

December 03, 2001

ADVANCED FINANCIAL ACCOUNTING

(MARKS 100)

PE-1 (PAPER-1)

(3 HOURS)

Q.1 The following balances have been extracted from the books of Alpha Limited, a listed company.

	Debit/(Credit) 2001	Debit/(Credit) 2000
	Rs. million	
Sales – local	(2395)	(2,223)
Sales – export	(396)	(373)
Opening stock of raw material and work in process	166	126
Purchases	1951	1623
Sales Tax	337	334
Sales Discount	50	40
Loss/(Profit) on sale of fixed assets	6	(9)
Liabilities no longer payable written back	(24)	--
Mark up on		
Long-term finance	37	13
Short-term running finance	73	72
Bank charges	3	3
Salaries, wages and benefits – Production	85	80
Salaries, wages and benefits – Administration	22	21
Salaries, wages and benefits – Selling	13	14
Electricity, gas and water – Plant	82	69
Depreciation on Plant & Machinery	57	49
Stores and spares consumed	44	37
Repairs and maintenance of Plant	47	40
Recovery of bye-products and scrap	(121)	(99)
Closing stock of raw material and work in process	(271)	(166)
Finished goods – opening stock	134	194
- purchases	1	1
- closing stock	(216)	(134)
Depreciation office equipment	3	4
Legal and professional	1	5
Donations	3	3
Auditor's remuneration	1	1
Sundry office expenses	11	9
Advertising and sales promotion	72	84
Provision for doubtful debts	9	11
Workers' profit participation fund	11	9
Workers' welfare fund	5	3
Taxation - current	31	56
- prior years	2	9
- deferred	2	10
Unappropriated profit brought forward	(3)	(1)
Appropriations		
Proposed dividend	71	61
Transfer to general reserve	22	21

Required: Prepare a profit and loss account for the year ended June 30, 2001, disclosing the disclosure requirements to the maximum possible extent under the Companies (Disclosure) Ordinance 1984

- Q.2 Bela Limited paid the NED University a large sum of money to design a new machine which will help in producing cheaper products. The machine has been successfully tested and will certainly be used for commercial production from the next financial year.

The company also paid a large sum of money to the National Institute of Chemistry to develop a cheaper raw material. Unfortunately, the project met with limited success as the raw material developed was of inferior quality and not suitable for further processing.

Required: Explain how this matter should be dealt in the published accounts in the light of IAS38 – Intangible Assets. Assume that the amounts involved are material (10)

- Q.3 Y Ltd is a research company which specialises in developing new materials and manufacturing processes for the furniture Industry. The Company receives payments from a variety of manufacturers, which pay for the right to use the Company's patented fabrics and processes.

The following draft trial balance has been extracted from the Company's computerised book keeping records, together with comparative figures for the last year. The figures for the year just ended and the comparative figures for the preceding year are as under:

	30 September, 2001		30 September, 2000	
	Rupees		Rupees	
Fees & Royalties		6,000,000		5,000,000
Research & Development costs	2,200,000		1,900,000	
Administrative Costs	200,000		180,000	
Government contract	300,000		----	
Interest paid	468,000		324,000	
Income Tax charge	1,150,000		720,000	
Income Tax liability		840,000		670,000
Dividends for year	500,000		300,000	
Proposed dividend		250,000		150,000
Capitalised development expenditure	560,000		800,000	
Premises				
- Cost	4,000,000		3,500,000	
- Depreciation		600,000		350,000
Plant & Equipment				
- Cost	5,200,000		3,800,000	
- Depreciation		1,300,000		760,000
Debtors	1,183,562		753,425	
Creditors		200,000		173,334
Bank	400		82,000	
Term Finance Certificates		2,600,000		2,860,129
Share Capital		300,000		300,000
Profit & Loss		3,671,962		2,095,962
	<u>15,761,962</u>	<u>15,761,962</u>	<u>12,359,425</u>	<u>12,359,425</u>

Notes:

- (i) The Government contract is a long-term project for the development of materials for seating in Government offices. The Government will reimburse costs incurred and will pay a further 10% of costs. This is subject to the Government charging a maximum of Rs. 700,000 in total. The balance on the contract account comprises all costs incurred during the first year of the contract. The project manager is confident that the remainder of the work will cost no more than Rs. 200,000.

