Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

6 June 2022
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 (a) During the preparation of financial statements of Quail Limited (QL) for the year ended 31 December 2021, it was noted that there is a significant decline in budgeted net cash flows of one of QL's Cash Generating Units (CGU). Value in use and fair value less cost of disposal of the CGU as on 31 December 2021 were estimated at Rs. 555 million and Rs. 568 million respectively.

Details regarding the individual assets of the CGU before impairment are as follows:

	Carrying value	Fair value less cost of disposal	Value in use
	--------------- Rs. in million ---------------		
Building (revaluation model)*	144	140	132
Equipment (cost model)	96	68	Not measurable
Machinery (cost model)	230	199	207
License (cost model)	70	Not measurable	
Goodwill	66	Not measurable	
Inventory	96	106	Not relevant

**Balance of surplus on revaluation of building as on 31 December 2021 amounted to Rs. 12 million.*

QL has no plans to sell this CGU in the near future.

Required:
Compute the amount of impairment loss to be taken to the statement of profit or loss for the year ended 31 December 2021 and carrying value of each individual asset of the CGU after impairment. **(07)**

(b) On 1 January 2021, Chicken Limited (CL) acquired 30% shareholding in a US based company, Sparrow Limited (SL), for USD 5 million and obtained significant influence over SL.

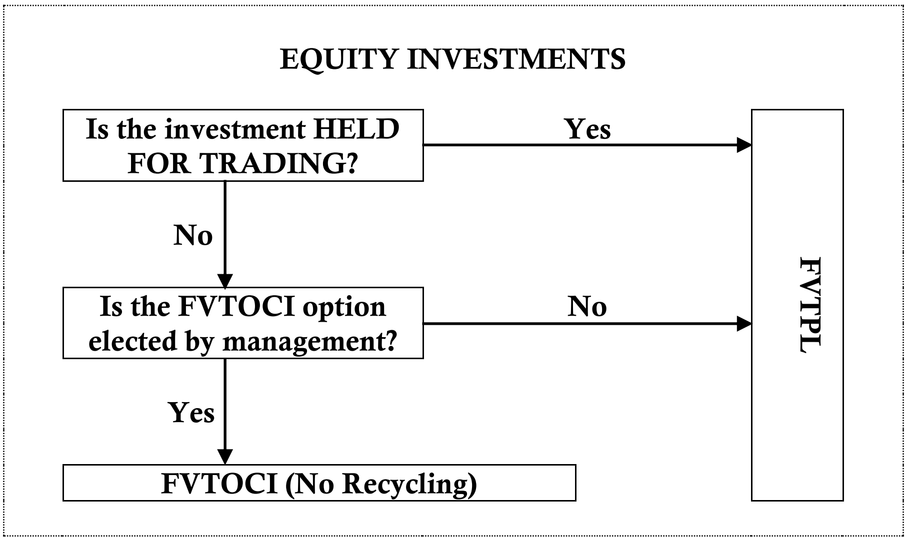
SL earned profit of USD 1.5 million for the year ended 31 December 2021. On 31 October 2021, SL paid dividend of USD 0.1 million to CL. On the same date, CL also sold goods for USD 0.2 million to SL at 30% profit margin. 25% of these goods remained unsold with SL on 31 December 2021. SL paid for the goods in 2022.

Following exchange rates are available:

	1 Jan 2021	31 Oct 2021	31 Dec 2021	Average for 2021
1 USD to Rs.	170	174	185	180

Required:
Discuss how the investment in SL should be dealt with in CL's consolidated financial statements for the year ended 31 December 2021. ***(Show all necessary workings)*** **(06)**

(c) Azam is your friend and has asked for your help in making a presentation regarding classification of equity investments and debt investments under IFRS 9. He has a clear understanding of classification of equity investments and prepared the following diagram:



However, he is confused in classification of debt investments. He believes that management can classify any debt investment into any measurement category i.e. amortised cost, fair value through other comprehensive income (FVTOCI) and fair value through profit or loss (FVTPL).

Required:
Keeping in mind the above diagram prepared by Azam for equity investments, prepare a similar diagram for classification of debt investments under IFRS 9. **(05)**

Q.2 Woodpecker Limited (WL) is engaged in the business of manufacturing and supplying industrial machinery. Naeem, ACA is WL's financial controller and reports to Mubeen, FCA, who is the chief financial officer. Financial statements for the year ended 31 December 2021 were prepared by Mubeen in the absence of Naeem who was on annual leaves. On returning from annual leaves, Mubeen asked Naeem to present the financial statements to the senior management as Mubeen would not be available for few days.

