Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

6 December 2021
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 Year 2021 has been a difficult year for Magellanic Limited (ML) due to COVID-19. In view of the severe liquidity issues, ML entered into the following arrangements during 2021:

(i) On 1 January 2021, ML sold its production plant to Finance Limited (FL) for Rs. 90 million. Immediately before the transaction, the plant was carried at Rs. 50 million and had remaining useful life of 10 years. At the same time, ML entered into a contract with FL to use the plant for 5 years, with annual payment of Rs. 20 million payable in arrears. Fair value of the plant at the date of sale was Rs. 80 million. The rate of interest implicit in the lease is 10% per annum.

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

(ii) On 1 January 2021, ML issued 1.5 million TFCs of Rs. 100 each for Rs. 150 million. Each TFC is convertible on 31 December 2025 into 2 ordinary shares having par value of Rs. 10 each. Interest is payable at 8% per annum on 31 December each year. On the date of issue, market interest rate for similar debt without conversion option was 11% per annum. ML expects that the conversion option will not be exercised.

(iii) On 1 April 2021, ML issued 2 million bonds of Rs. 100 each for Rs. 200 million. Each bond is mandatorily convertible on 31 March 2024 into 3 ordinary shares having par value of Rs. 10 each. Interest is payable at 5% per annum on 31 March each year at the discretion of ML. On the date of issue, market interest rate for similar debt with mandatory interest and without conversion option was 11% per annum. ML intends to pay interest in each year.

(iv) On 1 July 2021, ML issued 4 million cumulative preference shares of Rs. 100 each for Rs. 400 million. Each preference share is entitled to a cumulative dividend at 10% per annum and has similar voting right to an ordinary share. These shares are only redeemable at the option of ML.

ML's outstanding ordinary shares as at 1 January 2021 were 25 million shares of Rs. 10 each.

Required:

(a) Discuss how the above arrangements should be dealt with in ML's financial statements for the year ending 31 December 2021. **(15)**
(Show all calculations wherever possible)

(b) Calculate basic and diluted EPS of ML for the year 2021. Assume that ML would earn a profit of Rs. 215 million for the year 2021. **(06)**

Q.2 Triangulum Limited (TL) is finalizing its financial statements for the year ended 31 December 2020. Following information has been gathered for preparing the disclosures relating to taxation:

(i) Profit before tax for the year after making all necessary adjustments was Rs. 350 million.

(ii) TL operates a funded pension plan for its employees. Following relevant information has been extracted from the actuarial report for the year ended 31 December 2020:

	Rs. in million
Fair value of plan assets:	
▪ 1 January 2020	275
▪ 31 December 2020	315
Present value of defined benefit obligations:	
▪ 1 January 2020	325
▪ 31 December 2020	360
Current service cost	63
Contribution to the fund	49
Pension paid	33

Yield on high quality corporate bonds	12%

Under the tax laws, contribution to the fund is allowed as an expense.

(iii) On 1 July 2019, TL obtained a loan of USD 2 million at 1.5% per annum which was entirely used to acquire a license from a multinational company on the same date. The loan was repaid on 30 June 2020. However, interest on loan was paid semi-annually. TL estimates the useful life of license to be indefinite. The exchange rate per USD on various dates are as follows:

1 Jul 2019	31 Dec 2019	30 Jun 2020
Rs. 145	Rs. 150	Rs. 160

Under the tax laws, exchange differences arising on foreign currency loans are added to / deducted from the cost of asset. Amortisation on license is allowed at 10% per annum on written down value. Further, full year's tax amortisation is allowed in the year of purchase.

(iv) On 1 January 2020, the carrying value and tax base of one of the production plants were Rs. 150 million and Rs. 120 million respectively. TL classified the plant as held for sale on 1 September 2020 when the fair value of plant and estimated cost of disposal was Rs. 140 million and Rs. 10 million respectively. On 31 December 2020, the fair value of plant and estimated cost of disposal was Rs. 144 million and Rs. 9 million respectively.

Depreciation is charged on written down value at 12% and 20% for accounting and tax purposes respectively.

