairment loss (if any) on plant, for the year ended 30 June 2018. **(07)**

Q.7 For the purpose of this question, **assume that the date today is 15 February 2018.**

Melon Limited (ML) is in the process of finalizing its financial statements for the year ended 31 December 2017. Following matters are under consideration:

(i) ML undertook a sales campaign in December 2017 whereby customers can avail 20% discount on the purchase of its new product by presenting a coupon, which formed part of newspaper advertisements. The offer is valid from 1 January 2018 to 28 February 2018.

So far discounts of Rs. 4.5 million have been availed and the management estimates that a further discount of Rs. 3 million will be given before the end of the scheme.

(ii) On 15 December 2017, a machine was disposed of for Rs. 3.5 million to Raspberry Limited (RL) for cash. However, as per agreement ML was also entitled to additional amount of Rs. 1.5 million which is dependent upon passing certain production tests after installation at RL's premises. On 25 January 2018 RL confirmed that the required production testing had successfully been completed.

(iii) On 10 December 2017, a worker filed a claim of Rs. 2.5 million and alleged violation of safety measures on the part of ML. As of 31 December 2017 the legal advisor of ML advised that there was only a remote possibility that the Court would award any compensation to the worker.

The case is still pending, however ML's legal advisor now believes that there is a 40% chance that the Court would award compensation of Rs. 2 million to the worker.

(iv) In November 2017, as part of restructuring plan an option of early retirement in exchange for a one-off payment of Rs. 1 million was offered to each employee aged above 50 years. According to restructuring plan, management expects that 25 employees would accept the offer. The option can be exercised till 31 March 2018. 10 employees have already opted for the scheme till 31 December 2017. A further 6 employees have opted for the scheme after year-end.

Costs related to the restructuring except one-off payments to employees have already been provided by ML in its financial statements.

Required:
Discuss how each of the above matters should be dealt with in ML's financial statements for the year ended 31 December 2017. **(12)**

(THE END)