The Institute of Chartered Accountants of Pakistan

Certificate in Accounting and Finance Stage Examination

2 September 2024
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Instructions to examinees:
(i) Answer all **NINE** questions.
(ii) Answer in **black** pen only.
(iii) Multiple Choice Questions must be answered in answer script only.

Section A

Q.1 Average Limited (AL) is preparing its consolidated financial statements for the year ended 30 June 2024. The following information is available:

(i) On 1 October 2023, AL acquired the entire shareholding of Xlookup Limited (XL) for Rs. 4,140 million. The carrying amount of net assets appearing in XL's books on the acquisition date are provided below:

	Rs. in million
Software	400
Product NEO	210
Other net assets	2,880
	3,490

Additional details in respect of the acquisition of XL are as follows:

- Up to the acquisition date, XL had incurred Rs. 150 million and Rs. 350 million respectively on research and development for the Product NEO. XL had only recognised cost incurred after the recognition criteria for capitalization of the internally generated intangible asset was met i.e. 1 July 2022.
- On the acquisition date, the fair value of the research and development work on NEO was estimated at Rs. 600 million. This fair value can be attributed to research component and development component in the ratio of 3:7.

(ii) XL incurred further directly attributable cost of Rs. 90 million on Product NEO after the acquisition until the launching date i.e. 31 December 2023. This comprises of materials for testing, staff salaries and training costs amounting to Rs. 32 million, Rs. 24 million and Rs. 34 million respectively. The commercial life of Product NEO was estimated to be 8 years.

(iii) On 1 October 2023, the remaining useful life of the software was 10 years.

(iv) On 1 April 2024, XL acquired a patent in respect of Product NEO at a cost of Rs. 48 million, with a useful life of 6 years.

(v) An impairment test carried out at year-end indicated that goodwill of XL has been impaired by 10% due to temporary adverse economic conditions.

Required:
Prepare the relevant extracts from AL's consolidated statement of profit or loss for the year ended 30 June 2024 and consolidated statement of financial position as at that date. ***(Comparative figures and notes to the financial statements are not required)*** **(10)**

Q.2 You are the finance manager of Proper Limited (PL). A new CEO has recently joined PL. Due to his limited knowledge of consolidation, the CEO has raised the following matters after going through the recent consolidated financial statements of PL:

(i) Since PL holds only 75% shares of Alpha Limited (AL), all balances of AL should be included only to the extent of 75%.
(ii) A loan given by PL to AL is not appearing in the financial statements, although the loan is still outstanding. Similarly, interest income on such loan is also missing, although AL has paid the full interest for the year.
(iii) Share capital of none of the subsidiaries is appearing in the statement of financial position though share capital of PL is appearing.
(iv) As PL holds only 45% of the voting shares capital of Beta Limited (BL), BL should not be consolidated, regardless of the fact that a further 10% is held by another shareholder who has agreed to vote as directed by PL.
(v) One of PL's associates has significant intangible assets but no intangible asset is appearing in the financial statements.

Required:
Briefly respond to the matters raised by the CEO. **(10)**

Q.3 Fact Limited (FL) entered into the following transactions during the year 2023:

(i) On 1 January 2023, FL purchased bonds issued by Chi Limited for Rs. 25 million. The par value of these bonds is Rs. 30 million and redemption will be at par. A transaction cost of Rs. 0.5 million was also incurred at the time of purchase. The bonds are held within a business model whose objective is to hold the bonds in order to collect contractual cash flows.

The coupon interest rate is 8%, payable annually on 31 December. The effective interest rate on the bond is 15% per annum.

On 31 December 2023, the fair value of the bonds was Rs. 28 million.

(ii) On 1 April 2023, FL purchased 30,000 shares of Delta Limited (DL) representing a 1.5% shareholding, at Rs. 360 per share, with a par value of Rs. 50 each. A transaction cost of Rs. 0.3 million was also incurred at the time of purchase. On initial recognition, FL elected to measure the investment at fair value through other comprehensive income.

On 30 September 2023, DL announced an interim cash dividend of 40%. DL reported a net profit of Rs. 240 million for the year ended 31 December 2023. The fair value of each share of DL was Rs. 430 as at 31 December 2023.

