Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

7 December 2020
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Accounting and Financial Reporting

Instructions to examinees:
(i) Answer all **FIVE** questions.
(ii) Answer in **black** pen only.

Q.1 For the purpose of this question, **assume that the date today is 1 February 2020.**

Financial statements of Hikmat Limited (HL) for the year ended 31 December 2019 are under preparation. In this respect, following matters are under consideration:

(a) On 1 September 2019, HL entered into a contract to develop a software for Doctor Limited (DL) for Rs. 150 million. HL ascertained that the promised development of software is a single performance obligation satisfied over time. The terms of the contract include a penalty of Rs. 14 million if the development of software is not completed before 29 February 2020. At the inception of the contract, HL determined that the expected cost of completing the contract would be Rs. 90 million and the software development would be completed before 29 February 2020.

Till 31 December 2019, HL incurred cost of Rs. 67.5 million. As the original contract was 75% complete, HL has recognized revenue and profit of Rs. 112.5 million and Rs. 45 million respectively in the draft financial statements.

However, HL and DL have amended the contract on 31 December 2019. As a result, the consideration and expected cost increased by Rs. 70 million and Rs. 40 million respectively. The allowable time for completion without penalty is increased by one month only. HL now expects that the development of software would not be completed by 31 March 2020. The additional work is not distinct from services under original contract. No adjustment has been made in HL's financial statements in respect of the amendment in the contract. **(07)**

(b) On 29 December 2019, the board of directors of HL decided to sell one of its major line of business. This segment earned a net loss during 2019 though it was earning significant profits in the prior years. At year-end, it was expected to realise Rs. 160 million from this sale. The actual sale of the segment was finalized in January 2020 at a price of Rs. 145 million. All the criteria for classification of the segment as 'held for sale' were met at 31 December 2019 when the carrying amounts of assets and liabilities of the segment appearing in the draft financial statements were as follow:

	2019	**2018**
	---- Rs. in million ----	
Property, plant and equipment	195	224
Intangible assets	28	35
Current assets	50	60
Liabilities	90	75

No change has been made in the amounts and presentation of financial statements in respect of the board of directors' decision. **(07)**

(c) HL had acquired 30% shareholding in Physician Limited (PL) in 2016 for Rs. 150 million which has been accounted for under equity method. On 31 December 2019, HL disposed of 20% shareholding in PL at a fair value of Rs. 180 million which resulted in loss of significant influence over PL. Before disposal, carrying amount of the investment had increased to Rs. 240 million due to profits and other comprehensive income of PL over the years. Upon disposal, HL has recognized the difference of sale proceeds and Rs. 160 million (240×20/30) as gain on disposal. No other adjustment has been made. **(05)**

(d) During 2019, HL announced a bonus scheme for its employees. Under the scheme, all employees completing 5 years of service at HL would be entitled to 2 bonus salaries.

HL was incorporated in 2016, so the first employee would complete 5-year period in 2021 and therefore nothing has been recorded in the HL's financial statements. **(04)**

Required:
Discuss how the above matters should be dealt with in HL's financial statements for the year ended 31 December 2019. Show all calculations wherever possible.

Q.2 On 1 January 2016, Tabeeb Limited (TL) purchased 2 million debentures (having face value of Rs. 100 each) issued by Fit Limited (FL) at Rs. 92 each. Transaction cost of Rs. 3 million was also incurred on purchase of debentures.

TL classified the investment in debentures as financial asset at fair value through other comprehensive income. At initial recognition, TL determined that debentures were not credit impaired.

Coupon rates for the year 2016, 2017 and subsequent years are 0%, 6% and 10% per annum respectively payable on 31 December each year. The effective interest rate is 8.9% per annum.

On 31 December 2017, TL received the interest but due to deteriorating credit rating of FL, TL determined that there had been a significant increase in credit risk since the acquisition of the debentures.

On 31 December 2018, FL defaulted in payment of interest and TL determined that the debentures were credit impaired.

