Certified Finance and Accounting Professional Stage Examination

The Institute of
Chartered Accountants
of Pakistan

3 June 2024
3 hours – 100 marks
Additional reading time – 15 minutes

Advanced Accounting and Financial Reporting

Instructions to examinees:
(i) Answer all **SIX** questions.
(ii) Answer in **black** pen only.

Q.1 Draft forecasted financial statements of Fork Limited (FL) for the year ending 30 June 2025 show the following amounts:

	Rs. in million
Total assets	410
Total liabilities	145
Net profit	65

During the process of finalisation of the forecasted financial statements, it was noted that FL is going to undertake a new project during the year ending 30 June 2025 whose effects have not been incorporated. Relevant details for the project are as under:

(i) The project would require an initial investment of Rs. 100 million for the new plant and machinery in July 2024. The useful life of the plant and machinery would be 8 years.
(ii) Revenues for the year ending 30 June 2025 are expected to be Rs. 76 million, of which Rs. 13 million would be received after 30 June 2025.
(iii) Operating costs for the year ending 30 June 2025 are expected to be Rs. 47 million of which Rs. 41 million will be paid before 30 June 2025.

FL is planning to finance the initial investment from one of the following two options:

(i) On 1 July 2024, FL would issue 1 million bonds for Rs. 105 million. The related transaction cost on issuance will be Rs. 5 million. Each bond will be convertible into 2 ordinary shares on 30 June 2029 at the option of the bond holders. Any unconverted bonds would be redeemed on that date at par value of Rs. 100 each.

Under the terms of the bonds, interest of Rs. 20 million will be paid on 30 June 2026 as well as on 30 June 2028. On the date of issue, the market interest rate for similar debt without a conversion option is expected to be 15% per annum. However, on account of transaction cost incurred on the issuance of bonds, the effective interest rate would change by 1.3% per annum.

(ii) On 1 July 2024, FL would sell its head office building to Tong Leasing (TL) for Rs. 100 million. Immediately before the transaction, the building would be carried in the books at Rs. 120 million and would have a remaining useful life of 20 years. At the same time, FL would enter into a contract with TL for the right to use the building for 10 years, with an annual payment of Rs. 13 million payable in arrears on 30 June each year. The fair value of the building at the date of sale is expected to be Rs. 150 million.

The rate of interest implicit in the lease is 15% per annum. The terms and conditions of the transfer of the building by FL would satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset.

Required:
Determine the revised amounts of total assets, total liabilities and net profit under each of the following independent situations:

(a) The initial investment for the project is financed through issuance of bonds. **(07)**
(b) The initial investment for the project is financed through sale and leaseback. **(08)**

Q.2 Following are the draft statements of profit or loss and other comprehensive income of Apron Limited (AL), Bowl Limited (BL) and Cleaver Limited (CL) for the year ended 31 December 2023:

	AL	BL	CL
	--- Rs. in million ---		F$ in '000
Revenue	1,485	924	5,500
Cost of sales	(700)	(528)	(2,500)
Gross profit	**785**	**396**	**3,000**
Administrative expenses	(320)	(156)	(1,800)
Finance cost	(58)	(72)	-
Net profit	**407**	**168**	**1,200**
Other comprehensive income	-	-	-
Total comprehensive income	**407**	**168**	**1,200**

Other information:

(i) On 1 March 2023, AL obtained control of BL by acquiring 70% shareholding at the following consideration:

- Cash payment of Rs. 700 million, including acquisition-related cost of Rs. 15 million.
- Further cash payment of Rs. 120 million to be paid in February 2024 if BL's net profit for the year 2023 would be more than Rs. 200 million. The fair value of this consideration on acquisition date was estimated at Rs. 80 million.
- Issuance of share options to BL's CEO to purchase AL's shares. These options would replace the share options issued by BL to him on 1 March 2021. The original share options vested on 28 February 2023 and had a fair value of Rs. 56 million and Rs. 72 million at 1 March 2021 and 1 March 2023 respectively.

  The replacement share options issued by AL does not require further services by the BL's CEO and had a fair value of Rs. 117 million and Rs. 136 million on 1 March 2023 and 31 December 2023 respectively.

Only cash payment of Rs. 700 million was recorded as the cost of investment in AL's books, and no subsequent adjustments have been made.

(ii) On the acquisition date of BL, the fair value of its net assets was equal to their carrying value of Rs. 840 million except for:

- BL's inventory, whose fair value was higher than its carrying value by Rs. 70 million. By year-end, 70% of these inventory items had been sold by BL at a profit of Rs. 40 million.
- a 10% bank loan of Rs. 450 million. Interest is paid annually on 28 February, and the entire principal is due on 28 February 2026. On the acquisition date, market rate for a similar loan was 14% per annum.

(iii) On 1 May 2023, AL acquired an 80% shareholding in CL for F$ 7 million paid in cash and a further amount of F$ 3.5 million payable on 30 April 2025.

Only the cash payment was recorded as the cost of investment in AL's books, and no subsequent adjustments have been made.

