THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations Autumn 2006

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FINANCIAL ACCOUNTING (MARKS 100)

Module C **(3 hours)**

Q.1 Following is the abridged balance sheet of Platinum International Traders Limited as at June 30, 2006.

	Rs. In Million 2006	2005
Property, plant and equipment	10,500	10,000
Intangible assets	1,200	1,000
Short term investments	750	500
Stocks	1,290	1,000
Trade receivables (net of provisions)	450	400
Advances and deposits	200	200
Cash and bank balances	160	100
Bank overdraft	400	200
Creditors and other liabilities	500	400
Provision for taxation	2,250	1,500
Net Equity and Surplus on Revaluation of Fixed Assets	11,400	11,100

The following additional information is also available:

(i) Accounting profit after tax is Rs. 3,000,000.
(ii) Income tax paid during the year amounted to Rs. 1,000,000.
(iii) Depreciation for the year is Rs. 750,000.
(iv) Provision for doubtful debts at the end of the year amounted to 5% of closing balance of trade receivables. The opening balance of the provision was NIL.
(v) 48,000 shares were issued during the year at a premium of Rs. 2.50 per share. Face value of the company's share is Rs. 10.
(vi) Markup paid during the year amounted to Rs. 500,000.
(vii) An old machine having book value of Rs. 500,000 was exchanged with a new machine costing Rs. 950,000. The company paid Rs. 350,000 as the difference. No other fixed asset was sold during the year.
(viii) Intangibles are amortized at 35% of book value.
(ix) The company revalues its major fixed assets periodically. A revaluation carried out during the year showed that the value of fixed assets had declined by Rs. 3,300,000. The amount was charged against surplus recorded in earlier years.

Required:
Prepare a cash flow statement under 'indirect method' in accordance with IAS-7. Also submit necessary workings. **(16)**

Q.2 Mr. Potassium, Radium and Uranium are partners in PRU & Company sharing profit in the ratio of 3:2:2. The firm has been doing excellent business for last many years and its products have a good reputation in the market. They decided to convert the firm into a company limited by shares with the name and style of Iron Limited. The final balance sheet of the firm immediately before the process of conversion was as under:

PRU & Company
Balance Sheet as at June 30, 2006

		Rs. in '000
Fixed Assets – Tangible		
Building	25,000	
Machinery	75,000	
Vehicle	10,000	
Furniture	12,000	
		122,000
Fixed Assets – Intangible		
Manufacturing Quota		7,000
Current Assets		
Stocks	23,000	
Trade Debtors	18,000	
Bank balances	4,000	
		45,000
Current Liabilities		
Trade Creditors	11,000	
Other liabilities	2,000	
		13,000
Net Assets		**161,000**
Represented by:		
Mr. Potassium	69,000	
Mr. Radium	46,000	
Mr. Uranium	46,000	
		161,000

The conversion was carried out on the following terms and conditions:

(i) A friend of the old partners, Mr. Calcium contributed 2,000,000 shares of Rs. 10 each in the capital of Iron Limited. He paid Rs. 20,000,000 to the company as share subscription money.
(ii) Mr. Radium was not willing to continue as equity-holder. Therefore, 480,000 long term debentures of Rs. 100 each were issued by Iron Limited against his capital in the partnership.
(iii) The company issued 14,000,000 fully paid shares of Rs. 10 each including the shares issued to Mr. Calcium.
(iv) Shares issued to the continuing partners are exactly in proportion to their final capital account balances after incorporating realization gain or loss.
(v) Other liabilities were not assumed by Iron Limited. These were fully settled by PRU & Company through cash payment of Rs. 1,800,000.
(vi) Trade debts amounting to Rs. 2,500,000 were considered as bad.

(vii) Vehicles having carrying value of Rs. 3,500,000 were not taken over by Iron Limited. PRU & Company sold these vehicles for Rs. 2,800,000.
(viii) Manufacturing quota has a ready market of Rs. 8,600,000.
(ix) The firm owns a patent right which has an estimated value of Rs. 2,100,000. Presently it is being carried by PRU & Company at nil value.
(x) All assets including cash and bank balances were taken over, and all liabilities towards trade creditors were assumed by Iron Limited after incorporating the above adjustments.
(xi) Goodwill is to be accounted for in the books of Iron Limited, if necessary.

July 01, 2006 may be assumed to be the effective date of all the above transactions.

