**Certified Finance and Accounting Professional Stage Examination**

**The Institute of Chartered Accountants of Pakistan**

5 June 2023
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 Following are the draft statements of financial position of Rose Limited (RL), Jasmine Limited (JL) and Lavender Limited (LL) as at 31 December 2022:

| | RL | JL | LL |
|---|---|---|---|
| | ------------ Rs. in million ------------ | | |
| **Assets** | | | |
| Property, plant and equipment | 3,400 | 2,265 | 655 |
| Investment in JL – at cost | 88 | - | - |
| Investment in LL – at cost | 400 | - | - |
| Other assets | 500 | 1,020 | 235 |
| | **4,388** | **3,285** | **890** |
| **Equity and liabilities** | | | |
| Share capital (Rs. 10 each) | 1,000 | 800 | 300 |
| Retained earnings | 2,223 | 1,580 | 300 |
| Revaluation surplus | 650 | - | 240 |
| Other liabilities | 515 | 905 | 50 |
| | **4,388** | **3,285** | **890** |

**Additional information:**

(i) On 1 March 2022, RL acquired 5% shareholding in JL at Rs. 22 per share and elected to measure the investment as a financial asset 'subsequently measured at fair value through other comprehensive income'.

(ii) On 1 July 2022, RL obtained control of JL by acquiring further 60% shareholding at the following consideration:

- Immediate issuance of two shares in RL for every five shares in JL.
- Further issuance of one share in RL for every ten shares in JL on 31 March 2023, provided JL achieves the profit target for the year 2022.

At the acquisition date, the fair values of each share of RL and JL were Rs. 70 and Rs. 30 respectively, which increased to Rs. 85 and Rs. 38 respectively on 31 December 2022. The fair value of JL's share is more reliably measurable than the fair value of RL's share. The issuance of shares has not been recorded yet by RL in its books. On the acquisition date, the fair value of the contingent issuance of share of RL has been estimated at Rs. 50 per share which increased to Rs. 75 on 31 December 2022.

(iii) On 1 July 2022, JL's retained earnings were Rs. 1,080 million and the fair value of JL's net assets was equal to their carrying value except for the following:

- A backlog of customer purchase orders which may be attributed fair value of Rs. 220 million. All these orders were executed before 31 December 2022.
- Right-of-use asset for a machinery having carrying value of Rs. 90 million. The corresponding lease liability on that date was Rs. 70 million. On the acquisition date, the fair values of the right-of-use asset and lease liability were determined at Rs. 100 million each. The lease term for the contract ends on 31 October 2022.

(iv) On 1 July 2020, RL acquired 80% shareholding in LL at goodwill of Rs. 80 million. On the acquisition date, LL's revaluation surplus was Rs. 60 million. The fair value of LL's net assets was equal to their carrying value. The goodwill has been impaired by Rs. 50 million till 31 December 2021.

(v) On 1 April 2022, RL disposed of 30% shareholding (leaving 50% with RL) in LL at its fair value of Rs. 28 per share. The shares were sold to Tulip Limited (TL), which already owned 20% shareholding in LL, resulting in joint control over the net assets of LL. The proceeds of disposal were credited to 'retained earnings'. On that date, the retained earnings and revaluation surplus of LL were Rs. 210 million and Rs. 190 million respectively.

(vi) RL 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 RL's consolidated statement of financial position as at 31 December 2022 in accordance with the requirements of IFRSs. **(25)**

Q.2 You are the Manager Finance of Sunflower Limited (SL). Your CEO has provided you with details on the following three plans along with his comments that will be presented at the next Board of Director (BOD) meeting to be held on 20 June 2023.

| | Plans | CEO's comments for BOD meeting |
|---|---|---|
| (i) | SL plans to provide interest-free loans to employees for purchasing vehicles or houses. Employees who have been associated with SL for atleast ten years will be entitled for this loan facility. These loans will be recovered over five years through deductions from employees' salaries. | The scheme seems great as it will have no profit or loss impact for SL in the current or next years. The loaned amount will be treated as prepaid salaries. |
| (ii) | SL plans to invest in bonds issued by Marigold Limited (ML). Although these bonds offer lower interest rate as compared to other bonds in the market, they can be converted into a fixed number of shares of ML at the end of three years. SL intends to hold the bonds for three years and will decide on conversion based on the market price of ML's shares at that time. This will be the first time that SL is making such an investment. | The convertible bonds can be classified into any of the three classification categories i.e. amortised cost, fair value through other comprehensive income, or fair value through profit or loss on initial recognition. The classification opted initially will continue to be used even after conversion into shares. |
| (iii) | SL will announce the plan to sell one of its business segments due to consistent losses. The operations of the segment will be gradually closed by 28 February 2024 and backlog of uncompleted customer orders will be eliminated before the sale of the segment. | The assets and liabilities of the segment will be presented as held for sale in financial statements for the year ending 30 June 2023, as the sale is highly probable to occur within twelve months. Further, the revenues and expenses of the segment will be disclosed as discontinued operation in the financial statements for the years ending 30 June 2023 and 2024. |

**Required:**
Keeping in view the CEO's comments for BOD meeting, discuss how the above plans would be dealt with in SL's financial statements in accordance with IFRSs. **(21)**

Q.3 (a) On 1 January 2021, Aster Limited (AL) granted 10,000 share options to each of its 80 managers to purchase AL's shares at Rs. 40 per share. The share options will vest and become exercisable upon completion of four years, provided that managers remain in service until the vesting period.

