ICAP

Certificate in Accounting and Finance Stage Examination

3 March 2025
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 The following information pertains to two intangible assets of Oud Limited (OL):

(i) On 1 January 2023, broadcasting rights were acquired for Rs. 250 million. While the expected period of cash generation from the acquisition date was 8 years, the rights were legally valid for only 5 years.

On 1 January 2024, OL got an option to renew these rights for an additional 5 years. However, this option was not available at the time of acquisition. OL immediately exercised this option by paying a significant cost of Rs. 80 million.

(ii) On 1 January 2023, a trademark was acquired for Rs. 300 million, with a useful life of 8 years and a residual value of Rs. 50 million. The revalued amounts and residual values based on an active market are as follows:

Date	Revalued amount	Residual value
	------------ Rs. in million	------------
31 December 2023	319	60
31 December 2024	220	53

Other information:
- OL applies the cost model for broadcasting rights and the revaluation model for trademark.
- Both assets are amortized on a straight-line basis.
- Maximum possible amount is transferred from the revaluation surplus to retained earnings on an annual basis.

Required:
Prepare the relevant extracts (including comparative figures) from OL's statement of profit or loss and other comprehensive income for the year ended 31 December 2024 and statement of financial position as of that date. ***(Notes to the financial statements are not required)*** **(08)**

Q.2 You are working as an accountant in Spark Limited (SL), a listed company. Until last year, SL had a simple capital structure, with all shares issued at par for cash and the remaining equity appearing in the retained earnings account. However, the management of SL has ambitious growth plans for future and has started raising funds. SL has issued additional shares at a premium for cash, and there are plans for further share issuance against cash as well as other assets. SL's management is also planning to issue bonus shares and a portion of retained earnings will also be transferred to another reserve account, which will not be available for distribution.

You have pointed out that these changes in capital will require additional disclosures as per the Fourth Schedule to the Companies Act, 2017. The CFO has requested you to prepare an illustrative note on 'Share capital' and 'Reserves', which needs to be included in SL's upcoming annual financial statements.

Required:
Prepare the notes as required by the CFO. ***(You may assume necessary details)*** **(06)**

Q.3 Malone Limited (ML) is a listed company with multiple subsidiaries and operates across various sectors. The CEO of ML has recently joined and upon reviewing ML's recent financial statements, has raised the following matters in respect of the disclosures related to segment information:

(i) The CEO suggests that, similar to the consolidated financial statements, segment information should also be presented in ML's separate financial statements, as ML individually operates in multiple businesses.

(ii) The CEO proposes that a new segment should be disclosed separately as an operating segment, even though it would not meet the 10% quantitative threshold at next year-end. The segment has recently started operations and is expected to become significant to ML in the coming years.

(iii) The information regarding two separate operating segments have been combined and reported as one operating segment. Clarification is required on whether the results of two separate segments can be combined and reported as a single operating segment and, if so, the criteria for such aggregation.

(iv) The CEO suggests that details of major customers should no longer be included in disclosures, as these customers are not ML's segments.

Required:
In accordance with the requirements of IFRS 8 'Operating Segments', briefly respond to the CEO's suggestions and inquiries. **(08)**

Q.4 The financial statements of Lancome Limited (LL) for the year ended 31 December 2024 are under preparation. While reviewing accounting treatment of a lease transaction entered during the year, it was noted that the accountant of LL has simply recognized the right-of-use asset and corresponding lease liability related to a plant at the present value of annual rentals of Rs. 48 million, discounted at the market rate of 16% per annum. The subsequent entries for depreciation and interest have been made based on these amounts, while the net initial direct cost has been expensed out.

Details regarding the lease transaction are as follows:

(i) The plant was leased on 1 January 2024 for a non-cancellable period of four years at an annual rental of Rs. 48 million, payable in advance on 1 January each year.

(ii) LL incurred initial direct cost of Rs. 12 million, out of which lessor reimbursed Rs. 4 million.

(iii) At the end of the lease term, LL has an option to purchase the plant at its estimated fair value of Rs. 50 million. It is reasonably certain that LL will exercise the option. The useful life of the plant is estimated at seven years.

(iv) The market interest rate for similar transactions is 16% per annum. However, as an incentive to LL for entering into the lease, the lessor has incorporated an implicit rate of 11% per annum, which is known to LL.

(v) LL is also obliged to incur decommissioning cost of Rs. 27 million at the end of the useful life of the plant.

(vi) A discount rate of 13% per annum may be assumed wherever required but not explicitly provided.