The contract provides that the company can charge for the proportion of the work completed by 30th September, subject to a 20% retention. No entries have been made in the books in respect of this charge.

- (ii) Research and development costs to be capitalised is Rs. 280,000. No entry has been passed for this also.
- (iii) Transactions involving tangible fixed assets can be summarised as follows:

	Premises Rs.	Plant & Equipment Rs.	Total Rs.
Cost at 30 Sept.2000	3,500,000	3,800,000	7,300,000
Disposals	—	(460,000)	(460,000)
Additions	500,000	1,860,000	2,360,000
Cost at 30 Sept.2001	4,000,000	5,200,000	9,200,000
Depreciation at 30 Sept. 2000	350,000	760,000	1,110,000
Disposals	—	(270,000)	(270,000)
Charge for year	250,000	810,000	1,060,000
Depreciation at 30 Sept. 2001	600,000	1,300,000	1,900,000

The plant was sold for Rs. 80,000. The loss on disposal and the depreciation charges for the year have been included in research and development costs for the year.

Required: Prepare Y Ltd's cash flow statement for the year ended 30 September, 2001 in the form required by IAS7 Cash flow statements. (indirect method) **(20)**

- Q.4 At the beginning of 1997, Mehran Limited received a grant of Rs. 5 million towards the cost of establishing a plant in the Thatta district for a minimum period of five years. The sanction letter states that if the company ceases to use the plant in the Thatta district, it is required to repay the grant less Rs. 1 million for each completed year of use.

The cost of the plant before the deduction of the grant was Rs. 15 million and the plant has a useful life of 10 years. The company uses the straight line method of depreciation.

At the beginning of 2000, following a re-organization of its operations, the company moved the plant to Karachi.

Required: How would the amount refunded be treated in the 2000 accounts if:

- the grant received was treated as deferred income; or
- as a deduction in arriving at the carrying amount of assets.

(07)

Q.5 Following is the list of assets and liabilities of A Ltd for the year ended December

	<u>Rs. (000)</u>
Investments – Long terms	2
Loan to employees:	
Current	35
Long term	30
Deposits given:	
Current	4
Long term	9
Trade debts	253
Other receivables	43
Cash & bank balances	497
Short term running finance	194
Long term bank loan	1,000
Creditors, accrued & others liabilities	2,100
Dividend payable	1,100
Open letters of credit	690

Note : Short term running finance and long-term loan carry interest @ 15% and 9% respectively.
There are no other interest bearing assets or liabilities.

Required: Prepare a suitable note to the financial statement in accordance with the requirement of IAS32 – Financial Instruments : Disclosure and Presentation. (10)

Q.6(a) Pak Limited has a branch in the United Kingdom which is integral to the operations of the company. The balance sheet of the branch at 31 December 2000 includes the following items, measured on the following bases:

- An office building carried at market value of Pound Stg.50,000 less subsequent depreciation of Pound Stg. 2,000. The valuation was carried out at 31 December 1999;
- Fixtures, fittings and office equipment acquired in March 1998 at a cost of Pound Stg. 10,000;
- Inventory purchased from Pak Limited for Pound Stg. 15,000. The cost to Pak Limited was Rs.800,000 and the net realizable value of the inventory at 31 December 2000 is Pound Stg 25,000;
- Receivables of Pound Stg. 20,000; and
- A liability to Pak Limited of Pound Stg 25,000.

