Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

7 June 2021
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Accounting and Financial Reporting

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

Q.1 Year 2020 remained a difficult year for Pudding Limited (PL) due to COVID-19. In view of the severe liquidity issues, PL entered into following arrangements with different banks in the last two months of the year ended 31 December 2020:

(i) On 31 October 2020, PL defaulted in making payment of annual instalment of a loan from Bank A. On 1 November 2020, Bank A agreed to extinguish the remaining loan in exchange of 3 million PL's shares having par value of Rs. 10 each.

On 1 November 2020, fair value of PL's share was Rs. 56 each. Under the arrangement, Bank A cannot sell these shares for a period of two years which reduces the fair value of share by 20%.

The above mentioned loan was acquired on 1 November 2018. The original disbursement amount was Rs. 140 million. The loan carried interest @ 10% per annum and was repayable in 5 annual instalments of Rs. 36.93 million each.

(ii) On 1 November 2020, PL sold one of its investments in debentures for Rs. 110 million to Bank B and simultaneously entered into a contract to buy the same debentures back on 1 July 2021 at Rs. 119 million.

PL purchased these debentures on 1 November 2019 for Rs. 114 million (par value Rs. 120 million). Debentures carry annual coupon at the rate of 11% per annum payable on 31 October each year and have effective yield of 12% per annum. PL carries this investment at amortised cost.

(iii) On 1 December 2020, PL transferred its receivables of South Region amounting to Rs. 40 million to Bank C for an immediate cash payment of 90% of its value against 8% factoring fee. Remaining 10% amount will be paid by Bank C in 30 days. Under the arrangement, PL is not liable to compensate Bank C for any default by PL's customers. 50% of receivables have not yet been recovered by Bank C till 31 December 2020.

(iv) On 1 December 2020, PL transferred its receivables of North Region amounting to Rs. 50 million to Bank D for an immediate cash payment of 90% of its value against 3% factoring fee. Under the arrangement, PL is liable to compensate Bank D after 40 days for any default by PL's customers in excess of 10%. PL is also entitled to receive the amount that the Bank D will recover in excess of 90% within 40 days. Till 31 December 2020, 75% of receivables have been recovered by Bank D.

(v) On 1 December 2020, PL transferred its receivables of Central Region amounting to Rs. 30 million to Bank E for a final payment of 95% of its value. Under the arrangement, PL is liable to compensate Bank E after 30 days for any default by PL's customers upto a maximum of 4%. Till 31 December 2020, Bank E has recovered all receivables except 3%, half of which are considered irrecoverable by PL.

Required:
Prepare journal entries in the books of PL in respect of the above for November and December 2020. **(20)**

Q.2 Following are the draft statements of profit or loss of Biscotti Limited (BL), Custard Limited (CL) and Doughnut Limited (DL) for the year ended 31 December 2020:

	BL	CL	DL
	------ Rs. in million -----		F$ in million
Revenue	9,500	3,600	250
Cost of sales	(3,500)	(1,860)	(120)
Gross profit	**6,000**	**1,740**	**130**
Operating expenses	(2,750)	(780)	(112)
Operating profit	**3,250**	**960**	**18**
Other income	305	120	-
Finance cost	(240)	(180)	-
Net profit	**3,315**	**900**	**18**

Other information:

(i) Details of BL's investments in CL are as follows:

Date of investment	% holding	Market price of each share	Cash payment	CL's share capital (Rs. 10 each)	CL's retained earnings
			------------- Rs. in million -------------		
1 Jan 2017	35%	Rs. 11	1,100	3,000	600
1 Apr 2020	40%	Rs. 15	1,400	3,000	1,300

(ii) In addition to cash payment of Rs. 1,400 million on 1 April 2020, it was agreed on acquisition that further cash of Rs. 320 million would be paid in March 2021 if CL's net profit for the year 2020 would be more than Rs. 500 million. Fair value of this consideration on acquisition date was estimated at Rs. 240 million.