On 2 January 2019, TL sold the debentures at Rs. 84 each. Transaction cost of Rs. 1 million was also incurred on sale of debentures.

Following information regarding the 2 million debentures at various dates is also available:

Date	Expected credit losses		Fair value in quoted market
	Life time	12 months	
	-------------- Rs. in million --------------		
01 January 2016	3.0	1.0	186.0
31 December 2016	4.5	1.0	211.0
31 December 2017	12.1	5.2	190.0
31 December 2018	25.3	10.1	171.2

Required:
Prepare journal entries in the books of TL in respect of the above for the years ended 31 December 2016 to 31 December 2019. **(20)**

Q.3 Health Pharma Limited (HPL) entered into the following arrangements during 2019:

(i) On 1 January 2019, HPL acquired a capsule manufacturing machine from Hi-Tech Industries Limited for a lease term of 5 years with instalments payable annually in advance. The useful life of the machine was estimated at 6 years.

HPL paid the 1st instalment of Rs. 50 million on 1 January 2019. However, subsequent lease payments are subject to increase/decrease in line with consumer price index (CPI). At lease inception, HPL estimated that CPI will increase by 10% annually. However, CPI increased by 14% in 2019 and consequently Rs. 57 million was paid on 1 January 2020 as 2nd instalment. At 31 December 2019, HPL estimated that the annual increase in CPI will continue to be 14% in future years.

HPL is also required to pay a usage fee of Rs. 0.3 per capsule produced in excess of 30 million capsules per annum from the machine. At lease inception, HPL planned to produce 40 million capsules each year during the lease term. During 2019, HPL produced 40 million capsules and accordingly an amount of Rs. 3 million was also paid along with 2nd instalment.

(ii) On 1 April 2019, HPL entered into a contract with Auto Limited (AL) for the use of 8 Refrigerated Trucks for a period of 3 years at semi-annual payment of Rs. 10 million payable in arrears. AL is also required to provide two drivers along with each truck. The amount of Rs. 10 million can be allocated to the trucks' rental and drivers' cost in the ratio of 70:30 respectively.

All costs pertaining to running and maintenance of trucks, would be paid by AL. However, HPL is required to reimburse 30% of the fuel cost to AL. Fuel cost for 2019 was Rs. 4 million. HPL paid its share of fuel cost in 2020.

HPL uses these trucks for transportation of inventory all over the country. In order to save fuel and time, AL often replaces a similar truck at the required location from one of AL's nearby office. AL is also required to provide a substitute truck in case of accident and maintenance work.

(iii) On 1 July 2019, HPL sold its warehouse building to Macro Finance Limited (MFL) for cash of Rs. 1,400 million. Immediately before the transaction, the building was carried at Rs. 900 million and had remaining useful life of 18 years. At the same time, HPL entered into a contract with MFL for the right to use the warehouse building for 10 years, with annual payment of Rs. 180 million payable in arrears. Fair value of the building at the date of sale was Rs. 1,500 million. The rate of interest implicit in the lease is 11% per annum.

The terms and conditions of the transaction are such that the transfer of the building by HPL satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15.

HPL's incremental borrowing rate is 12% per annum.

Required:
Prepare the extracts relevant to the above transactions from HPL's statement of financial position and statement of profit or loss for the year ended 31 December 2019 in accordance with the IFRS. ***(Comparative figures and notes to the financial statements are not required)*** **(20)**

Q.4 Shifa Limited (SL) has investment in following companies:

Investment type	**Date of investment**	**Investee**	**Shareholding**	**Goodwill/ (Bargain purchase) on acquisition (Rs. in million)**
Local	1-Jan-2015	LA	55%	130
	1-Jan-2019	LB	60%	220
	1-Apr-2019	LC	90%	(60)
	31-Dec-2019	LA	20%	?
Foreign	1-May-2019	FD	70%	?