In 2021 and 2022, the share price of AL has not increased as expected. The management is considering to amend the terms of the scheme, effective from 1 January 2023. Any one of the following amendments would be made:

(i) Extend the vesting period to 31 December 2025 and reduce the exercise price to Rs. 30 per share. The fair value of each share option immediately after the reduction in exercise price would be Rs. 22.
(ii) Increase the number of share options for each manager to 30,000.
(iii) Cancel the scheme altogether.

The management has gathered the following actual and forecasted information:

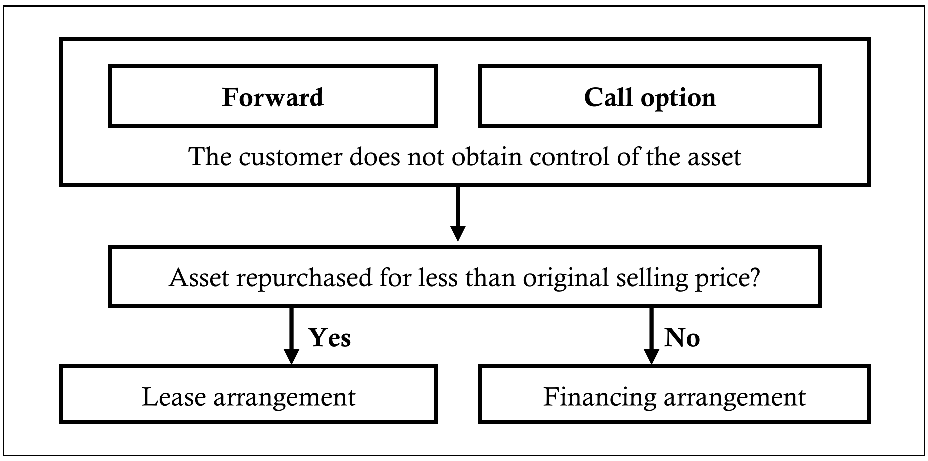
| | **1 January** | **31 December** | | | |
|---|---|---|---|---|---|
| | **2021** | **2021** | **2022** | **2023** | **2024** |
| Managers in employment | 80 | 76 | 74 | 73 | 70 |
| Managers expected to leave during the remaining vesting period | 10 | 7 | 4 | 2 | 2 |
| Fair value of each share ***(Rs.)*** | 65 | 70 | 50 | 52 | 60 |
| Fair value of each original share option ***(Rs.)*** | 29 | 36 | 12 | 15 | 20 |
| Fair value of each modified share option as per (i) ***(Rs.)*** | NA | NA | NA | 25 | 30 |

**Required:**
(I) Calculate the amounts related to share options scheme that are already recorded in AL's financial statements for the years ended 31 December 2021 and 2022. **(03)**
(II) For each amendment under consideration of management, calculate the amounts related to share options scheme to be recorded in AL's financial statements for the years ending 31 December 2023 and 2024. **(10)**

(b) One of your friends who has been working at Cosmos Limited (CL) has asked for your help in preparing a presentation on the accounting treatment of the 'Repurchase provisions' incorporated by CL in contracts with their customers. These repurchase provisions have been newly introduced by CL in the following three forms:

(i) CL's obligation to repurchase the asset sold (a forward);
(ii) CL's right to repurchase the asset sold (a call option); and
(iii) CL's obligation to repurchase the asset sold at the customer's request (a put option).

He has a clear understanding of the accounting treatment of a forward and a call option and has prepared the following diagram:




However, he is confused about the accounting treatment of a put option.

**Required:**
Keeping in mind the above diagram prepared by your friend for a forward and a call option, prepare a similar diagram for accounting treatment of a put option under IFRS 15. **(06)**

Q.4 Following are the draft statements of financial position of Daffodil Limited (DL) and Orchid Limited (OL) as at 31 December 2022 before incorporating the effects of the outstanding issues:

| | **DL's consolidated** | **OL's separate** |
|---|---|---|
| | **Rs. in million** | **USD in million** |
| **Assets** | | |
| Property, plant and equipment | 3,247 | 3.3 |
| Right-of-use assets | 700 | - |
| Investments | 1,000 | - |
| Goodwill | 1,050 | - |
| Current assets | 2,650 | 2.3 |
| | **8,647** | **5.6** |
| **Equity and liabilities** | | |
| Share capital (Rs. 10/USD 1 each) | 950 | 1.5 |
| Retained earnings | 2,575 | 3.5 |
| Exchange translation reserves | 985 | - |
| Non-controlling interest | 1,798 | - |
| Lease liabilities | 658 | - |
| Other liabilities | 1,681 | 0.6 |
| | **8,647** | **5.6** |

**Outstanding issues:**

(i) Apart from consolidating other subsidiaries, DL has also consolidated the balances of OL assuming that OL's control has been transferred to DL through acquisition of 60% shareholding. However, DL has only significant influence over OL due to a contract with other shareholders of OL.