(iii) On acquisition date of CL, fair value of its net assets was equal to their carrying value except for:

- inventory which was carried at Rs. 600 million and had a fair value of Rs. 960 million. 40% of this inventory is still included in CL's inventory as at 31 December 2020.
- a 14% bank loan of Rs. 800 million. Mark up is paid annually on 31 March while entire principal would be paid on 31 March 2022. On acquisition date, market rate for similar loan was 10% per annum.

(iv) On 1 January 2019, BL acquired 80% shareholding in DL for F$ 120 million. On acquisition date, fair value of DL's net assets was equal to their carrying value except for an office building whose fair value was higher than its carrying value by F$ 10 million. Remaining useful life of the building was 5 years.

(v) There was no goodwill / bargain purchase on acquisition of DL.

(vi) DL's profit for the year ended 31 December 2019 was F$ 14 million.

(vii) DL was not acquired exclusively with a view of resale; however, owing to difficulties in managing such major geographical operation, BL disposed of its entire shareholdings in DL for Rs. 2,000 million on 31 December 2020. The sale proceeds were credited to revenue. No other adjustment has been made on disposal.

(viii) The exchange rates per F$ are as follows:

1 Jan 2019	31 Dec 2019	31 Dec 2020	Average rate for	
			2019	2020
Rs. 10	Rs. 9	Rs. 11.5	Rs. 9.5	Rs. 10.5

(ix) The income and expenses of all companies may be assumed to have accrued evenly during the year except stated otherwise.

(x) BL values non-controlling interest on the acquisition date at its proportionate share of the fair value of the subsidiary's identifiable net assets.

Required:
Prepare BL's consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2020 in accordance with the requirements of IFRSs. ***(Disclosures relating to allocation of profit or loss and comprehensive income attributable to non-controlling interest and owners of the parent are not required)*** **(25)**

Q.3 Marmalade Limited (ML) is a manufacturer of Industrial machines. During 2020, ML launched a new machine with model name Alpha. Each unit of Alpha is being sold for Rs. 10 million payable upon delivery. Revenue from sale of Alpha is recognised upon delivery to the customer premises. Further, two year support service contract for Alpha is sold separately at Rs. 0.1 million payable monthly. Revenue from support services is recognized over contract period. Customers can also obtain such support services from third parties.

Sales of Alpha have remained below expectation so far. The marketing department has proposed the following options to increase the sales of Alpha:

Option 1:

ML would offer customers a bundle of Alpha and support services at a combined price of Rs. 11 million.

Option 2:

ML would sell Alpha at Rs. 10 million on lease. The rate of interest implicit in the lease would be 5% per annum which is significantly lower than market interest rate of 12% per annum. Customers would pay in five equal annual instalments payable in advance. Ownership of Alpha would be transferred to the customer at the end of five years.

Option 3:

Upon purchase of one unit of Alpha, customers would be provided with an option to purchase another unit of Alpha within 12 months at a material discount of 25%. It is estimated that 40% customers will avail the option.

Option 4:

Customer would be given an option to get customized version of Alpha. The price would vary in each case; however, the customer would be required to pay the entire amount in advance as these machines could not be sold to other customers. The manufacturing of customized Alpha might take an average of 3 months.

Required:
Discuss the recognition and amount of revenue under each of the above independent options. Compute the amount of revenue, wherever possible. **(18)**

Q.4 Ice Cream Limited (ICL) is a listed company. A junior accountant has prepared draft consolidated financial statements of ICL for the year ended 31 December 2020 in which results of Gelato Limited (GL) and Trifle Limited (TL) have also been included. However, he could not prepare consolidated statement of changes in equity due to certain outstanding issues.

For the purpose of preparation of consolidated statement of changes in equity, following information is available:

(i) Share capital of ICL, consolidated retained earnings and non-controlling interest as of 31 December 2018 were Rs. 700 million, Rs. 1,013 million and Rs. 310 million respectively.

