Certified Finance and Accounting Professional Stage Examination

The Institute of
Chartered Accountants
of Pakistan

2 December 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 Saroli Limited (SL) is finalizing its financial statements for the year ended 31 December 2023. The following information has been gathered to prepare the disclosures relating to taxation:

(i) Profit before tax for the year, after all necessary adjustments, is Rs. 237 million.

(ii) On 1 January 2023, SL revalued its factory building for the second time, resulting in an upward revaluation of Rs. 36 million. Prior to this revaluation, the carrying amount was recorded at Rs. 162 million (gross revalued amount of Rs. 180 million and accumulated depreciation of Rs. 18 million).

The first revaluation, on 1 January 2021, had resulted in a revaluation loss of Rs. 24 million.

Under tax laws, revaluation has no effect. The tax base of the building on 1 January 2023 was Rs. 130 million, and depreciation at 20% on the tax base is allowed each year.

(iii) On 1 January 2023, SL sold its manufacturing plant to Finance Limited (FL) for Rs. 430 million. Immediately before the transaction, the plant was carried in the books at Rs. 360 million and had a remaining useful life of 15 years. Concurrently, SL entered into a contract with FL for the right to use the plant for 8 years, with an annual payment of Rs. 50 million payable in arrears. The fair value of the plant at the date of sale was Rs. 480 million. The terms and conditions of the transfer satisfies the IFRS 15 requirements for the sale of an asset.

Under tax laws, such arrangements are considered sales, and only subsequent lease rentals are allowed as an expense. The tax base of the plant on 1 January 2023 was Rs. 300 million, and depreciation at 20% on the tax base is allowed each year.

(iv) On 1 April 2023, SL delivered a product to a customer at a price of Rs. 100 million. It was agreed that 30% of the transaction price is payable upfront, while the remaining 70% is payable at the end of three years from the delivery.

Under the tax laws, the full transaction price is taxable in the year of delivery.

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

(vi) Applicable tax rate is 30%.

(vii) A discount rate of 14% per annum may be used wherever required.

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

Q.2 The following are the consolidated statements of financial position of Alphonso Limited (AL):

Consolidated statement of financial position as at 31 December 2023

	2023	2022
Assets	----- Rs. in million -----	
Property, plant and equipment	2,940	3,100
Goodwill	140	250
Investment in associate	609	-
Financial assets (FVOCI)	-	150
Inventory	761	880
Receivables	750	650
Cash and cash equivalents	70	100
Total assets	**5,270**	**5,130**
Equity and liabilities		
Share capital (Rs. 10 per share)	1,500	1,500
FVOCI reserve	80	60
Other reserves	2,100	1,650
Non-controlling interest	500	580
Long-term loans	520	650
Trade and other payables	570	690
Total equity and liabilities	**5,270**	**5,130**

Additional information:

(i) On 1 May 2023, AL purchased an additional 25% shareholding in Fajri Limited (FL), increasing its total interest in FL to 35% and obtained significant influence. The original 10% investment in FL was classified as FVOCI, being the only investment under this classification. During 2023, FL reported a profit of Rs. 120 million and paid a dividend of Rs. 40 million to its shareholders in November 2023.

(ii) On 1 October 2023, AL disposed of 20% shareholding in Palmer Limited (PL), reducing its ownership from 75% to 55%, for Rs. 184 million. At the disposal date, there was no goodwill related to PL in the consolidated financial statements and break-up of PL's net assets was as follows:

- Property, plant, and equipment: Rs. 500 million
- Inventory: Rs. 100 million
- Receivables: Rs. 80 million
- Cash: Rs. 60 million
- Trade and other payables: Rs. 120 million

(iii) On 1 December 2023, AL disposed of its entire 60% shareholding in Raspuri Limited (RL) for Rs. 320 million in cash, resulting in a loss of control. At the disposal date, RL's goodwill was Rs. 80 million and break-up of RL's net assets was as follows:

- Property, plant, and equipment: Rs. 450 million
- Inventory: Rs. 90 million
- Receivables: Rs. 70 million
- Cash (overdrawn): Rs. 40 million
- Trade and other payables: Rs. 100 million

The shareholding in RL was acquired many years ago for Rs. 140 million.

