THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2005

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ADVANCED ACCOUNTING & FINANCIAL REPORTING

(MARKS 100)
(3 hours)

Q.1 Chemi Limited (CL) is engaged in manufacturing, purchasing and marketing of chemicals, including investments in other chemical manufacturing operations.

During the year ended 31 December 2004, CL changed its accounting policy with respect to the following:

(i) In previous years, investments in associates were based on fair value method, where such investments were initially recognized at cost and carried at fair value to the balance sheet. Fair values of investments were determined on the basis of market value at the balance sheet date. Adjustments arising from re-measurement to fair value were reflected through statement of changes in equity. This policy has been changed to bring it in line with the Group's policy which states that investments are initially recognized at cost and at the subsequent reporting dates, the recoverable amounts are estimated in order to determine the extent of impairment losses and carrying amounts of investments are adjusted accordingly. Impairment losses are recognized as expenses.

(ii) Upto previous year, dividends and other distributions proposed after balance sheet date but before the financial statements were authorized for issue were recorded as liability. After the change in the 4th Schedule of the Companies Ordinance 1984, from the current year onwards, dividends and other distributions are to be recognized as a liability in the period in which they are declared.

Following information is available from the financial statement of CL:

	2004	2003	2002
Market value of shares of A Limited an associated company as at 31st December (Rupees per share)	45	47	50
Recoverable amount as per IAS 36 of A Limited (Rupees per share)	40	44	48
Net profit after tax as per old policy (Rupees in thousand)	4,004,044	3,144,509	Not given
Capital Reserves – (Rupees in thousand)	160,000	160,000	Not given

Dividend declaration has been as under:

For 2002 declared in 2003	Rupees 8.00 per share
For 2003 declared in 2004	Rupees 10.00 per share
For 2004 declared in 2005	Rupees 12.00 per share

Bonus shares declared and issued in 2003 @ 15%
Share Capital of CL as at 1 January 2003 – 256, 495,902 shares of Rs. 10 each
Unappropriated profits as at 1 January 2003 – Rs.8,218,203,000
Investment in A Limited - 100 million shares at Rs.50 per share.
The effective tax rate applicable to the company may be assumed at 35%.

Required:

A statement of changes in equity for the year ended 31 December 2003 and 2004 as per IAS 8 together with relevant notes. (You may round off all rupee figures to the nearest thousand). **(20)**

Q.2 Ahmed Limited (AL) is a manufacturer of leather shoes and allied products. On January 1, 2003 it acquired the shares of the following companies:

- Bilal Limited (BL) – 90% voting interest;
- Jamal Limited (JL) – 60% voting interest.

BL further acquired 30% shares of JL on January 1, 2004.

Following balances appear in the books of AL, BL and JL as at December 31, 2004:

	AL	**BL**	**JL**
		Rupees in thousands	
Investment in BL	500,000	-	-
Investment in JL	250,000	150,000	-
Plant and machinery	680,000	648,800	500,000
Equipment	-	1,200	-
Liabilities	(300,000)	(110,000)	(100,000)
Capital	(600,000)	(450,000)	(300,000)
Retained earnings	(400,000)	(120,000)	(80,000)
Dividends declared	200,000	20,000	10,000
Sales	(1,200,000)	(800,000)	(600,000)
Cost of sales and expenses	894,000	663,000	570,000
Dividend income	(24,000)	(3,000)	-

Other information relating to past period is as follows:

Retained earnings (January 1, 2003)	(300,000)	(90,000)	(40,000)
Net profit for 2003	(140,000)	(60,000)	(50,000)
Dividend declared 2003	40,000	30,000	10,000
Retained earnings (December 31, 2003)	(400,000)	(120,000)	(80,000)

Note: Figures in brackets represent credit balances.

Required:

You are required to prepare consolidated balance sheet and profit and loss account for the year ended December 31, 2004. **(18)**

Q.3 (a) Explain the terms contingent liabilities and contingent assets as per IAS 37.

(b) AAR Limited started to operate an offshore oilfield on January 1, 2004. Following are some of the events which took place during the year:

(i) The head office of the company was set up in a small house leased under an operating lease agreement. On December 31, 2004 AAR relocated its head office to another location. The lease on the old head office continues for the next two years. As per the agreement it cannot be cancelled or re-let to another user. Monthly rental of the house is Rs.50,000.