A draft consolidated statement of financial position of SL and its local subsidiaries as on 31 December 2019 is as under:

Assets	**Rs. in million**	**Equity and liabilities**	**Rs. in million**
Property, plant and equipment	14,200	Share capital	6,000
Goodwill	350	Group reserves	6,745
Investment property at fair value	200	Non-controlling interest	2,315
Investment at cost:		Liabilities	13,360
FD (CNY 100 million)	2,000		
LA (20% investment)	120		
Current assets	11,550		
	28,420		**28,420**

The effects of the following have not been considered while preparing the above statement of financial position:

(i) Investment property represents a warehouse owned by SL and rented out to LB on 1 July 2019 for 9 months at a rent of Rs. 2 million per month. Upto 30 June 2019, the warehouse was rented out to other tenants. Carrying value and remaining useful life of the warehouse on 1 July 2019 was Rs. 180 million and 15 years respectively. On 31 December 2019, rent of 2 months was not paid by LB.

(ii) A contingent liability of Rs. 150 million as disclosed in LB's financial statements was not included by SL in the net assets of LB at the acquisition date. SL's legal advisor had at that time estimated that LB would be liable to pay Rs. 40 million to settle the claim.

As at 31 December 2019, it was still appearing as contingent liability in LB's financial statements while SL's legal advisor revised its estimate to Rs. 60 million to settle the claim.

(iii) While calculating bargain purchase for LC, a purchase consideration of Rs. 121 million, payable in cash on 31 March 2021 was not considered. Applicable discount rate is 10% per annum.

(iv) LC which deals in office equipment, sold equipment to LB on 1 July 2019 for Rs. 70 million at cost plus 40%. LB depreciates this equipment over 5 years.

(v) On the date of additional investment of 20% in LA, the net assets of LA other than goodwill were amounted to Rs. 700 million.

For consolidation of FD, the following information is available:

(i) FD is registered in China and its functional currency is Chinese Yuan (CNY). On the date of acquisition, FD's retained earnings were CNY 20 million. Fair value of its net assets was equal to their book value, except for an intangible asset whose fair value was higher than its carrying value by CNY 15 million. Its remaining useful life at the date of acquisition was estimated at 10 years

(ii) FD's statement of financial position as on 31 December 2019 is as under:

Assets	CNY in million	Equity and liabilities	CNY in million
Property, plant and equipment	100	Share capital	60
Intangible assets	40	Retained earnings	42
Investment property at fair value	10	Liabilities	138
Current assets	90		
	240		**240**

(iii) The exchange rates per CNY are as follows:

1-May-2019	31-Dec-2019	Average for May-Dec 2019	Average for 2019
Rs. 20	Rs. 24	Rs. 23	Rs. 22

SL values non-controlling interest at its proportionate share of the fair value of the subsidiaries' net identifiable assets.

Required:
Prepare revised consolidated statement of financial position of SL as on 31 December 2019 in accordance with the requirements of IFRSs. **(25)**

Q.5 Following information is available from the records of Long Life Equity Fund (an open-end mutual fund) for the year ended 30 June 2020:

(i) Undistributed income as at 1 July 2019 comprised of realised income and unrealised loss of Rs. 269 million and Rs. 12 million respectively.
(ii) Total net assets at 1 July 2019 amounted to Rs. 9,690 million.
(iii) Allocation of net income for the year is as follows:

	Rs. in million
Total comprehensive income	364
Income already paid on units redeemed	(85)
	279

(iv) Accounting income available for distribution only relates to capital gains.
(v) Final distribution of Rs. 255 million i.e. @ 5% for the year ended 30 June 2019 was made during the year.
(vi) Details of issuance and redemption of units during the year are as follows:

	Issuance	Redemption
Units in million	660	750
	----------- Rs. in million	-----------
Capital value	12,606	(14,250)
Element of income / (loss)	120	(144)
	12,726	**(14,394)**

(vii) Unrealized income included in undistributed income as at 30 June 2020 amounted to Rs. 7 million.

Required:
Prepare a statement of movement in unit holders' fund for the year ended 30 June 2020. ***(Ignore disclosure of comparative figures and net assets value per unit)*** **(12)**

(THE END)