(iv) Interest of Rs. 70 million was paid during the year, of which Rs. 15 million was capitalized as part of the cost of constructing a new building.

(v) During the year, AL group acquired property, plant and equipment (excluding the interest capitalised) for Rs. 560 million, of which Rs. 65 million remained unpaid at the year-end.

(vi) During the year, dividends of Rs. 100 million were paid to non-controlling interests, and Rs. 180 million to the owners of the parent.

(vii) AL values the non-controlling interest on the acquisition date at its proportionate share of the fair value of identifiable net assets.

Required:
Prepare AL's consolidated statement of cash flows for the year ended 31 December 2023, using the **indirect method** in accordance with the IFRSs. **(20)**

Q.3 During the review of the draft consolidated financial statements of Chaunsa Limited (CL) for the year ended 31 December 2023, the following errors have been noted:

(i) On 1 March 2023, CL acquired 80% shareholding in Neelum Limited (NL). While calculating goodwill arising on the acquisition of NL, one of the consideration of Rs. 500 million, payable after two years, was included at its gross amount (i.e. Rs. 500 million). Further, NL's head office building was included in net assets at its carrying value of Rs. 800 million, although its fair value at that date was Rs. 1,100 million. The remaining useful life of the building at acquisition date was 5 years.

(ii) On 1 May 2023, CL acquired 75% shareholding in Dusehri Limited (DL), a foreign subsidiary with FC$ as its functional currency, for FC$ 5,000 million. While consolidating DL's financial statements at year-end, the exchange rate prevailing at the acquisition date has been used for translating all amounts of DL (including goodwill). Other consolidation adjustments have been correctly made. DL's summarized statement of financial position as on 31 December 2023 is as follows:

Assets	FC$ in million	Equity and liabilities	FC$ in million
Non-current assets	5,400	Share capital	2,160
Current assets	3,240	Retained earnings – opening	530
		Profit for the year	982
			1,512
		Liabilities	4,968
	8,640		**8,640**

On the acquisition date, DL's retained earnings were FC$ 720 million. The fair value of DL's net assets was equal to their book value, except for an intangible asset whose fair value exceeded its carrying value by FC$ 540 million. The remaining useful life of this intangible asset at the acquisition date was 6 years.

The exchange rates per FC$ are as follows:

1-May-2023	31-Dec-2023	Average for May-Dec 2023	Average for 2023
Rs. 2.4	Rs. 3.0	Rs. 2.6	Rs. 2.7

Other information:

(i) CL values the non-controlling interest on the acquisition date at its proportionate share of the fair value of identifiable net assets.
(ii) A discount rate of 14% per annum may be used wherever required.

Required:
Discuss how the identified errors should be corrected in the CL's consolidated financial statements for the year ended 31 December 2023. ***(Give correcting entries wherever possible)*** **(20)**

Q.4 The following information is available regarding some transactions of Kesar Limited (KL):

(i) On 1 January 2022, KL granted 5,000 share options to each of its 1,000 regional sales officers to purchase KL's shares at Rs. 90 per share. These options would vest and become exercisable upon the completion of four years, provided the officers remain in service until the end of the vesting period and their region's sales have increased by at least 20% over the four-year period ending 31 December 2025.

On 1 January 2023, KL modified the share option scheme due to a change in strategy. Under the modified scheme, the vesting period was reduced by one year so that the options would vest on 31 December 2024 instead of 31 December 2025, while the sales target was also reduced to 15% by 31 December 2024 (instead of the original 20% target by 2025).