WL's statement of financial position as on 31 December 2021 prepared by Mubeen is as follows:

	Rs. in million		Rs. in million
Non-current assets		**Equity**	
Property, plant and equipment – owned	5,600	Share capital (Rs. 10 each)	2,000
		Convertible bonds	1,250
Right of use assets	1,240	Retained earnings	3,150
	6,840		**6,400**
Current assets			
Inventory	1,140	Liabilities	2,910
Receivables	960		
Other current assets	370		
	2,470		
	9,310		**9,310**

Naeem identified that all budgeted targets (including profit) given by the senior management have been achieved as per these financial statements which was quite surprising for Naeem. He also identified that budgeted targets were not met in the first draft of the financial statements. However, some adjustments by Mubeen resulted in meeting the targets. These adjustments were made in respect of the following:

(i) On 1 January 2021, WL issued 12.5 million bonds of Rs. 100 each for Rs. 1,250 million. The related transaction cost on issuance amounted to Rs. 50 million. Each bond is convertible on 31 December 2024 into 2 ordinary shares at the option of bond holders. Any unconverted bonds would be redeemed on that date at par value.

Under the terms of the bond, there is no interest on bond for 2021 and 2022. However, interest is payable at 16% per annum on 31 December 2023 and 2024. On the date of issue, market interest rate for similar debt without conversion option was 12% per annum payable each year. However, on account of transaction cost incurred on issuance of bonds, the effective interest rate would increase to 13.2% per annum.

In the financial statements, the proceeds have been recorded as convertible bond classified under equity and the transaction cost has been expensed out.

(ii) On 1 July 2021, WL sold its warehouse building to Ostrich Finance Limited (OFL) for Rs. 1,100 million. Immediately before the transaction, the building was carried in the books at Rs. 1,000 million and had remaining useful life of 15 years. At the same time, WL entered into a contract with OFL for the right to use the building for 7 years, with annual payment of Rs. 120 million payables in arrears. The rate of interest implicit in the lease is 11% per annum. Fair value of the building at the date of sale was Rs. 930 million. However, the building was not considered impaired due to higher value in use.

The terms and conditions of the transfer of the building by WL satisfies the requirements of IFRS 15 to be accounted for as sale of the asset. However, in the financial statements, the transfer of building has not been treated as sale of the asset and consequently the proceeds have been recorded as financial liability and interest has been accrued @ 11%.

(iii) On 1 October 2021, WL entered into a contract with Parrot Limited (PL) to supply 50 units of a specialized machine at a total consideration of Rs. 600 million. The machines will be delivered in lots of 25 units at the end of every six months. PL has paid 10% non-refundable consideration in advance while the remaining consideration will be paid in two equal instalments, only after delivery of each lot and not before. Upto year ended 31 December 2021, WL had manufactured 15 units of the machine at a cost of Rs. 120 million which will be delivered on 31 March 2022.

The sales team of WL was working on obtaining this contract since the start of 2021 and spent incremental cost of Rs. 15 million for preparing and presenting the proposal for the contract. The team was rewarded with a bonus of Rs. 20 million on obtaining the contract.

Since the machines are of specialised nature, revenue and receivable for 15 units manufactured so far has been recognized without adjusting any amount from the advance received. Further, the sales team cost of Rs. 35 million has been recorded as contract cost which would be taken to profit or loss on completion of the contract.

Required:

(a) Prepare the revised statement of financial position after incorporating the effects of the above matters. **(19)**

(b) Briefly explain how Naeem may be in breach of the fundamental principles of Code of Ethics for Chartered Accountants if he presents the financial statements without any changes. Also state how Naeem should respond in this situation to avoid the breach. **(05)**

Q.3 Following information has been extracted from the financial statements of Greater Flamingos Limited (GFL), Eagle Limited (EL) and Raven Limited (RL) for the year ended 31 December 2021:

	GFL	EL	RL
	--------- Rs. in million --------		
Revenue	1,462	928	450
Cost of sales	(637)	(380)	(230)
Gross profit	**825**	**548**	**220**
Operating expenses	(580)	(323)	(150)
Other income	189	86	30
Net profit for the year 2021	**434**	**311**	**100**
Retained earnings as at 31 December 2020	2,250	670	236

Additional information:

(i) Details of investments are as follows:

Date	1 Jan 2020	1 Apr 2020	1 Jul 2021
Investor	GFL	GFL	EL
Investee	EL	RL	RL
Holding %	90%	40%	20%
Fair value of each share of investee	Rs. 17	Rs. 14	Rs. 21
Consideration (Rs. in million)	795	250	176
Investee's share capital (Rs. 10 each) (Rs. in million)	500	400	400

(ii) On 1 April 2021, GFL disposed off 7.5 million shares of EL against cash consideration of Rs. 228 million and recorded the gain on disposal as other income.

(iii) On 1 January 2020, GFL acquired EL at bargain purchase of Rs. 170 million. On acquisition date, fair value of EL's net assets was equal to their carrying value.

(iv) On 1 January 2021, EL rented out one of its investment properties having remaining useful life of twenty years to GFL, for one year at a rent of Rs. 21 million. EL had purchased this property on 1 January 2020 for Rs. 250 million and was carried in EL's book at fair value of Rs. 300 million and Rs. 340 million on 31 December 2020 and 2021 respectively.

