Certified Finance and Accounting Professional Stage Examination

The Institute of Chartered Accountants of Pakistan

5 December 2022
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 (a) On 1 July 2021, Rugby Limited (RL) entered into a joint arrangement with Volleyball Limited to set up an industrial unit, Tennis Limited (TL) with paid-up capital of Rs. 50 million. RL has 60% share in the equity and operations of TL. The following information relates to activities of TL for the year ended 30 June 2022:

- On 1 August 2021, TL obtained long term loan of Rs. 30 million from a commercial bank to finance an industrial unit which was constructed at a cost of Rs. 80 million. The unit commenced its operation from 1 October 2021 and has useful life of ten years.
- During the year, TL earned revenues of Rs. 60 million out of which Rs. 12 million was outstanding at year-end. TL also paid operating cost of Rs. 26 million.
- TL's finance cost of Rs. 4 million was paid by RL which TL has agreed to settle after the year-end.

Required:
Discuss how the above information would be dealt with in RL's consolidated financial statements for the year ended 30 June 2022 if TL is treated as:

(i) Joint operation **(05)**
(ii) Joint venture **(03)**
(Also calculate the amounts to be included in RL's consolidated financial statements)

(b) You have recently joined as Finance Manager of Soccer Limited (SL), a football manufacturer. Being one of the sponsors for the upcoming world cup in Qatar, SL's delegation has been invited to watch few matches of the world cup in the stadium.

You have been informed that the statutory audit of SL for the year ended 30 June 2022 is in final stage and the auditor has recommended certain material adjustments in the financial statements before issuing an unmodified audit report. In a meeting with CFO, who is a chartered accountant, you have been informed about the disappointment of the SL's directors due to selected audit adjustments which slide SL's profit below the target. Therefore, CFO has asked you to take up the matter with the audit engagement partner regarding the selected adjustments and also asked you to invite the audit partner to the trip to Qatar with SL's delegation.

Required:
Briefly explain how CFO may be in breach of the fundamental principles of ICAP's Code of Ethics for Chartered Accountants. Also state the potential threats that you may face in the above circumstances and how you should respond. **(08)**

Q.2 Draft financial statements of Archery Limited (AL) for the year ended 31 December 2021 show the following amounts before incorporating the outstanding issues and taxation:

	Rs. in million
Total assets	1,300
Total liabilities	450
Profit before tax	250
Other comprehensive income	-

Details of outstanding issues:

(i) AL operates a funded pension plan for its employees. During the year ended 31 December 2021, no entries have been made in the books of AL in respect of the pension except for contribution paid to the fund debited to pension liability.

Following relevant information has been extracted from the actuarial report for the year ended 31 December 2021:

	Rs. in million
Fair value of plan assets on 1 January 2021	250
Present value of defined benefit obligations on 1 January 2021	350
Current service cost	73
Contribution paid to the fund	62
Pension paid by the fund	53
Actuarial gains	34
Actual return on plan assets during the year	44

Yield on high quality corporate bonds (per annum)	14%

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

(ii) No entries have been made in the AL's books in the years 2020 and 2021 in respect of share appreciation rights (SARs) scheme for employees announced on 1 January 2020.

On 1 January 2020, AL granted 100,000 cash-settled SARs to each of its 50 employees on the conditions that they will remain in AL's employment for 3 years and AL achieves an average annual growth rate of 20% in revenue during the three years ending 31 December 2022.

Relevant details on various dates are as follows:

	1 Jan 20	**31 Dec 20**	**31 Dec 21**
Fair value of each SAR (Rs. per share)	16	21	25
Intrinsic value of each SAR (Rs. per share)	11	15	20
AL's expectation to meet growth target	Yes	No	Yes
No. of employees already left till date	-	2	6
Further no. of employees expected to leave	8	7	5

Under tax laws, payments against SARs are admissible as an expense.

(iii) Investment in bonds of Wrestling Limited was accounted for as a financial asset 'subsequently measured at fair value through profit or loss' instead of accounting for the financial asset as 'subsequently measured at fair value through other comprehensive income'.