(ii) Net profit for 2020 as per draft consolidated financial statements amounted to Rs. 440 million (2019: Rs. 312 million) of which Rs. 60 million (2019: Rs. 50 million) was attributable to non-controlling interest.

(iii) The draft consolidated statement of financial position as on 31 December 2020 shows total assets and total liabilities of Rs. 3,804 million and Rs. 985 million respectively.

(iv) On 1 January 2019, ICL acquired 80% shareholding in GL for Rs. 800 million. Equity of GL includes share capital and share premium of Rs. 500 million and Rs. 400 million respectively. Fair value of GL's identifiable net assets on the date of acquisition amounted to Rs. 950 million.

(v) Following dividends were declared and paid by the group entities:

- On 1 August 2019, ICL made a bonus issue of 20%.
- On 1 March 2020, ICL declared a final cash dividend for the year 2019 at 15%.
- On 1 December 2020, GL made an interim cash dividend of 20%.

(vi) ICL values non-controlling interest on the acquisition date at its proportionate share of the fair value of the subsidiary's net identifiable assets.

Details of outstanding issues:

(i) On 1 January 2019, ICL acquired an asset on lease at a semi-annual rental of Rs. 90 million payable in arrears for 5 years. Though accounting for both years have been made, the accountant has not taken into account the fact that after expiry of first 6 months, both the lessee and the lessor has the right to terminate the lease at any time without permission from the other party with no penalty. Discount rate of 10% per annum has been used.

(ii) On 31 December 2020, ICL cancelled share appreciation rights (originally granted to 10 executives on 1 January 2019) and, in their place, granted 32,000 share options to those executives on the condition that they will remain in ICL's employment for the next two years.

ICL originally granted 30,000 share appreciation rights to each of 10 executives that will be settled in cash on the condition that they will remain in ICL's employment for the next four years.

Fair value of each share appreciation right as at 31 December 2019 and 2020 was estimated at Rs. 150 and Rs. 190 respectively. On 31 December 2020, the fair value of each share option was estimated at Rs. 200. All the executives are expected to remain in employment for the required period of time.

Nothing has been recorded in 2020 in respect of share appreciation rights and their cancellation.

(iii) On 31 December 2020, TL issued further shares to increase its outstanding shares from 1 million to 2.2 million. The new shares were issued to Cookie Limited (a third party) which then obtained controlled of TL. Market value of each TL's share was Rs. 300 on 31 December 2020.

ICL owns 0.6 million shares in TL since 2017. The carrying values of TL's assets (excluding proceeds from further issue) and TL's liabilities in the ICL's consolidated financial statements as at 31 December 2020 were Rs. 405 million and Rs. 85 million respectively. In addition, goodwill of Rs. 57 million had been recognised upon the acquisition of TL and has not subsequently been impaired.

Required:

(a) Determine the revised amounts of total assets and total liabilities after incorporating the effects of the above corrections. **(10)**

(b) Prepare ICL's consolidated statement of changes in equity for the year ended 31 December 2020 along with comparative figures after incorporating the effects of the above corrections, if any. ***(Ignore taxation. 'Total' column is not required.)*** **(15)**

Q.5 The following data of Jelly Life Insurance Company is available for the year ended 31 December 2020:

Description	Rs. in million
Regular premium individual policies	21,533
Group policies with cash value	350
Group policies without cash value	4,108
Single premium individual policies	439
Reinsurance premium ceded	1,156
Provision for experience refund	119
Investment income	17,881
Net fair value losses on financial assets at fair value through profit or loss	2,568
Net rental income	742
Other income	362
Claims under individual policies	12,448
Claims under group policies	8,105
Recoveries from reinsurer	497
Claims related expenses	10
Net increase in insurance liabilities (other than outstanding claims)	9,325
Acquisition expense	5,892
Marketing and administrative expenses	1,386
Other expenses	211
Finance cost	20

Required:

Prepare statement of profit or loss of Jelly Life Insurance Company for the year ended 31 December 2020. **(12)**

(THE END)