Required: How would the above balances be translated in the financial statements of Pak Limited under IAS 21 – The effects of changes in Foreign Exchange Rates. (06)

- (b) Gul Limited decided in the year 2000 to enhance the retirement benefits available to its employees under a defined benefit plan. The actuarially determined cost is Rs.500,000. The amount of the additional benefit is determined by reference to the salaries earned by the participating employees over the last ten years. Rs.320,000 relates to current employees who have an average expected remaining working life of eight years. The balance of Rs.180,000 relates to participating employees who have already retired.

Required: How will Gul Limited deal with the Income Statement and the Balance Sheet consequences of the increased valuation under IAS 19 – Retirement Benefits Costs? (04)

Q.7 You are in the process of finalizing the audit of a large listed company. The audit incharge has prepared the following list of problems which have to be resolved before the accounts for the year

- (a) In respect of the assessment year 2000-2001, the Income Tax Department assessed a tax liability of Rs.66 million which is Rs.8 million in excess of the amount paid by the company. The company disagrees with the tax liability assessed and has filed an appeal under section 156 of the Income Tax Ordinance 1979 and an application under section 129 of the Income Tax Ordinance 1979 with the Appellate Authority. The Commissioner of Income Tax and is confident that the same would be decided in favour of the company. (02)
- (b) The company is committed to pay the following rentals under non-cancellable operating lease agreements in respect of property and vehicles.

<u>Year</u>	<u>Rs.'000</u>
2002	1,121
2003	676
2004	152

(02)

- (c) A fire broke out at the company's godown on July 7, 2001. The stocks were completely destroyed. The destroyed stocks were not insured. (02)
- (d) Machinery with a book value of Rs. 1 million was disposed off on July 10, 2001 for Rs.100,000. (02)
- (e) The market value of short-term investments (book value Rs.500,000) was Rs.510,000 on June 30, 2001. However, this value declined significantly after the balance sheet date and was Rs.250,000 on July 15, 2001. (02)
- (f) The currency in which foreign currency deposits were held was substantially devalued on July 1, 2001. (02)
- (g) One of the company's employee was injured in the fire. Investigations indicate that the fire occurred due to short circuiting. The electricity inspector had earlier drawn the management's attention towards the faulty wiring in the company's premises, but his report was ignored. The company's lawyer had advised that the employee has a very strong case. However, the lawyer is unable to estimate the likely financial damages in the absence of further medical evidence. (04)
- (h) One of the company's customer is claiming compensation for losses sustained as a result of a delayed delivery. The customer had ordered a special brand of paper with the intention of producing brochures for a sales campaign. There was a delay in supplying the paper and the brochures could not be prepared in time. The company's lawyers have advised that there was no specific agreement to supply the goods in time for this campaign and furthermore, that it would be almost impossible to attribute the failure of the sales campaign to the delay in the supply of the paper. (04)

Required: Explain how each of these matters should be dealt with in the published accounts for the year ended June 30, 2001 in the light of the International Accounting Standards. Assume that the amounts involved are material in every case.

Q.8 Indus Limited entered into an agreement with a consortium of banks for long term finance under mark up arrangements for plant and machinery. The salient features of the agreement are as follows:

	<u>Sales Price</u> (Rs.'000)	<u>Purchases Price</u> (Rs.'000)	<u>Number of Installments and commencement date</u>
Bank A	80,000	140,376	7 half yearly - 31.12.2000
Bank B	75,000	126,652	6 half yearly - 29.06.2001
Bank C	60,000	80,076	7 half yearly - 01.05.2001
Bank D	100,000	163,654	12 quarterly - 30.09.2001
Bank E	150,000	211,520	6 half yearly - 31.12.2002

The installments due during the year were paid on the due dates.

You also ascertain that the arrangements are secured by way of a joint equitable mortgage on all present and future immovable properties on plot A 99 Industrial Area, Karachi, and other assets of the company, excluding inventories and book debts.

Required: Prepare a note to the accounts for the year ended June 30, 2001 meeting the disclosure requirements under the Companies Ordinance, 1984 in respect of these arrangements. (08)