(v) On 1 July 2019, TL acquired an investment property for Rs. 100 million. The fair value of property as on 31 December 2019 and 2020 was Rs. 115 million and Rs. 125 million respectively. TL follows fair value model for accounting purposes.

Tax authorities allow depreciation at 10% per annum. Further, full year's tax depreciation is allowed in the year of purchase.

(vi) As on 31 December 2020, taxable temporary differences on other items amounted to Rs. 19 million (2019: Rs. 35 million).

(vii) The tax rate for the year is 30% (2019: 32%) which was enacted through Finance Act on 15 January 2020.

Required:
Prepare relevant notes on taxation and deferred tax liability/asset for inclusion in TL's financial statements for the year ended 31 December 2020 in accordance with IFRSs. **(20)**

Q.3 Following are the draft statements of financial position of Andromeda Limited (AL) and Elliptical Limited (EL) as at 31 December 2020:

	AL	EL
	------ Rs. in million ------	
Assets		
Property, plant and equipment	5,300	1,700
Investments	320	650
Current assets	5,380	1,900
Assets held for sale	-	400
	11,000	**4,650**
Equity and liabilities		
Share capital (Rs. 10 each)	3,400	1,100
Share premium	1,200	-
Retained earnings	3,500	2,470
Liabilities	2,900	1,080
	11,000	**4,650**

Additional information:

(i) On 1 January 2020, AL acquired 60% shareholdings in EL through share exchange of one share in AL for every three shares in EL. The fair values of each share of AL and EL were Rs. 105 and Rs. 30 respectively on that date. Shares issued by AL have not been recorded in the books.

On acquisition date, EL's retained earnings were Rs. 2,050 million. Fair value of EL's net assets was equal to their carrying value except the following:

- EL's investment represents investment in Pinwheel Limited (an associate) whose fair value was higher than its carrying value by Rs. 100 million. Further, EL's share of profit from the associate for the year 2020 amounted to Rs. 120 million and has not been recorded in EL's books.
- Fair value of assets held for sale was higher than their carrying value by Rs. 15 million because of 'cost to sell'.
- Contingent assets and contingent liabilities disclosed in the financial statements of EL at acquisition date had a fair value of Rs. 20 million and Rs. 60 million respectively. Provision in respect of these contingent liabilities has been recognised by EL at Rs. 35 million as at 31 December 2020.
- Value of Rs. 80 million may be attributed to the existing assembled workforce of EL which is not recognised in EL's books.

(ii) On 1 July 2017, AL had acquired 54 million shares of Rs. 10 each of Sombrero Limited (SL) representing 90% shareholdings at a cash consideration of Rs. 870 million. On acquisition date, fair value of net assets was equal to their carrying value. SL's goodwill had been impaired by Rs. 30 million till 31 December 2019.

On 1 January 2020, AL disposed of 30 million shares in SL. The consideration of Rs. 550 million was credited to 'Investments' upon receipt. On 1 October 2020, AL further disposed of 9.6 million shares in SL. However, AL still retains significant influence on SL. The consideration of Rs. 208 million was credited to 'Retained earnings' upon receipt.

Retained earnings and fair value of each share of SL at various dates are as follows:

	1 Jul 2017	1 Jan 2020	1 Oct 2020	31 Dec 2020
Retained earnings **(Rs. in million)**	250	340	385	410
Fair value of each share **(Rs.)**	13	18	19	20

(iii) AL values non-controlling interest on the acquisition date at its fair value.

Required:
Prepare AL's consolidated statement of financial position as at 31 December 2020 in accordance with the requirements of IFRSs. Also list down the information given in the question but have no effect in your working. **(25)**

Q.4 You are the Finance Manager of Centaurus Limited (CL). You have been asked to prepare the projected financial statements of CL for the year ending 31 December 2022 for submission to its bank alongwith a loan application. The bank requires minimum return on assets of 10% per annum and a maximum gearing ratio of 75%.