Following further information is also available:

	1-Jan-22	31-Dec-22	1-Jan-23	31-Dec-23
Fair value of KL's share	Rs. 210	Rs. 240	Rs. 240	Rs. 275
Fair value of the original share option	Rs. 100	Rs. 135	Rs. 135	Rs. 170
Fair value of the modified share option	NA	NA	Rs. 175	Rs. 220
No. of officers already left till date	-	20	20	60
Further no. of officers expected to leave	80	70	70	50
% of officers expected to meet target sales	60%	70%	85%	90%

(ii) On 1 January 2022, KL acquired a warehouse and logistics facility for a lease term of 10 years, with instalments payable annually in arrears. The details are as follows:

- The first instalment is Rs. 42 million. The subsequent instalments are subject to increase/decrease in line with the Consumer Price Index (CPI), which is projected to increase by 5% each year.
- KL's incremental borrowing rate is 13% per annum.
- KL provided a residual value guarantee of Rs. 180 million at the end of the lease term. On the commencement date, none of this amount is expected to be payable by KL.

Additional information:

- On 1 January 2022, KL received a one-time payment of Rs. 5 million from the lessor as reimbursement of relocation cost. Further, KL incurred Rs. 3 million in legal fees to negotiate the lease and Rs. 8 million on the redesigning of the warehouse.
- On 31 December 2023:
  - an instalment of Rs. 45 million was paid, adjusted for a change in the CPI, which is now projected to increase annually by 4%.
  - KL reassessed the residual value guarantee, estimating that a guaranteed payment of Rs. 100 million will be required at the end of lease term, a change from the initial expected Rs. nil.
  - KL's incremental borrowing rate is 11% per annum.

Required:
Prepare the relevant extracts *(including comparative figures)* from KL's separate statement of financial position and statement of profit or loss for the year ended 31 December 2023, in accordance with the IFRSs. **(16)**
(Notes to the financial statements and the bifurcation of current and non-current items in the statement of financial position are not required)

Q.5 In your role as Finance Manager at Tainong Limited (TL), the CFO has shared information on two proposed transactions, along with concerns about their potential impact on TL's financial statements. The CFO has provided the following details about these transactions:

(i) Hedge of Equity Investment with a Put Option
TL is considering to invest in shares of a technology company and intends to hedge this investment through put options purchased on the date of share acquisition. This option will grant TL the right to sell the shares at a predetermined price. On acquisition, TL will make an irrevocable election to present changes in the shares' fair value within other comprehensive income.

Both the investment in shares and the associated put option are expected to be held for a specified period. TL intends to apply hedge accounting, as this hedging relationship will meet qualifying criteria for hedge accounting.

(ii) Issuance of a Convertible Financial Instrument with Various Features
TL is considering issuing a bond that will have no maturity (perpetual bond) and will carry a fixed annual interest. The bond may include one of the following additional features:

- After 5 years, bondholders will have the right to convert each bond into three shares of TL.
- TL may choose to pay interest in the form of its own shares, with the number of shares determined based on prevailing share price on the date of payment.

Required:
(a) For **transaction 1**, discuss how the equity investments and associated put options would impact TL's profit and other comprehensive income. **(06)**
(b) For **transaction 2**, evaluate the effect of inclusion of each feature on the classification of bond as a liability or equity in TL's financial statements. **(07)**

Q.6 (a) As the Finance Manager at Raspuri Limited (RL), you are responsible for preparing RL's financial statements. You recently presented a draft statement of cash flows to the CFO. After reviewing the draft, the CFO instructed you to reclassify interest paid from operating activities to financing activities, citing the following reasons:

- RL has committed to specific targets for cash generated from operating activities, which would not be met if the interest paid is presented in operating activities as consistent with previous year.
- This reclassification would help achieve those targets, thereby ensuring that all employees, including you, receive performance-related bonuses.

The CFO has assured you that IAS 7 allows flexibility in presenting cash flows related to interest payments.

Required:
Briefly explain how the CFO may be in breach of the fundamental principles of ICAP's Code of Ethics for Chartered Accountants. Also, discuss the potential threats that you may face in these circumstances. **(07)**

(b) A public sector entity that prepares and presents general purpose financial statements under the cash basis of accounting must apply the requirements of IPSAS: Financial Reporting Under the Cash Basis of Accounting. Under this standard, what are the three components of the financial statements? **(03)**

(THE END)