(iv) On the acquisition date, the fair value of CL's net assets was equal to their carrying value of F$ 8.8 million except for research relating to a new product, which was not recognized as an asset in CL's books. The fair value of the research was initially estimated by AL's management at F$ 1.2 million. After the acquisition, an expert was hired to calculate the fair value of the research. The expert reported after two months that at the acquisition date, the fair value and the remaining useful life of the research were F$ 1.8 million and 8 years respectively.

(v) On the acquisition date, the fair value of the non-controlling interest in CL was estimated at F$ 2.2 million.

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

1 May 2023	31 Dec 2023	Average rate for	
		2023	May – Dec 2023
Rs. 176	Rs. 164	Rs. 172	Rs. 168

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

(viii) AL values the non-controlling interest in BL on the acquisition date at its proportionate share of the fair value of BL's identifiable net assets, while AL values the non-controlling interest in CL on the acquisition date at its fair value.

(ix) At year-end, it was assessed that all goodwill balances are impaired by 20%.

(x) A discount rate of 14% may be used wherever required but not given.

Required:
Prepare AL's consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2023 in accordance with the requirements of IFRSs. **(25)**
(Disclosures relating to allocation of profit or loss and comprehensive income attributable to non-controlling interest and owners of the parent are not required)

Q.3 Saucer Insurance Limited (SIL) is engaged in the life insurance business, selling conventional, Takaful and group life insurance policies. The following information is available regarding premium/contribution revenue of SIL for the year ended 31 December 2023.

	Rs. in million
Regular premium/contribution individual policies	24,127
Single premium/contribution individual policies	542
Group policies	3,715
Provision for experience refund	159
Reinsurance premium/contribution ceded on:	
▪ individual policies	246
▪ group policies	606
Experience refund from reinsurers	85

Additional information:

(i) Further break-up for individual policies is also available:

	Gross premium/ contribution	Reinsurance premium/ contribution
	------------ Rs. in million	------------
First year	5,579	41
Second year renewal	5,379	33
Subsequent years renewal	13,169	172
	24,127	**246**

(ii) Group policies include Rs. 19 million for policies with cash value.

Required:
Prepare a note on Net Insurance Premium/Contribution Revenue of SIL for the year ended 31 December 2023. **(06)**

Q.4 (a) Masher Limited (ML) is involved in the manufacturing and trading of automobiles. On 1 March 2023, Micro Assist Welfare (MAW), an NGO, entered into a contract with ML for the purchase of 1,000 rickshaws at a price of Rs. 400,000 per rickshaw for distribution to needy persons. As per the contract, ML will deliver the rickshaws in two lots of 500 each, on 15 April 2023 and 15 September 2023. The payment for each lot will be made within 2 months after delivery. MAW will also have a right to return the undistributed rickshaws within 3 months of delivery. Based on historical evidence, ML estimated that MAW will return 10% of the rickshaws.

The first lot of rickshaws was delivered as planned. On 1 June 2023, MAW returned 20 rickshaws. On 5 June 2023, MAW made the payment after adjusting for the returned rickshaws. On 15 July 2023, MAW returned the remaining 12 undistributed rickshaws. A credit note was issued to MAW to adjust the amount in the invoice for second lot.

On 1 August 2023, the contract was modified to include a third lot of 400 rickshaws at a price of Rs. 325,000 each, to be delivered on 15 February 2024. The additional 400 rickshaws will be sold at a lesser price due to following reasons:

- A credit/discount totalling Rs. 7.5 million was given to MAW for the below average fuel efficiency of the rickshaws delivered in the first lot; and
- There will be no right to return in the second and third lots.

The delivery of the second lot was delayed till 15 November 2023, for which a further price reduction of Rs. 1 million was given in the invoice for second lot.

Required:
Prepare journal entries in the books of ML in respect of the above for the year ended 31 December 2023. ***(No marks will be awarded on entries without dates)*** **(08)**

(b) Peeler Limited (PL) has 75% shareholding in Grater Limited (GL). PL values the non-controlling interest in GL at the proportionate interest in GL's net identifiable assets. PL considers GL as a separate cash-generating unit. On acquisition of GL, goodwill was determined to be Rs. 64 million. Because other cash-generating units of PL were expected to benefit from the synergies of the combination with GL, the goodwill of Rs. 28 million related to those synergies was allocated to other cash-generating units within PL.

At 31 December 2023, annual impairment testing is being carried out. PL has determined the recoverable amount of GL as Rs. 255 million. The following amounts related to GL are included in PL's draft consolidated financial statements for the year ended 31 December 2023:

	Carrying value	**Fair value less cost to sell**
	--------- Rs. in million	**---------**
Building (revaluation model)*	77	75
Machinery (cost model)	52	43
Equipment (cost model)	67	Not measurable
Investment property (cost model)	28	Not measurable
Goodwill	64	Not measurable
Asset arising from pension benefits	15	Not measurable
Inventory (at NRV)	38	38
Net assets of GL including goodwill	**341**	

**Balance of surplus on revaluation of building as on 31 December 2023 amounted to Rs. 10 million.*

Required:
Compute carrying value of GL's assets after allocating impairment loss. Also, compute the amount of impairment loss to be taken to the PL's consolidated statement of profit or loss for the year ended 31 December 2023. **(09)**

Q.5 You are a chartered accountant working as the finance manager at Juicer Limited (JL). Due to JL's recent listing on Pakistan Stock Exchange, you prepared the first interim financial statements for the quarter ended 31 May 2024 and sent them to Kashif Raza, the CEO, for review.