Required:
Prepare relevant extracts from FL's statement of profit or loss and other comprehensive income for the year ended 31 December 2023 and statement of financial position at that date. **(06)**

Q.4 For the purpose of answering this quesiton, use the information provided in **Question 3**. The addtional information regarding taxation rules applicable to FL is given below:

(i) Transaction costs incurred on purchase of financial assets are allowable as expense upon purchase.
(ii) Applicable tax rate is 30%.

Required:
Compute the deferred tax liability or asset that should be recognized in FL's statement of financial position as at 31 December 2023. Also, state whether the corresponding effect should be recognized in 'profit or loss' or in items presented 'outside profit or loss'. **(04)**

Q.5 On 1 January 2022, Concatenate Limited (CL) acquired an equipment on lease from Gamma Limited (GL). Details are as follows:

(i) An instalment of Rs. 5 million is to be paid annually in advance on 1 January.
(ii) The lease is valid for 5 years with an option for CL to buy the equipment at the end of fifth year for Rs. 6 million.
(iii) CL also has an option to return the equipment to GL at the end of third year and terminate the lease. For this, CL needs to pay an additional Rs. 2 million with the third instalment (i.e. at the start of the third year). It is reasonably certain that CL will exercise this option.
(iv) On 1 January 2022, CL's incremental borrowing rate is 14% per annum. This rate is expected to increase by 1% every year.
(v) On 1 January 2022, the fair value and useful life of the equipment were Rs. 25 million and seven years respectively.
(vi) The equipment was delivered to CL on 1 January 2022 but was ready for use on 1 April 2022. A cost of Rs. 1 million was incurred by CL on installation of the equipment.

Required:
Prepare journal entries in the books of CL for the years ended 31 December 2022 and 31 December 2023 to record the above transactions. ***(Narrations are not required)*** **(10)**

Q.6 Select the most appropriate answer(s) from the options available for each of the following Multiple Choice Questions.

(i) Parent Limited (PL) has a 75% shareholding in Subsidiary Limited (SL) since 2021. During 2023, SL made sales of Rs. 10 million to PL at a profit of Rs. 2 million. At 31 December 2023, PL had 60% of these goods in its inventory.

What would be the impact of unrealised profit on consolidated financial statements?

(a) Reduction in inventory, group reserves and non-controlling interest by Rs. 1.2 million, Rs. 0.9 million and Rs. 0.3 million respectively
(b) Reduction in inventory, group reserves and non-controlling interest by Rs. 2 million, Rs. 1.5 million and Rs. 0.5 million respectively
(c) Reduction in inventory, group reserves and non-controlling interest by Rs. 1.2 million, Rs. 0.72 million and Rs. 0.48 million respectively
(d) Reduction in inventory and group reserves by Rs. 1.2 million each **(02)**

(ii) Which of the following is **NOT** required to be disclosed as per IFRS 8?

(a) Revenues from external customers for each product and service, or each group of similar products and services.
(b) Non-current assets located in the entity's country of domicile and in all foreign countries in which the entity holds assets.
(c) Profit or loss attributable to the entity's country of domicile and to all foreign countries from which the entity derives profit or loss.
(d) Extent of reliance on major customers, including details if revenue from a customer exceeds 10% of the entity's revenue. **(01)**

(iii) Ibrahim is a member of ICAP working as a finance manager. During the preparation of monthly employees' salaries, he noted that last month, he had not included house rent allowance given to all employees in the taxable salary due to a spreadsheet formula error, resulting in lower tax deductions.

Which of the following potential threats are involved in the above situation?

(a) Self-interest threat and self-review threat
(b) Self-interest threat and advocacy threat
(c) Advocacy threat and self-review threat
(d) Familiarity threat and intimidation threat **(01)**

(iv) The following are the examples of situations creating threats to compliance with ICAP's code of ethics:

(I) Acceptance of a gift or preferential treatment
(II) A dominant personality attempting to influence decisions of the chartered accountant.

Which threats arise out of above situations, respectively?

	(I)	**(II)**
(a)	Familiarity	Intimidation
(b)	Advocacy	Advocacy
(c)	Self-review	Intimidation
(d)	Familiarity	Self-review

(01)

(v) Which of the following scenarios would **NOT** result in the recognition of a deferred tax liability/asset?