On 1 January 2022, DL acquired 60% shareholding in OL, a foreign company, at a consideration of USD 2 million. On the acquisition date, OL's retained earnings were USD 2.5 million and fair value of OL's net assets was equal to their carrying value. The relevant exchange rates per USD are as follows:

| 01-Jan-2022 | 31-Dec-2022 | Average for 2022 |
|---|---|---|
| Rs. 200 | Rs. 250 | Rs. 220 |

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

(ii) On 1 April 2022, DL sold its head office building to Iris Leasing (IL) for Rs. 400 million, which was credited to the building account. Immediately before the transaction, the building was carried in the books at Rs. 480 million and had a remaining useful life of twenty years. At the same time, DL entered into a contract with IL for the right to use the building for ten years, with an annual payment of Rs. 50 million payable in arrears. The fair value of the building at the date of sale was Rs. 600 million. Applicable discount rate is 15% per annum.

The terms and conditions of the transfer of the building by DL satisfy the requirements of IFRS 15 to be accounted for as sale of the asset.

(iii) No entries have been made in the DL's books regarding modification to terms of a loan except fees paid for the restructuring, which were immediately expensed.

On 1 July 2022, DL entered into a restructuring plan to modify the original terms of a loan with the bank. According to the plan, DL will make a single payment of Rs. 920 million on 30 June 2027, instead of originally scheduled payments. The market interest rate at the time of restructuring was 15% per annum.

On the restructuring date, the carrying amount of the original loan was Rs. 500 million, while its effective rate was 11% per annum. The original loan was repayable in equal annual installments in arrears, ending on 30 June 2027. A fee of Rs. 24 million was paid for the restructuring plan.

**Required:**
Prepare the revised consolidated statement of financial position of DL as at 31 December 2022 after incorporating the effects of the above outstanding issues. **(25)**

Q.5 (a) Following is the draft statement of movement in unit holders' fund of Flax Income Fund for the year ended 30 June 2022:

| | Capital value | Undistributed income | Total |
|---|---|---|---|
| | ------------ Rs. in '000 ------------ | | |
| **Net assets at the beginning of the year** | 3,003,640 | (163,106) | 2,840,534 |
| | | | |
| Issue of 5,580,000 units: | | | |
| – Capital value (at net asset value per unit at the beginning of the year) | 2,790,000 | - | 2,790,000 |
| – Element of income | 55,800 | - | 55,800 |
| Total proceeds on issuance of units | 2,845,800 | - | 2,845,800 |
| | | | |
| Redemption of units: | | | |
| – Capital value (at net asset value per unit at the beginning of the year) | (2,905,000) | - | (2,905,000) |
| – Element of loss | (72,540) | (250,000) | (322,540) |
| Total payment on redemption of units | (2,977,540) | (250,000) | (3,227,540) |
| | | | |
| Total comprehensive income for the year | 940,000 | - | 940,000 |
| | | | |
| Total cash distribution (including refund of capital) during the year | - | (19,250) | (19,250) |
| **Net assets at the end of the year** | **3,811,900** | **(432,356)** | **3,379,544** |
| | | | |
| Undistributed income brought forward | | | |
| – Realized income/(loss) | | (193,671) | |
| – Unrealized income/(loss) | | 30,565 | |
| | | (163,106) | |
| **Accounting income available for distribution** | | | |
| – Relating to capital gain | | - | |
| – Excluding capital gain | | (20,000) | |
| | | (20,000) | |
| Distribution during the year | | (19,250) | |
| **Undistributed income carried forward** | | **(202,356)** | |

**Required:**
Prepare list of errors and omissions in the above statement. **(06)**
***(Note: There are no casting errors in the given information. Redrafting of the statement is not required)***

(b) Bluebell Limited (BL) has been operating in a highly inflationary economy for the past three years. The directors of BL are concerned that the regulator may require a restatement of financial statements according to IAS 29 at any time. Following is the extract from the draft statement of financial position of BL as at 31 December 2022 prepared under historical cost:

| | 2022 | 2021 |
|---|---|---|
| | ------ Rs. in million ------ | |
| **Assets** | | |
| Property, plant and equipment | 600 | 700 |
| Investment stated at market value | 225 | 175 |
| Inventories | 400 | 250 |
| Account receivables | 186 | 165 |
| Cash and bank | 195 | 135 |
| | **1,606** | **1,425** |
| **Liabilities** | | |
| Long-term loans | 471 | 595 |
| Trade and other payables | 287 | 207 |
| | **758** | **802** |

**Required:**
For each item reported in the statement of financial position, identify whether the balance reported (including comparatives) under historical cost needs to be restated under IAS 29 or not. **(04)**

**(THE END)**