The Institute of
Chartered Accountants
of Pakistan

Certificate in Accounting and Finance Stage Examination

10 March 2018
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 For the purpose of preparation of statement of changes in equity for the year ended 31 December 2017, Daffodil Limited (DL) has extracted the following information:

	2017 Draft	2016 Audited	2015 Audited
	--------- Rs. in million ---------		
Net profit	650	318	214
Transfer to general reserves	112	-	141
Transfer of incremental depreciation	-	49	55
Final cash dividend	-	-	7.5%

Additional information:

(i) Details of share issues:

- 25% right shares were issued on 1 May 2016 at Rs. 18 per share. The market price per share immediately before the entitlement date was also Rs. 18 per share.
- A bonus issue of 10% was made on 1 April 2017 as final dividend for 2016.
- 50 million right shares were issued on 1 July 2017 at Rs. 15 per share. The market price per share immediately before the entitlement date was Rs. 25 per share.
- A bonus issue of 15% was made on 1 September 2017 as interim dividend.

(ii) After preparing draft financial statements, it was discovered that depreciation on a plant costing Rs. 700 million has been charged @ 25% under reducing balance method, from the date of commencement of manufacturing i.e. 1 July 2014. However, the plant was available for use on 1 February 2014.

(iii) Share capital and reserves as at 31 December:

	2015	2014
	------ Rs. in million ------	
Ordinary share capital (Rs. 10 each)	1,600	1,600
General reserves	1,850	1,709
Retained earnings	1,430	1,302

Required:
Prepare DL's statement of changes in equity for the year ended 31 December 2017 along with comparative figures. ***(Ignore taxation)*** **(14)**

Q.2 (a) Using the information given in **Question no. 1** above, compute DL's basic earnings per share for the year ended 31 December 2017 along with the comparative figure. **(08)**

(b) Explain how dividend on preference shares is dealt with while computing basic EPS. **(03)**

Q.3 Following are the draft statement of financial position of Jasmine Limited (JL) and its subsidiary, Sunflower Limited (SL) as on 31 December 2017:

	JL	SL
	------ Rs. in million ------	
Property, plant and equipment	880	330
Intangible assets	40	50
Investment in SL	520	-
Loan to JL	-	120
Current assets	640	345
	2,080	**845**
Share capital (Rs. 10 each)	700	200
Share premium	240	-
Retained earnings	720	410
Loan from SL	96	-
Current liabilities	324	235
	2,080	**845**

Additional information:

(i) JL acquired 75% shares of SL on 1 January 2017. Cost of investment in JL's books consists of:

- 10 million JL's ordinary shares issued at Rs. 24 per share; and
- cash payment of Rs. 280 million (including professional fee of Rs. 10 million for advice on acquisition of SL)

(ii) On acquisition date, carrying value of SL's net assets was equal to fair value except an intangible asset (brand) whose fair value was Rs. 40 million as against carrying value of Rs. 25 million. The remaining useful life of the brand is estimated at 5 years. The recoverable amount of the brand at 31 December 2017 was estimated at Rs. 28 million.

(iii) JL values non-controlling interest at fair value. The market price of SL's shares was Rs. 36 at the date of acquisition, which has increased to Rs. 40 as of 31 December 2017.

(iv) JL and SL showed a net profit of Rs. 200 million and Rs. 60 million respectively for the year ended 31 December 2017.

(v) The loan was granted on 1 July 2017 and carries mark-up of 10% per annum. A cheque of Rs. 30 million including interest was dispatched by JL on 31 December 2017 but was received by SL after the year end. No interest has been accrued by SL in its financial statements.

(vi) On 1 May 2017 SL sold a machine to JL for Rs. 52 million at a gain of Rs. 12 million. However, no payment has yet been made by JL. The remaining useful life of the machine at the time of disposal was 2 years.

(vii) During the year, JL made sales of Rs. 250 million to SL at 20% above cost. 60% of these goods are included in SL's closing stock.

(viii) SL declared interim cash dividend of 10% in November 2017 which was paid on 2 January 2018. The dividend has correctly been recorded by both companies.

Required:

Prepare JL's consolidated statement of financial position as at 31 December 2017. **(15)**

Q.4 The following information pertains to property, plant and equipment of Orchid Limited (OL), a listed company:

Description	Date of purchase	Cost Rs. in million	Original useful life	Depreciation method	Subsequent measurement model
Buildings	1-Jan-15	600	30 years	Straight line	Revaluation
Plant	1-Jan-15	475	25 years	Straight line	Cost

Buildings
The revalued amount of buildings as determined by Shabbir Associates, an independent valuer, on 31 December 2015 and 2017 was Rs. 700 million and Rs. 463 million respectively.

On 30 June 2017 a building having original cost of Rs. 66 million was sold to Baqir Limited for Rs. 85 million. It was last revalued at Rs. 87 million. OL incurred a cost of Rs. 2 million on disposal.

OL transfers the maximum possible amount from revaluation surplus to retained earnings on an annual basis.

Plant
On 31 December 2016 the recoverable amount of the plant was assessed at Rs. 360 million with no change in useful life.

During 2017, OL has decided to change the depreciation method for plant from straight line to reducing balance. The new depreciation rate would be 10%.