On 1 January 2021, AL purchased 4 million bonds (having face value of Rs. 50 each) at Rs. 150 million maturing on 31 December 2025. Transaction cost of Rs. 3 million was also incurred on purchase of bonds. Coupon rate on bonds is 8% per annum payable annually on 31 December while effective rate of interest is 15% per annum. At initial recognition, AL determined that bonds were not credit impaired.

On 31 December 2021, AL received the interest however, due to deteriorating credit rating of the bonds, AL determined that there had been a significant increase in credit risk since the acquisition of the bonds.

Following information regarding the 4 million bonds at various dates is also available:

Date	Expected credit losses		Fair value in quoted market
	Life time	12 months	
	-------------- Rs. in million --------------		
1 January 2021	5	2	150
31 December 2021	15	7	136

Under tax laws, impairment and fair value adjustments do not affect taxable profits while interest income is taxable at coupon rate. Further, transaction cost is allowed to be capitalised in the cost of investment.

Required:

(a) Determine the revised amounts of total assets, total liabilities, profit before tax and other comprehensive income after incorporating the effects of the above outstanding issues. ***(Ignore taxation)*** **(14)**

(b) Prepare relevant notes on taxation and deferred tax liability / asset for inclusion in AL's financial statements for the year ended 31 December 2021. ***(Assume tax rate of 30%)*** **(11)**

Q.3 Following are the details of few transactions of Badminton Limited (BL):

(i) On 1 January 2020, BL acquired a building on lease for a non-cancellable period of 4 years at Rs. 45 million per annum, payable in arrears. The agreement contains an option for BL to extend the lease for further 3 years at Rs. 45 million per annum payable in arrears. On 1 January 2020, BL's incremental borrowing rate was 15% per annum and BL was not reasonably certain that the option to extend the term will be exercised.

However, on 1 January 2021, BL was reasonably certain that the option to extend the term will be exercised due to increasing rentals in the markets. BL's incremental borrowing rate was 14% per annum on that date.

On 1 July 2021, BL sub-leased this building for a lease term of five and half years at Rs. 24 million payable semi-annually in advance. **(09)**

(ii) On 1 September 2020, BL entered into a contract for the purchase of a manufacturing plant at a cost of USD 1.5 million. On the same date, BL entered into a forward contract with a bank for the purchase of USD 1.5 million at a fixed rate in order to hedge the cash flows relating to purchase of the plant. The forward contract would be settled after seven months i.e. 1 April 2021 when the payment needs to be made against the plant.

Relevant exchange rates per USD are as follows:

	1-Sep-2020	31-Dec-2020	1-Apr-2021
Spot rate	Rs. 167	Rs. 177	Rs. 190
Forward contract (settlement date 1 April 2021)	Rs. 183	Rs. 187	NA

You may assume that all IFRS 9 conditions for the application of cash flow hedge accounting have been met.

At 31 December 2021, the plant was still in installation phase and a cost of Rs. 24 million has been incurred on the installation. **(08)**

(iii) On 1 January 2020, BL issued 4 million six-year convertible debentures at par value of Rs. 100 each at a fixed rate of 13% per annum. Interest is payable at the end of each year whereas the principal is to be repaid in lump sum at the end of 2025.

Debentures were issued with an option to convert 10 debentures into 3 ordinary shares of BL till the date of redemption. On initial recognition, the liability was not designated as subsequently measured at fair value through profit or loss. The market interest rate for non-convertible debentures issued by entities having similar credit risk and tenure is 15% per annum.

On 1 January 2021, BL repurchased 1 million debentures at Rs. 112 per debenture.

The market interest rates and market values of BL's shares are given below:

Date	Interest rate per annum	Market value per share (Rs.)
1 January 2020	15%	260
1 January 2021	14%	290

(08)

Required:
Prepare the extracts ***(including comparative figures)*** relevant to the above transactions from BL'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 and bifurcation of current and non-current in statement of financial position are not required.)