Required:
Prepare correcting journal entries in the books of LL for the year ended 31 December 2024. **(10)**

Q.5 Gaultier Limited (GL) is engaged in agricultural activities, including cultivation of fruit orchards and the growth of seasonal crops. GL follows IFRSs in preparing its financial statements. The following transactions and events occurred during the year ended 31 December 2024:

(i) On 1 January 2024, GL planted 50,000 apple saplings, expecting them to mature and start producing apples in five years. The initial cost of planting (including land preparation, labour, irrigation, and fertilizers) amounted to Rs. 20 million. GL also incurred Rs. 5 million in up-keeping costs, which were necessary for the healthy growth of the trees.

The apple trees are expected to have a productive life of 20 years and are not expected to have any residual value at the end of their useful life. The fair value of the saplings as of 31 December 2024 was estimated at Rs. 28 million.

(ii) During 2024, GL planted wheat crops over 100 hectares of farmland. GL incurred Rs. 8 million in planting and cultivation costs, including land preparation, seeds, fertilizers, irrigation and labour.

Harvesting was done in October 2024, yielding a total of 300,000 kg of wheat. At the point of harvest, the fair value of wheat was Rs. 100 per kg.

By 31 December 2024, GL sold 72% of the wheat at an average price of Rs. 125 per kg. The fair value of the remaining wheat as of 31 December 2024 was estimated at Rs. 120 per kg.

(iii) In November 2024, GL planted corn crops over 80 hectares of farmland. GL incurred Rs. 4 million in planting and cultivation costs, including land preparation, seeds, fertilizers, irrigation and labour.

The corn crop is expected to be ready for harvest in March 2025. As of 31 December 2024, the fair value of the unharvested corn crop was estimated at Rs. 5.5 million.

(iv) On 1 July 2024, GL received a government grant of Rs. 10 million to promote farming in a particular location. The grant requires GL to repay the entire grant if GL farms at the location for less than three years. GL is expected to farm at the location for three years.

Required:
Prepare the relevant extracts from GL's statement of profit or loss and other comprehensive income for the year ended 31 December 2024 and statement of financial position as of that date. **(08)**

Q.6 Select the most appropriate answer from the options available for each of the following Multiple Choice Questions (MCQs). Each MCQ carries **ONE** mark.

(i) A professional accountant discovers that his employer is engaging in tax evasion. What should be his first course of action?

(a) Report the matter to tax authorities immediately
(b) Resign from the company
(c) Discuss the issue internally with management or legal advisors
(d) Dispose of relevant documents to avoid legal repercussions

(ii) The following items are not recognized in the financial statements:

(I) Dividends that were proposed or declared after the year-end but before the financial statements were authorized for issue.
(II) Any cumulative preference dividends for the year that have not been declared.

Which of the above items should be disclosed in the notes to the financial statements?

(a) Only item (I)
(b) Only item (II)
(c) Both items (I) and (II)
(d) Neither item (I) nor item (II)

(iii) A company (the parent) acquired a subsidiary during the year. The subsidiary has an internal research project that has been expensed out by the subsidiary but has a reliably measured fair value. The subsidiary also has a customer list that the parent has not been able to value.

Which of the following best describes how the parent should treat these intangibles of the subsidiary in the consolidated financial statements?

(a) They should be included as part of the goodwill
(b) The research should be capitalised as a separate asset, while the customer list should be included as part of goodwill
(c) The research should be included as part of goodwill, while the customer list should be capitalised as a separate asset
(d) They should be capitalised as separate assets

(iv) How are inter-company balances and unrealised profits from trading and asset transfers between an investor and an associate to be dealt with under the equity method?

(a) The investor's share of inter-company balances, as well as unrealised profits, are not eliminated
(b) Inter-company balances are eliminated in full, while only the investor's share of unrealised profits is eliminated
(c) The investor's share of inter-company balances are eliminated, while unrealised profits is eliminated in full
(d) Inter-company balances are not eliminated, while only the investor's share of unrealised profits is eliminated

(v) Which of the following best describes the key difference between functional currency and presentation currency?

(a) Functional currency is chosen by management, whereas presentation currency is determined by IFRS
(b) Functional currency is based on the economic environment, while presentation currency is used for financial reporting
(c) The currency of consolidated financial statements is called functional currency, while the currency of separate financial statements is called presentation currency
(d) Functional currency is used for publishing financial statements, whereas presentation currency is used for recording day-to-day transactions

(vi) Which of the following contracts requires revenue recognition over time rather than at a point in time?

(a) A sale of a laptop
(b) A contract to build a custom warehouse
(c) A contract between a manufacturer and a retailer for supply of goods
(d) A sale of finished goods with a return policy

(vii) Which of the following best exemplifies a violation of the principle of integrity?