(a) Accelerated depreciation for tax purposes compared to accounting purposes.
(b) Revaluation of property, plant, and equipment where the revaluation is not recognized for tax purposes.
(c) Interest income taxed only when received.
(d) Dividend income taxable at a rate lower than the normal tax rate. **(01)**

(vi) Alpha Livestock Limited (ALL) operates a goat-breeding farm. ALL sells goats to local meat businesses and goats-milk to cosmetics companies. On 1 March 2024, ALL bought 40 goats for Rs. 51,000 each (i.e., at fair value of Rs. 50,000 and 2% commission) from a nearby market. The market broker also charges 3% commission from the seller on each transaction.

The amount to be charged to profit or loss upon initial recognition would be:

(a) Nil (b) Rs. 100,000
(c) Rs. 40,000 (d) Rs. 60,000 **(01)**

(vii) Which of the following statements is/are correct?

(I) Bearer biological assets are those that are harvested as agricultural produce or sold as biological assets.
(II) Consumable biological assets include fruit trees from which fruit is harvested.

(a) Only (I) is correct (b) Only (II) is correct
(c) Both (I) and (II) are correct (d) None is correct **(01)**

(viii) Which **TWO** of the following would provide disclosures related to IFRS 8 in the financial statements?

(a) A listed company with a single reportable segment
(b) A listed company with multiple reportable segments
(c) A non-listed company with a single reportable segment
(d) A non-listed company with multiple reportable segments **(01)**

(ix) Which **TWO** of the following are considered as lease payments for the lessee?

(a) Variable lease payments that depend on an index or a rate
(b) Amounts expected to be payable by the lessee under residual value guarantees
(c) Residual value guarantees provided to the lessor by the lessee
(d) Residual value guarantees provided to the lessor by a party related to the lessee **(01)**

Section B

Q.7 **For the purpose of this question, assume that the date today is 1 September 2024.**

Weekday Limited (WL) is currently in the process of finalizing its financial statements for the year ended 30 June 2024. The following matters are under consideration:

(i) On 1 January 2024, WL acquired entire shareholding of Eta Limited (EL). The purchase agreement includes contingent consideration of Rs. 90 million, payable if EL achieves a specified target profit in the next 12 months. At the acquisition date, it was not probable that EL would meet this target. However, at 30 June 2024, EL has attained 60% of the target profit within six months, and it is now probable that the target will be achieved.

(ii) On 20 June 2024, WL experienced a significant cybersecurity breach, resulting in the loss of customers' critical data. WL made a public announcement of the breach on 31 August 2024. The full extent of the breach and its financial impact is not yet known, but it is expected to be substantial and will result in significant claims by customers for damages in the coming months.

(iii) On 29 June 2024, Sigma Tech (ST), a key supplier of WL, had gone bankrupt, potentially disrupting the supply chain for several critical components used by WL. The bankruptcy of ST is resulting in significant delays and additional costs for WL to source alternative suppliers. Financial impact of these potential delays and additional costs is expected to be Rs. 16 million of which Rs. 12 million has already been incurred in the past two months.

(iv) WL sells Product Leo with a one-year warranty. The warranty arrangement with the manufacturer i.e. Kappa Tech (KT) is as follows:

- If a defect arises in the first six months, WL is responsible to customers for repairing or replacing the items. WL then submits the details of warranty claims to KT, which reimburses 75% of the costs incurred by WL. Historically, KT has always honoured these claims.
- If a defect arises in the next six months, KT is responsible to customers for repairing or replacing the items. However, KT charges 10% of the costs incurred, to WL.

The average costs of repairing each minor and major defect are Rs. 10,000 per unit and Rs. 55,000 per unit respectively. The probability of a claim arising for a unit sold is as follows:

Nature of defect	First six months	Next six months
Minor	4%	7%
Major	5%	11%

During the year ended 30 June 2024:

- WL sold a total of 20,400 units of the Product Leo.
- the total repair costs for first six months' claims incurred by WL were Rs. 36 million, of which Rs. 27 million has been recovered from KT.
- KT has claimed Rs. 7 million from WL for next six months' claims.