Q.4 Following are the draft statements of financial position of Hockey Limited (HL), Golf Limited (GL) and Cricket Limited (CL) as at 30 June 2022:

	HL	GL	CL
	------ Rs. in million ------		C$ in million
Assets			
Property, plant and equipment	6,065	3,130	330
Investment in GL	890	-	-
Investment in CL	2,400	-	-
Investment in a joint venture	-	650	-
Current assets	2,870	2,875	170
	12,225	**6,655**	**500**
Equity and liabilities			
Share capital (Rs./C$ 10 each)	3,000	2,000	150
Retained earnings	6,500	3,280	235
Net pension liability	650	280	-
Other liabilities	2,075	1,095	115
	12,225	**6,655**	**500**

Additional information:

(i) On 1 July 2021, HL acquired 60% shareholdings in GL. The purchase consideration was one debenture (having par value of Rs. 50) issued by HL for every two shares held in GL. The fair value of each share of GL was Rs. 24 on that date.

These debentures would be redeemed after 6 years at par value. The debentures carry an interest of 14% per annum though market interest rate for similar debentures was 12% per annum. The issuance of debenture is not yet recorded in HL's books. Annual interest paid on 30 June 2022 was charged to profit or loss.

(ii) On acquisition date, GL's retained earnings were Rs. 2,580 million and the fair value of GL's net assets was equal to their carrying value except the following:

- Investment in joint venture had a carrying value of Rs. 510 million using equity method and fair value of Rs. 680 million. The fair value of investment in the joint venture as on 30 June 2022 was estimated at Rs. 840 million.
- Land carried in GL's book at its cost of Rs. 240 million. The land is held by GL for the purpose of building a residential complex, however, HL intends to build a factory on this land. Fair value of land based on its use as residential complex and factory is estimated at Rs. 450 million and Rs. 390 million respectively.
- Net pension liability of Rs. 220 million was appearing in GL's books. It was estimated that the full settlement of this liability would require net amount of Rs. 290 million on acquisition date.

(iii) On 1 January 2022, further 15% shareholdings in GL were acquired for Rs. 890 million paid in cash. GL's retained earnings on that date were Rs. 2,860 million.

(iv) On 1 July 2020, HL acquired 80% shareholdings in CL (a foreign company) at a consideration of C$ 240 million.

On acquisition date, CL's retained earnings were C$ 180 million. On the same date, fair value of CL's net assets was equal to their carrying value except for an office building whose fair value was higher than its carrying value by C$ 10 million with remaining useful life of five years.

(v) On 1 July 2021, HL disposed off 50% shareholdings (leaving 30% with HL) in CL against cash consideration of C$ 215 million which was credited to 'Retained earnings' upon receipt. However, HL still retains significant influence in CL. On the date of disposal, the fair value of CL's share and CL's retained earnings were C$ 25 per share and C$ 210 million respectively.

(vi) The exchange rates per C$ are as follows:

1 July 2020	**30 June 2021/ 1 July 2021**	**30 June 2022**	**Average rate for year**	
			2020-21	**2021-22**
Rs. 10	Rs. 12	Rs. 14	Rs. 11	Rs. 13

(vi) HL 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 HL's consolidated statement of financial position as at 30 June 2022 in accordance with the requirements of IFRSs. **(25)**

Q.5 (a) A newly hired accountant has prepared the following statement of profit or loss of Polo General Insurance Limited for the year ended 31 December 2021 and has submitted it for your review.

	Rs. in '000
Gross written premium	165,000
Insurance claims and acquisition expenses	(63,600)
Net reinsurance expense	(46,550)
Management expenses	(20,250)
Gross profit	34,600
Investment and other income	24,850
Other expenses	(3,750)
Profit before tax	55,700
Income tax expense	(21,185)
Profit after tax	**34,515**

Required:
Prepare list of errors and omissions in the above statement. **(05)**
(Note: There are no casting errors. Redrafting of the statement is not required)

(b) Briefly discuss how musta'jir (lessee) accounts for profit or loss arising on sale of an asset in a "sales and leaseback transactions" under IFAS 2 Ijarah? **(04)**

(THE END)