Required:
Prepare the following:
(a) Realization Account.
(b) Statement of shareholding in Iron Limited.
(c) Balance sheet of Iron Limited as at July 01, 2006. **(16)**

Q.3 The Chief Accountant of Shaheed & Company (Pvt.) Limited has resigned. Management has hired you to prepare the balance sheet as at June 30, 2006 and the profit and loss account for the year then ended. The records of the company have not been maintained properly. While going through some of the files you found a report in which the following ratios and information have been shown.

Current Ratio	1.50
Liquid/Quick/Acid test ratio	1.00
Stock turnover ratio	14.40
Gross profit	20%
Return on combined equity (ROCE)	20%
Return on equity (ROE)	27.2%
Debt collection period (months)	1.00
Revenue reserve as a percentage of capital	25%
Cost of goods sold to fixed assets	1.92

The management has informed you that the above ratios are mostly accurate. You have also ascertained that the sale during the year was Rs. 216 million and selling & administrative expenses amounted to Rs. 14.057 million. Tax rate applicable to the company is 30% of net profit and 90% of the tax has been paid during the year.

Required:
Develop a summarized balance sheet as at June 30, 2006 and profit and loss account for the year then ended. **(11)**

Q.4 Copper Leasing Limited engaged in leasing of high cost sports equipment undertook following transactions on June 01, 2006.

(i) A speed boat of a famous brand ABC was given on 3 years lease to Mr. Carbon at an annual lease rental of Rs. 215,365 payable at the end of each year.

(ii) A motor boat of XYZ make was leased to Ms. Chlorine at an annual rent of Rs. 1,040,886 payable at the end of each year for three years. The price charged in case of outright sale is Rs. 2,500,000.

(iii) A water bike of XYZ make was leased to Mr. Sulphur at an annual rent of Rs. 98,763 payable at the end of each year. The agreed lease term is three years. Outright sale price of this bike is Rs. 250,000.

(iv) The following additional information is available:

- The company is also a sole dealer of XYZ make in the city and operates an outlet for that purpose.
- At the above outlet 25% area is used as company's administrative office.
- Outlet's rent and other maintenance expenditures are approximately Rs. 660,000 per month.
- Marketing staff is given a commission at 2% of price of goods whether they are leased or sold outright.
- The company paid Rs. 3,770 to a local authority, for inspection of each unit.
- Registration charges incurred by the company for each unit of speed boat, motor boat and water bike were Rs. 3,500 Rs. 22,500 and Rs. 2,000, respectively.
- Cost of speed boat, motor boat and water bike were Rs. 500,000 Rs. 2,400,000 and Rs. 230,000, respectively.
- The ownership is transferred to lessees at the end of the lease.
- The company charges 9% markup on leases of water bikes as against prevailing market rate of 11%.

Required:

(a) Compute 'gross investment in lease' and 'unearned financial income' in respect of each lease. **(13)**

(b) Prepare all necessary journal entries on June 01, 2006 and on receipt of first rental. **(07)**

Note: Present values of an annuity of Re. 1 received at the end of the year for three years are as follows:

Rate	8%	9%	10%	11%	12%	13%	14%
Present Value	2.5771	2.5313	2.4869	2.4437	2.4018	2.3612	2.3216

Q.5 Gold Shoes Limited, a company engaged in manufacturing of pure and artificial leather shoes has been facing a sharp decline in their profits for few years due to severe competition from shoes imported from China. The board of directors of the company formed a committee of executives to look into the matter. A detailed plan was submitted by the committee, which was considered and approved by the board on May 08, 2006. The approved plan has been circulated to members and other stakeholders.

The following activities have taken place subsequently:

(i) Production of artificial leather shoes was discontinued and a number of new designs of leather shoes were introduced from July 2006.

(ii) Some processing units having book value of Rs. 35 million have been sold, at a price of Rs. 31 million in July 2006.

(iii) Certain work force was terminated in June 2006 for which payment of compensation of Rs. 10.5 million was agreed with the union in July 2006.

(iv) Company's legal advisor has been asked to prepare various sale agreements of fixed assets and stocks, preparation of memorandums of understanding with the distributor and workers union etc. related to discontinued business. The legal advisor charged Rs. 0.2 million as fee in addition to his monthly retainership fee amounting to Rs. 0.05 million in July 2006.