You sent the draft projected financial statements to the CEO and CFO for their suggestions regarding three planned transactions which may be executed in two ways. Their suggestions have been summarised below:

Planned transactions	CEO's suggestion	CFO's suggestion
Investment in Hoag Limited	Acquire 1.2 million shares (i.e. 15% shares) without significant influence.	Acquire 1.6 million shares (i.e. 20% shares) with significant influence.
Share based payment to executives	Issue shares at the end of vesting period.	Pay cash equivalent to the market value of shares at the end of vesting period.
Acquisition of warehouse	Lease for four years.	Lease for one year only.

Return on assets and gearing ratio as per draft projected financial statements (excluding the three planned transactions) are computed as follows:

- Return on assets $= \dfrac{\text{Profit}}{\text{Total assets}} \times 100 = \dfrac{126 \text{ million}}{840 \text{ million}} \times 100 = 15\%$
- Gearing ratio $= \dfrac{\text{Total liabilities}}{\text{Total equity}} \times 100 = \dfrac{340 \text{ million}}{500 \text{ million}} \times 100 = 68\%$

Details of planned transactions:

(i) **Investment in Hoag Limited (HL):**
CL is planning to acquire shares of HL, a listed company on 1 April 2022. Quoted price of each share of HL on 1 April 2022 and 31 December 2022 is expected to be Rs. 45 and Rs. 55 respectively. Purchase of 1.2 million shares will require additional price of Rs. 3 per share while purchase of 1.6 million shares will require additional price of Rs. 5 per share. HL is expected to earn profit and other comprehensive income of Rs. 62 million and Rs. 14 million respectively for the year ending 31 December 2022. HL is not expected to pay any dividend during 2022.

CL accounts for investment in associate under equity method while other equity investments are classified as fair value through other comprehensive income.

(ii) **Share based payment to executives:**
CL is planning to introduce share based payment scheme for its 8 executives on 1 January 2022. The scheme would be introduced in one of the following manners:

- Each executive would get 100,000 shares of CL upon completion of three years of service.
- Each executive would get cash equivalent to market value of 100,000 shares of CL upon completion of three years of service.

The fair value of each share of CL as at 1 January 2022 is estimated to be Rs. 90 per share which is expected to increase by 16% each year.

(iii) **Acquisition of warehouse:**
CL is planning to acquire a warehouse on 1 July 2022 on lease. Following options are under consideration:

- Lease for a non-cancellable term of four years with annual instalment of Rs. 10 million payable in advance.
- Lease for one year at annual payment of Rs. 12 million payable in advance.

Applicable discount rate is 12%.

Required:
Calculate revised return on assets and gearing ratio if:

(a) all suggestions of CEO are implemented. **(10)**
(b) all suggestions of CFO are implemented. **(08)**
(c) the best combination of suggestions is implemented. **(04)**

Q.5 Whirlpool Limited (WL) operates an approved and funded gratuity plan for 150 employees. Following information is available for the preparation of the fund's financial statements for the year ended 30 September 2021:

	Rs. in million
Accrued expenses	0.2
Actuarial valuation fee	0.4
Bank balances	9.8
Bank charges	0.1
Contribution received	11.5
Dividend received	10.6
Listed securities	68.2
Opening balance of members' fund	143.3
Paid to outgoing members	8.1
Pakistan Investment Bonds	56.8
Profit on investments	5.3
Sukuk certificates	27.5

Additional information:

(i) An amount of Rs. 4.3 million is payable to outgoing members as at 30 September 2021.

(ii) Increase in fair value of listed securities amounting to Rs. 3.5 million has not been accounted for.

(iii) Audit fee of Rs. 0.5 million has not been accrued.

(iv) The latest actuarial valuation was carried out on 30 September 2021 using the 'projected unit credit method'. The actuary has recommended WL to contribute Rs. 13 million during the year ended 30 September 2021.

(v) Present value of the defined benefit obligations and fair value of the plan assets as on 30 September 2021 amounted to Rs. 207 million and Rs. 168 million respectively. Salary increment and discount rate of 9% and 7% respectively were used by the actuary in the determination of liability.

Required:
Prepare the financial statements including relevant notes (wherever possible) of WL employees' gratuity fund for the year ended 30 September 2021. **(12)**

(THE END)