(v) On 1 August 2021, GFL paid 30% cash dividend amounting to Rs. 270 million while EL paid 6% cash dividend for the half year ended 30 June 2021. GFL recorded its share of EL's dividend as other income.

(vi) RL earned a profit of Rs. 80 million during the year 2020 and did not pay any dividend.

(vii) On 31 December 2021, an impairment test carried out indicated that goodwill of RL was impaired by 10% .

(viii) GFL group values non-controlling interest on the date of acquisition at fair value.

(ix) GFL and EL subsequently measure investment in RL at cost in their respective separate financial statements.

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

Required:
Prepare GFL's consolidated:

(a) statement of profit or loss for the year ended 31 December 2021. **(15)**

(b) statement of changes in equity for the year ended 31 December 2021.
(Comparative figures and Column for total are not required) **(10)**

Q.4 Following are the details of few transactions of Pigeon Limited (PL):

(i) On 1 January 2021, PL approved a share based scheme for its employees who have completed 5 years of service in PL. Under the scheme each employee will be issued 1,000 shares (having par value of Rs. 50 each) at the end of each year for three consecutive years. There are no conditions attached other than continuous service till the date of issuance of shares. On the grant date of 1 January 2021, total employees eligible for the scheme were 100.

Initially, PL expected that none of the eligible employees will leave PL during the 3 years. However, 5 eligible employees left PL during 2021 and PL now expects that further 4 and 3 employees will leave during 2022 and 2023 respectively.

Fair value of PL's share at the grant date was Rs. 240 per share which has increased to Rs. 265 on 31 December 2021. **(05)**

(ii) PL operates a funded pension plan for its employees. Following relevant information has been extracted from the actuarial report:

	2021	**2020**
	Rs. in million	
Current service cost	63	75
Negative past service cost	-	120
Contribution to the fund	29	60
Pension paid	40	32
Present value of defined benefit obligations on 31 December	620	550
Fair value of plan assets on 31 December	650	612
Asset ceiling on 31 December (Present value of economic benefits available)	25	45

The net pension liability at 1 January 2020 was reported as Rs. 80 million. Applicable discount rate is 12% per annum. **(05)**

(iii) On 1 January 2020, PL leased a plant from Bulbul Limited for 8 years at Rs. 30 million, payable annually in arrears. On that date, fair value and useful life of this plant were Rs. 170 million and 10 years respectively, whereas, PL's incremental borrowing rate was 12% per annum.

On 1 January 2021, the lease contract was amended with mutual consent by reducing the original lease term from 8 years to 5 years with the same annual payments. PL's incremental borrowing rate on 1 January 2021 was 14% per annum. **(07)**

(iv) On 1 January 2020, PL purchased 5 million debentures of Kiwi Limited having face value of Rs. 100 each for Rs. 515 million. Transaction cost of Rs. 4 million was also incurred on purchase of debentures. At initial recognition, PL determined that debenture was not credit impaired and classified the investment in debentures as financial asset at fair value through other comprehensive income. Coupon rate of debentures is 12% which is payable annually on 31 December.

Following further information regarding debentures is available:

	1 Jan 2020	**31 Dec 2020**	**31 Dec 2021**
	------- Amount in Rs. per debenture -------		
Quoted price	105.0	109.0	111.0
12 months expected credit losses	2.0	2.5	4.0
Life time expected credit losses	8.5	12.2	15.3

(08)

Required:
Prepare the extracts ***(including comparative figures)*** relevant to the above transactions from PL's statement of financial position and statement of profit or loss and other comprehensive income for the year ended 31 December 2021 in accordance with the IFRSs. ***(Notes to the financial statements are not required)***

Q.5 Following disclosures have been extracted from the draft financial statements of Falcon Bank Limited for the year ended 31 December 2021:

7 LENDINGS TO FINANCIAL INSTITUTIONS

	2021	2020
	Rs. in million	
Call / clean money lendings	300	505
Repurchase agreement lendings (Reverse Repo)	28,000	23,500
Bai Muajjal receivable	5,205	3,506
	33,505	**27,511**
Provision held against lending to financial institutions	(3,500)	(2,500)
Lending to financial institutions - net of provision	**30,005**	**25,011**

7.1 Lendings include foreign currency lendings of Rs. 9,501 million.

7.2 Securities held as collateral against lending to financial institutions

	2021	2020
	Rs. in million	
Market Treasury Bills	14,000	10,000
Pakistan Investment Bonds	15,000	13,500
	29,000	**23,500**

7.3 Details of provision held

	2021	2020
	Rs. in million	
Domestic	2,140	1,860
Overseas	1,240	640
	3,380	**2,500**

Required:
Prepare list of errors and omissions in the above disclosures. **(08)**
(Note: There are no casting errors in the given information. Redrafting of the note is not required)

(THE END)