(a) Deliberately misclassifying expenses to reduce taxable income
(b) Seeking clarification on an unclear accounting standard
(c) Consulting legal counsel before disclosing confidential information
(d) Declining an assignment due to lack of expertise

(viii) Which of the following is **NOT** a factor to consider when determining whether a promised good or service is distinct and should be treated as a separate performance obligation under IFRS 15 'Revenue from Contracts with Customers'?

(a) The customer can benefit from the good or service either on its own or together with readily available resources
(b) The promise to transfer the good or service is separately identifiable from other promises in the contract
(c) The entity regularly sells the good or service separately to other customers
(d) The good or service is a minor component of the overall contract and does not significantly affect the contract's value

(ix) A company designates a bond investment at FVTPL instead of Amortized Cost. Which of the following is a valid reason for this designation?

(a) The bond has a high credit risk
(b) To eliminate or reduce an accounting mismatch
(c) The bond is issued by a related party
(d) The bond has a fixed interest rate

(x) A manufacturing company enters into a contract where price adjustments depend on customer satisfaction ratings. How should this be accounted for?

(a) Recognize revenue at the full contract price
(b) Recognize revenue based on the most likely amount to be received
(c) Recognize revenue at the minimum price
(d) Recognize revenue to the extent of costs incurred by the company

Section B

Q.7 **For the purpose of this question, assume that the date today is 28 February 2025.**

Versace Limited (VL) is a manufacturer specializing in high-precision metal spare parts. On 15 December 2024, an accident occurred in VL's factory, causing serious injuries to 12 workers and disrupting factory operations until 31 December 2024. As a result, the following financial implications have arisen:

(i) VL was not legally obliged to pay compensation to the injured workers. However, on 5 January 2025, VL voluntarily announced compensation of Rs. 2 million per affected worker, which was paid on 15 January 2025. In similar past incidents, VL has also provided financial compensation to injured workers.

(ii) On 16 January 2025, after receiving the announced compensation, 9 workers filed a negligence lawsuit against VL, demanding an additional Rs. 5 million each. VL's legal advisor believes VL has a strong defence, estimating only a 40% probability that the court may rule in favour of the workers. If awarded, the compensation could range from Rs. 1.5 million to Rs. 3 million per worker, with the most probable amount being Rs. 2 million. The court's decision is still pending.

(iii) Due to the accident, VL was unable to fulfil an order for a key customer, leading to contract cancellation without penalties. This cancellation will result in a future loss of profit of Rs. 50 million.

Information related to raw materials for the contract is as follows:

- Before the cancellation, VL had already procured raw materials worth Rs. 3 million in December 2024, specifically intended for this contract. These materials cannot be repurposed for other operations due to their specialized nature and are non-returnable to the supplier.
- Additionally, another shipment of the same raw material, valued at Rs. 7 million, is expected to be received next month. On 20 January 2025, VL cancelled the contract and paid a penalty of Rs. 2 million.

The salvage value of the above raw materials is estimated to be 40% of their purchase price.

(iv) To boost employees' morale following the factory disruption, VL's management announced a one-time bonus of Rs. 30 million on 30 January 2025.

(v) A machine damaged during the accident is currently under assessment. A preliminary report suggests that repair costs will amount to Rs. 18 million. However, even after repairs, the machine's efficiency may decline by 30%. Management is considering selling the machine in the coming months, with an expected sale price of Rs. 220 million in its current state. The carrying value of the machine as at 31 December 2024 was Rs. 340 million.

Required:
In the context of relevant IFRSs, discuss how the above financial implications should be dealt with in the financial statements of VL for the year ended 31 December 2024. **(15)**

Q.8 The following information has been gathered for preparing the tax-related disclosures of Calvin Klein Limited (CKL) for the year ended 31 December 2024:

(i) The accounting profit before tax for the year, after making all necessary adjustments, was Rs. 175 million.
(ii) The expenses for the year include cash donations of Rs. 18 million, which are not allowable for tax purposes.
(iii) The other income for the year includes a government grant of Rs. 14 million, which is not taxable.
(iv) The accounting depreciation for the year on owned property, plant and equipment amounted to Rs. 40 million (including incremental depreciation of Rs. 6 million), whereas the tax depreciation for the year amounted to Rs. 60 million. Revaluation does not affect taxable profit.
(v) On 1 January 2024, CKL leased an asset for a non-cancellable period of 5 years with an annual rental of Rs. 25 million, payable in arrears. Initial direct costs of Rs. 3 million were also incurred by CKL on the asset. The interest rate implicit in the lease is 18% per annum, but that is not known to CKL. CKL has guaranteed a residual value of Rs. 62 million at the end of 5 years, although it expects to pay only Rs. 15 million, as the asset is expected to have a residual value of Rs. 47 million. Under tax laws, all payments related to leased assets are allowed as an expense.
(vi) On 1 April 2024, CKL delivered a product to a customer for Rs. 140 million. It was agreed that 20% of the transaction price is payable upfront, while the remaining 80% is payable at the end of three years from the delivery. Under tax laws, the full transaction price is taxable in the year of delivery.
(vii) On 1 July 2024, CKL purchased bonds for Rs. 152 million, including a transaction fee of Rs. 2 million. The nominal value of the bonds is Rs. 180 million, with interest payments of 7% due on 30 June each year. The effective interest rate on the bond is 10% per annum, and CKL intends to hold the bonds until maturity. The market value of the bonds at 31 December 2024 was Rs. 160 million. Under the tax laws, the transaction fee is an allowable expense in the year of payment, while interest income is taxable on a receipt basis and capital gain is taxable at the time of sale.
(viii) The audit of the prior-year tax return resulted in disallowance of certain expenses due to a lack of withholding tax deduction evidence, increasing taxable income by Rs. 20 million. CKL accepted the error in the return.
(ix) The corporate tax rate for 2024 is 30% (2023:35%).
(x) A discount rate of 16% per annum may be assumed wherever required but not given.
(xi) Breakup of deferred tax liability / (asset) as of 31 December 2023 was as follows:

	Rs. in million
Property, plant and equipment	84
Tax credits (Adjustable against tax liability)	(5)
	79

Required:
(a) Prepare a note on taxation for inclusion in CKL's financial statements for the year ended 31 December 2024, along with a reconciliation explaining the relationship between tax expense and accounting profit. **(14)**
(b) Compute the deferred tax liability / asset for each temporary difference as of 31 December 2024. **(04)**

(Comparative figures are not required)

Q.9 The following balances have been extracted from the records of Gucci Limited (GL), Swizzles Limited (SL) and Burberry Limited (BL) for the year ended 31 December 2024:

	GL	SL	BL
	---------- Rs. in million ----------		
Sales	7,440	5,536	3,412
Cost of sales	4,650	3,460	1,820
Operating expenses	2,503	1,560	864
Other income	936	1,164	238
Finance cost	265	180	106
Investment in SL – at cost	560	-	-
Investment in BL – at cost	750	-	-

Additional information:

(i) Details of GL's investments are as follows:

Date of investment	Holding %	Investee	Share capital (Rs. 10 each) of investee	Retained earnings of investee
			------------- Rs. in million -------------	
1 Jan 23	35%	BL	1,500	540
1 Apr 24	45%	SL	1,700	1,700

(ii) Despite holding 45% of SL's shares, GL controls SL due to an agreement with a bank that owns 15% of SL's shares and has agreed to vote as directed by GL.

(iii) The cost of investment in SL includes a professional fee of Rs. 8 million incurred at the time of acquisition. The following considerations related to the acquisition of SL's shares are still unrecorded:

- Issuance of 52 million ordinary shares of GL.
- A further cash payment of Rs. 3.2 per share, to be made on 31 March 2026.

On the date of investment, the market prices of GL and SL shares were Rs. 26 and Rs. 24 respectively. The applicable discount rate is 11%.

(iv) At the date of SL's acquisition, the carrying values of its net assets were equal to fair values, except for the following:

- SL's inventory, whose fair value was higher than the carrying value by Rs. 300 million. By year-end, 60% of these inventory items had been sold by SL.
- A building whose fair value exceeded its carrying amount by Rs. 240 million. The remaining useful life of the building on the acquisition date was 16 years, but it was later revised to 12 years at year-end.

(v) Details of intra-group sales are as follows:

	*SL to GL	BL to GL
	----- Rs. in million -----	
Sales	1,700	1,360
Seller's profit on intra-group sales	450	360
Buyer's profit on sale to third party	540	432
Included in buyer's closing inventory	340	680

**All sales took place after 1 April 2024*

(vi) On 1 October 2024, GL sold vehicles with a carrying value of Rs. 40 million to SL for Rs. 72 million in cash. They had a remaining useful life of 8 years on date of disposal.

(vii) The impairment test carried out at year-end indicated that SL's goodwill had been impaired by 25%.

(viii) The income and expenses of all companies had accrued evenly during the year.

(ix) GL measures non-controlling interest at the acquisition date at its fair value.

Required:
Prepare GL's consolidated statement of profit or loss for the year ended 31 December 2024. **(17)**

(THE END)