The CEO has responded you with the following email:

> Gentleman
>
> I have reviewed the draft of the first quarterly financial statements that you have prepared. Being the first interim financial statements to be published, they are extremely critical for JL's future success. Please update them in respect of the following matters which will reduce their overall size and will ensure that they show true profitability:
>
> (i) You have prepared the statement of profit or loss and the statement of comprehensive income separately, as you do it in the annual financial statements. These two statements should be combined into a single statement.
>
> (ii) As recommended by our Software Development Manager, you have recorded the development costs of software as an asset in these interim financial statements, as these costs are expected to meet the recognition criteria during the next quarter. I believe that we should not recognize these costs as an asset, rather expense them in these quarterly financial statements.
>
> (iii) Although there have been some significant transactions with the related parties during this quarter, these may be covered in the next annual report. Hence, disclosures of related party transactions should be removed from the quarterly financial statements.
>
> (iv) 40% of the annual sales are usually generated during the Eid season, which will be in the second quarter of this year. However, we are producing the inventory evenly throughout the year, incurring significant costs. Following the matching principle, a fair proportion of the Eid sales should be accrued in the first quarter's financial statements, compensating for the costs being incurred in the manufacturing of inventories.
>
> (v) Variable lease payments for the plant and machinery based on achieving the annual sales target should be accrued, even though the related sales target has not been achieved in the first quarter but is expected to be achieved during the full year.
>
> I greatly appreciate your efforts and believe you deserve a promotion. I look forward to seeing the revised quarterly financial statements after incorporating my suggestions.
>
> Best regards
> Kashif

Required:

(a) Analyse whether the suggestions pointed out by the CEO should be incorporated into the quarterly financial statements in accordance with the requirements of IAS 34. **(10)**

(b) Briefly explain how you may be in breach of the fundamental principles of ICAP's Code of Ethics for Chartered Accountants if you accept all the suggestions of the CEO. Explain how you should respond in this situation to avoid the breach. **(06)**

Q.6 Kettle Limited (KL) is finalizing its financial statements for the year ended 31 December 2023. The following information has been gathered for preparing the disclosures relating to taxation:

(i) Profit before tax for the year, after all necessary adjustments, was Rs. 262 million.

(ii) KL operates a funded pension plan for its employees. The following relevant information has been extracted from the actuarial report for the year ended 31 December 2023:

	Rs. in million
Fair value of plan assets on 1 January 2023	280
Present value of plan obligations on 1 January 2023	320
Current service cost	63
Contribution to the fund	94
Pension paid	33
Actuarial gain arising on plan obligations	38
Return on plan assets	74
Asset ceiling on 31 December 2023 (Present value of economic benefits available)	37
Yield on high-quality corporate bonds	15%

Under the tax laws, contributions to the fund are allowed as an expense.

(iii) On 1 March 2023, KL purchased a 12% bond for Rs. 200 million with a par value of Rs. 250 million. The bond carries an effective interest of 16%. Coupon interest is received on 31 October each year. The bond is carried at fair value through other comprehensive income.

At year-end, the fair value of the bonds exceeds its amortised cost by Rs. 20 million.

As at 31 December 2023, due to deteriorating credit rating of the bonds, KL determined that there has been a significant increase in credit risk since the acquisition of the bond. Expected credit losses related to bond were estimated as follows:

	Life time	12 months
	------ Rs. in million ------	
1 March 2023	21	10
31 December 2023	45	18

Under the tax laws, interest income is taxable on a receipt basis, while capital gain is taxable at the time of sale. Further, adjustment for impairment is not allowed as an expense.

(iv) On 1 January 2023, KL setup a joint venture with another venturer at a cost of Rs. 750 million. KL contributed 60% of the cost. Joint venture's total comprehensive income for the year amounted to Rs. 180 million (including other comprehensive income of Rs. 30 million). KL received a dividend of Rs. 42 million from the joint venture on 1 November 2023. KL has no plan to sell this investment in the near future.

Under the tax laws, dividend income is taxable on receipt basis at 20%, while capital gain is taxable at the time of sale at 30%.

(v) As on 31 December 2023, taxable temporary differences on other items amounted to Rs. 99 million (2022: Rs. 75 million).

(vi) The tax rate for the year is 30% except stated otherwise.

Required:
Prepare relevant notes on taxation and deferred tax liability/asset for inclusion in KL's financial statements for the year ended 31 December 2023 in accordance with the IFRSs. **(21)**

(THE END)