Required:
Discuss how the above issues should be dealt with in the financial statements of WL for the year ended 30 June 2024. Support your answers in the context of relevant IFRSs. **(16)**

Q.8 Count Limited (CL), a company listed on Pakistan Stock Exchange, has its registered office in Karachi. Specializing in the manufacturing and marketing of personal care products, CL operates a manufacturing facility in Faisalabad. This plant has a production capacity of 20,000 kg, of which 75% is currently utilized. The summarized trial balance of CL as at 30 June 2024 is given below:

Particulars	Debit	Credit
	----- Rs. in million -----	
Advances to suppliers	108	
Biological assets	106	
Current assets	278	
Deferred tax liability		67
Investment in Alpha Limited at cost	100	
Long-term loan		250
Property, plant and equipment	740	
Share Capital		500
Trade and other payables		98
Unappropriated profit		417
	1,332	**1,332**

Additional information:

(i) Advances to suppliers represents an advance paid for a machine to be imported. The total price of the machine was F$ 3 million of which 60% was paid as advance on 1 October 2023. The machine was received on 1 March 2024, and the balance was settled on 15 July 2024. Depreciation on machines is charged at an annual rate of 20%. The following exchange rates are available:

Date	1 Oct 2023	1 Mar 2024	30 June 2024	15 July 2024	Average
Rs. per F$	60	68	80	85	66

No entries have been made in respect of the above information after 1 October 2023.

(ii) In November 2023, CL initiated a pilot project involving the purchase of several cows, classifying them as biological assets at the initial cost of Rs. 81 million. Feeding cost of Rs. 13 million and other farm-related expenses of Rs. 12 million were also capitalized in the cost of cows. At 30 June 2024, the fair value of the cows was estimated at Rs. 120 million. The associated cost of sale is anticipated to be 5%.

(iii) On 1 February 2024, CL acquired 6 million shares of Alpha Limited (AL), representing a 30% shareholding. For the year ended 30 June 2024, AL reported a net profit of Rs. 80 million. AL distributed dividends totalling Rs. 24 million, of which CL recorded its share as other income. CL has the policy to account for its investment in associates using the equity method.

(iv) On 30 June 2024, a machine originally purchased for Rs. 30 million was auctioned to Beta Traders for Rs. 5 million. The full amount of the proceeds was erroneously credited to sales and the disposal of the asset was not recorded in the books. At the time of disposal, the carrying value of the machine was Rs. 8 million.

(v) The temporary differences have decreased by Rs. 80 million. However, no adjustment has been made to reflect this change. The applicable income tax rate is 35%.

(vi) The authorized share capital of CL is Rs. 800 million, divided into ordinary shares with a nominal value of Rs. 10 each.

(vii) CL's Board of Directors, in their meeting on 28 August 2024, approved the issuance of bonus shares at a rate of 10%.

(viii) Trade and other payables includes unclaimed dividends of Rs. 5 million.

Required:
Prepare CL's statement of financial position as at 30 June 2024 along with the relevant notes showing possible disclosures as required under IFRSs and the Companies Act, 2017. ***(Comparative figures and note on accounting policies are not required)*** **(18)**

Q.9 Value Limited (VL) is a water purification company that provides hardware for water treatment and its installation services. VL also provides hosting services for water quality monitoring software, allowing customers to manage water quality from anywhere in the world. During the year ended 30 June 2024, VL entered into the following two contracts:

(i) Contract 1:
On 1 February 2024, VL entered into a contract with Epsilon Water for a total price of Rs. 10.5 million, which was paid immediately. Under the contract, VL will provide the specified hardware, installation services and hosting services. The standalone prices of the hardware, installation services and hosting services are Rs. 10 million, Rs. 2 million, and Rs. 1 million respectively. Each element of the package can be purchased independently without affecting the performance of any other element. VL regularly sells each element separately and generally does not integrate the goods and services into a single solution.

VL delivered the hardware on 1 March 2024 and completed its installation on 1 April 2024. The hosting services are to be provided over one year starting from 1 April 2024.

(ii) Contract 2:
On 1 June 2024, VL delivered 400 units of one of its water treatment hardware products to Zeta Water (ZW) at Rs. 25,000 per unit. ZW immediately paid the amount and obtained control upon delivery. Under the contract, ZW is allowed to return unused units within 30 days and receive a full refund.

At the inception of the contract, VL estimated that 5% of units would be returned based on historical data. VL's cost of the product is Rs. 18,000 per unit, and it uses the perpetual system for recording inventory transactions.

On 30 June 2024, ZW returned 25 units and was refunded in full for these units.

Required:
Explain how the above contracts should be recorded in VL's books for the year ended 30 June 2024. Give journal entries and workings in support of your explanation. **(16)**

(THE END)