(ii) AAR's licensing agreement to operate offshore oilfield requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the year-end, the rig has been constructed but no oil has been extracted. The cost of removing rig and restoration of seabed is estimated to be Rs.10.0 million in present value terms at the end of 10^{th} year of operation.

(iii) Under new legislation, AAR is required to fit smoke filters to its refinery by the end of 2004. The cost of such filters is Rs.1.0 million, which has not been incurred till the year-end. The penalty in case of non-compliance is Rs.0.5 million.

(iv) AAR has announced a detailed formal plan to restructure its refinery business which gives rise to constructive obligation. As a result of this restructuring the company will have to face future operating losses of Rs.15.0 million in present value terms.

Required:

Give the treatment for the aforesaid events under the relevant accounting standards together with the basis for the same. **(10)**

Q.4 Market Searchers Limited (MS) had 5.0 million ordinary shares at the beginning of the year 2002. In the month of February 2003, it announced a right issue of one new share for each five shares issued at the exercise price of Rs.5.00 per share with the last date of exercise of right being March 1, 2003. Fair value of one ordinary share prior to exercise on March 1, 2003 was Rs.11.

Moreover, it issued 500,000 convertible bonds on January 1, 2004. Each block of 10 bonds is convertible into 3 ordinary shares. Interest expense for the year 2004 relating to the liability component of the convertible bond is Rs.10.0 million. Current and deferred tax relating to that interest expense is Rs.4.0 million. Interest expense includes Rs.1.0 million being the amortization of discount arising on initial recognition of the liability component as per IAS 32.

Net profits for the year ended on December 31 of each year are as follows:

- 2002 – Rs.1,100 million
- 2003 – Rs.1,500 million
- 2004 – Rs.1,800 million

Required:

(a) Compute earnings per share for the years 2002, 2003 and 2004 as per IAS 33.
(b) Discuss whether or not the financial instruments or other contracts that may be settled by payment of financial assets or issuance of ordinary shares of the reporting enterprise, at the option of the issuer or the holder are deemed to be potential ordinary shares under IAS 33. **(05)**

Q.5 (a) An enterprise agrees to enter into a new lease agreement with a new lessor. The lessor agrees to a rent free period for the first three years as incentive to the lessee for entering into the new lease. The new lease has a term of 20 years, at a fixed rent of Rs.200,000 per year from year 4 to 20. Determine the amount of expense to be charged by the lessee for the first three years and the remaining 17 years. What amount would the lessor recognize as income from year 1 to year 20? **(05)**
(b) Give disclosure requirements for the 'Discontinued Operation' under IFRS 5. **(05)**
(c) Discuss the implication of change in accounting policy in interim financial reporting requirements. **(05)**

Q.6 Pearl Bank Limited has local currency deposits of Rs.1,300 million which includes remunerative deposits from financial institutions of Rs.400 million as at 31st December 2004. It also has foreign currency deposits of Rs.200 million. Deposits from customers, other than financial institutions, are fixed, savings and current deposits of Rs.100 million, Rs.700 million and Rs.300 million respectively.

Included in the above deposits are deposits from individuals Rs.300 million, business and professionals Rs.250 million, textile companies Rs.400 million, pharmaceutical companies Rs.100 million and others Rs.50 million.

Required:

You are required to give necessary disclosures in the financial statements of Pearl Bank on the basis of above information in line with those under the Banking Companies Ordinance, 1962. **(10)**

Q.7 (a) State the items which should be reconciled while preparing a reconciliation between the information disclosed for reportable segment and the aggregated information in the consolidated or enterprise's financial statement as per IAS-14. **(04)**
(b) The following information pertains to Star Corporation and its operating segment for the year ended June 30, 2004.

Operating Segment	Revenue	Profit	Assets
A	10,000,000	1,750,000	20,000,000
B	8,000,000	1,400,000	17,500,000
C	6,000,000	1,200,000	12,500,000
D	3,000,000	550,000	7,500,000
E	4,250,000	675,000	7,000,000
F	1,500,000	225,000	3,000,000
	32,750,000	5,800,000	67,500,000

Required:

Indicate which of the above segments would be treated as reportable operating segment in segment information for 2004. Also mention criteria for each case separately. **(03)**

(THE END)