Required:
Prepare following notes (along with comparative figures) to be presented in the financial statements of OL for the year ended 31 December 2017 in accordance with the requirements of relevant IFRSs and Companies Act, 2017:

(a) Property, plant and equipment **(18)**
(b) Change in depreciation method **(02)**

Q.5 Umer Sheikh, ACA is Manager Finance at Charming Limited (CL) and reports to Abid, FCA who is the Chief Financial Officer of CL. Abid is also a close relative of the major shareholder of CL.

CL is negotiating an important financing arrangement with Union Standard Bank (USB) in order to expand its business in foreign markets. The rate quoted by USB is comparatively higher than existing rates being paid by CL.

During a meeting with the Executive Vice President (EVP) of USB, where Umer Sheikh was also present, Abid revealed that his son has applied for a house financing in USB last month but has not received any response from USB so far. Abid requested EVP to consider his application. EVP agreed to look into the matter. On conclusion of the meeting, Abid asked Umer Sheikh to prepare a note for the board of directors proposing the acceptance of the rate offered by USB.

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

Q.6 Rose Limited (RL) is finalizing its financial statements for the year ended 31 December 2017. In this respect, the following information has been gathered:

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

(ii) During the year RL incurred advertising cost of Rs. 15 million.

This cost is to be allowed as tax deduction over 5 years from 2017 to 2021.

(iii) Trade and other payables amounted to Rs. 40 million as on 31 December 2017 which include unearned commission of Rs. 10 million.

Commission is taxable when it is earned by the company. Tax base of remaining trade and other payables is Rs. 25 million.

(iv) Other receivables amounted to Rs. 17 million as on 31 December 2017 which include dividend receivable of Rs. 8 million.

Dividend income was taxable on receipt basis at 20% in 2017. However, with effect from 1 January 2018, dividend received is exempt from tax. Tax base of remaining other receivables is Rs. 6 million.

(v) On 1 April 2017, RL invested Rs. 40 million in a fixed deposit account for one year at 10% per annum. Interest will be received on maturity.

Interest was taxable on receipt basis at 10% in 2017. However, with effect from 1 January 2018, interest received is taxable at 15%.

(vi) On 1 January 2016, a machine was acquired on lease for a period of 4 years at annual lease rental of Rs. 28 million, payable in advance. Interest rate implicit in the lease is 10%.

Under the tax laws, all lease related payments are allowed in the year of payment.

(vii) Details of fixed assets are as follows:

- On 1 January 2017 RL acquired a plant at a cost of Rs. 250 million. It has been depreciated on straight line basis over a useful life of six years. RL is also obliged to incur decommissioning cost of Rs. 50 million at the end of useful life of the plant. Applicable discount rate is 8%.
- On 1 July 2017 RL sold one of its four buildings for Rs. 60 million. These buildings were acquired on 1 January 2013 at a cost of Rs. 100 million each having useful life of 30 years.

The dismantling costs will be allowed for tax purposes when paid. Tax depreciation rate for all owned fixed assets is 10% on reducing balance method. Further, full year's tax depreciation is allowed in year of purchase while no depreciation is allowed in year of disposal.

Required:
Compute the deferred tax liability/asset to be recognised in RL's statement of financial position as on 31 December 2017. **(16)**

Q.7 Draft financial statements of Tulip Limited (TL) for the year ended 31 December 2017 show the following amounts:

	Rs. in million
Total assets	2,700
Total liabilities	1,620
Net profit for the year	398

While reviewing the draft financial statements, following matters have been noted:

(i) TL commenced development of a new product on 1 January 2017. Following directly attributable costs have been incurred upto the launching date of 1 October 2017 and have been capitalized as intangible asset:

	Rs. in million
Staff salary	30
Equipment (having useful life of 5 years)	360
Consumables	90
Consultant fee	212
Total	**692**

The recognition criteria for capitalization of internally generated intangible assets was met on 1 March 2017. All costs have been incurred evenly during the period except equipment which was purchased specifically for this product on 1 January 2017.

TL estimated that useful life of this new product will be 10 years. However, TL had not charged any amortization in 2017. **(06)**

(ii) After preparation of draft financial statements, a claim of Rs. 20 million was lodged by a customer for supplying defective units of a product in 2017. According to TL's lawyers, the chance that claim would succeed is 80%.

At year-end, 800 units of this product were included in TL's inventory at a cost of Rs. 150,000 per unit. All these units have the same defects. Normal selling price of each unit is Rs. 200,000. TL has already committed to sell 300 units to Jamal Enterprises at a price of Rs. 220,000 per unit.

TL has estimated that Rs. 80,000 per unit would be incurred to remove the above defect. Further, each defective unit can be sold for Rs. 130,000 in current condition. **(04)**

(iii) The receipt of Rs. 130 million on account of sale and leaseback arrangement of machine with Sabir Limited was recorded as a financial liability on 31 December 2017.

This transfer has satisfied the requirements of IFRS 15 to be accounted for as sale of an asset. However, the machine is still included in total assets at carrying value of Rs. 100 million. Fair value of this machine at year end was Rs. 155 million. Under the lease agreement, TL is required to make annual payments of Rs. 20 million for 8 years payable in arrears. Incremental borrowing rate is 11% per annum. **(06)**

Required:
Determine the revised amounts of total assets, total liabilities and net profit, after incorporating the impact of above adjustment(s), if any.

(THE END)