(v) Stock of artificial leather shoes available in company's store on June 30, 2006, costing Rs. 11 million was sold in first week of July 2006 to the sole distributor of the company at an agreed price of Rs. 12 million.

(vi) In July 2006 total assets of Peshawar office, having carrying value of Rs. 1.8 million on June 30, 2006 were agreed to be sold to a party for Rs. 2 million.

(vii) Purchase of additional machinery costing Rs. 3 million was approved in July 2006, for which a valid and firm quotation was received from the supplier in June 2006.

(viii) Manager of Peshawar office was transferred to Islamabad due to closure of Peshawar office in July 2006. A relocation compensation of Rs. 0.5 million is agreed.

(ix) Certain workers of the discontinued unit were given the option to continue their employment subject to successful completion of a specific training from a reputed institute. They completed the required training in June 2006. In July 2006 the company as a gesture of good relations reimbursed 75% of their training expenditure, which amounted to Rs. 0.50 million.

(x) It has been estimated, with reasonable accuracy, that as a result of the sale promotion and marketing costs of new designs of shoes, there will be an operating loss of Rs. 8 million by the time the whole process is completed (sometimes in December 2006).

Required:
Explain how each of the above matters will be recorded in the financial statements clearly indicating whether:

- a provision will have to be made; or
- a disclosure will be required; or
- neither provision nor disclosure is necessary.

Give reasons to support your opinion. (No journal entries are required to be made). **(15)**

Q.6 You have recently been appointed as the Chief Accountant of Steel Air Limited, a commercial airline. Your accountant has prepared the financial statements for the year ended June 30, 2006. You have reviewed them and found them satisfactory except for the note on tangible fixed assets. You have scrutinized the records and extracted the following information:

(i) The company acquired land on 99 years lease on January 1, 1999 for Rs. 200 million.

(ii) The company has a fleet of nine aircrafts, relevant details of which are as under:

- Each aircraft consists of two major components i.e engine and airframe having useful economic life of 20 and 12 years respectively. 70% of the cost of aircrafts pertains to the engine and 30% to the airframe. The company has 10 years replacement policy for airframes.

- Five aircrafts were acquired on January 1, 2000 for Rs. 220 million each.

- Four used aircrafts were also bought on January 1, 2000 from another airline for Rs. 55 million each. Each aircraft was renovated and overhauled at a cost of Rs. 25 million. Rs. 10 million were spent on the airframe and Rs. 15 million on the engine. 15% of these expenditures has been in respect of costs of consumables. The useful economic lives of engines and airframes are estimated to be the same as those of the new aircrafts.

- Salvage value of engines as well as the airframes is estimated at 10% if sold at the end of their economic life. Salvage value of airframes at the time of replacement is estimated at 15% of the cost.

- A newly acquired aircraft was damaged during landing due to computer malfunction on October 31, 2005. It remained in-operative during the remaining period of the year. However, it does not require any revaluation.

(iii) Engineering machineries were acquired on April 01, 2000 for Rs. 330 million. As a result of annual checkup, certain parts were replaced at a cost of Rs. 50 million on July 01, 2005. This replacement did not enhance the useful life nor did it affect the efficiency of the machineries. New parts have a useful life of 30,000 hours. Cost of replaced defective parts was Rs. 20 million and they were sold for Rs. 8 million.

Total useful life of machinery is 60,000 hours and the average usage has been 500 machine hours per month. Estimated salvage value is 10% of cost.

(iv) Hangers for aircrafts have been in use since July 1, 2000. The total cost of their construction was Rs. 20 million and the total estimated useful life is 20 years.

(v) Furniture and fixtures costing Rs. 13 million, Rs. 7 million and Rs. 4 million were acquired on July 01, 2000, July 01, 2002 and July 01, 2005 respectively.

(vi) Ten vehicles were taken on finance lease on July 1, 2005 with fair market value of Rs. 1 million each.

(vii) The company's policy as regards depreciation is as under:

- Leasehold land – straight line method.
- Hangers – straight line method.
- Aircrafts – straight line method.
- Engineering plant and equipment –machine hours used.
- Leased vehicles – declining balance method at the rate of 20% per annum.
- Furniture and fixture – declining balance method at the rate of 10% per annum.

Required:
Draft a note to the accounts on fixed assets strictly in accordance with the requirements of International Accounting Standards and the Companies Ordinance, 1984. Also submit necessary workings. (Give all figures to the nearest thousand) **(22)**

(THE END)