THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations Spring 2006

March 06, 2006

FINANCIAL ACCOUNTING **(MARKS 100)**

Module C **(3 hours)**

Q.1 Following is the trial balance of Shams Limited, a public quoted company, as at June 30, 2005:

Particulars	Debit Rs. in '000'	Credit Rs. in '000'
Ordinary share capital		30,000
Land	12,000	
Building	22,000	
Office furniture and equipment	5,500	
Investments	13,000	
Advance tax deducted by a customer	800	
Trade debtors	4,000	
Other receivables	6,000	
Prepayments	2,000	
Bank overdraft		9,400
Trade creditors		2,500
Accrued expenses		1,000
Long term loans from banks		15,000
Sales		117,000
Administrative and selling expenses	21,000	
Profit on investment		1,800
Dividend paid	1,500	
Interest expenses on bank overdraft	500	
Purchases (merchandise)	86,000	
Other direct expenses	2,400	
	176,700	**176,700**

Some other relevant information is as under:

i) Company has authorized share capital of Rs. 100,000,000 divided into 10,000,000 ordinary shares.

ii) The store department reported closing value of stores at Rs. 1,800,000 that includes stock in trade amounting to Rs. 1,650,000.

iii) Trade debts include credit balance of a customer amounting to Rs. 100,000.

iv) A long term loan amounting to Rs. 17,500,000 was obtained from a bank on September 25, 2004. The principal is payable in equal installments on 25th of March and September each year. It carries a markup of 12% payable with each installment.

v) Interest on long term loan paid with the first installment was wrongly debited to administrative and selling expenses.

vi) The land was revalued on June 30, 2005 at Rs. 18,000,000 and directors approved the revaluation.

vii) Depreciation is charged on building at 5% and on office equipment and furniture at 10% per annum. These assets were acquired on October 01, 2004.

viii) Investments include some securities amounting to Rs. 4,500,000 maturing on August 31, 2006.

ix) The directors approved and declared a 5% interim stock dividend on June 18, 2005. The shares were allotted on June 28, 2005 but no certificate has yet been issued to any shareholder.

x) The company has signed another long term loan agreement amounting to Rs. 5,000,000 with a bank in May, 2005 whereby the bank has given firm commitment of its disbursement on or before June 05, 2005. However, actual disbursement was made on July 05, 2005.

xi) The tax rate applicable to the company is 35%. However, tax on profit on investment is payable at the rate of 20%.

Required:

You are required to prepare balance sheet, profit and loss account and statement of changes in equity (without any notes to the accounts) for the year ended June 30, 2005 under the Companies Ordinance, 1984. Please also submit important workings and computations. **(24)**

Q.2 Qamer Trading Company Limited is facing a litigation due to an alleged breach of contract. The directors have made the following assessment about the damages:

Particulars	**Probability**
i) The contract contains a clause that prescribes damages of Rs. 5,000,000 in case of default.	60%
ii) The company has incurred a sum of Rs. 600,000 as legal expenses, of which 50% is recoverable in case of a favourable decision.	40%
iii) The plaintiff has claimed Rs. 1,000,000 as legal expenses.	40%
iv) The plaintiff has also claimed Rs. 500,000 as interest on damages.	5%

Required:

Explain how the above information would affect the financial statements of the company. **(06)**

Q.3 Following information has been extracted from the books of Sayyarah Limited.

i) The company, to curb the sharp decline in sales of its products 'Y' and 'Z', paid Rs. 1.7 million to a consulting company for improvement in the design of the products, if possible.

ii) On the basis of consultant's report, production of ‘Z’ was discontinued. The consultant had suggested three new designs for 'Y'. One of them was selected and company incurred Rs. 0.65 million on new moulds and patented the design at a cost of Rs. 0.3 million. 60% of the fee payable to the consultant is directly attributable to ‘Y’.

iii) Manufacturing license of product 'Z' is expiring on June 30, 2008 and has a book value of Rs. 0.5 million. This license is not transferable.

iv) The company paid Rs. 1.0 million to an agency for an advertisement campaign for product 'Y' that increased the company's sales substantially and there is a strong evidence that it will also bring net cash flow of Rs. 6.5 million in the next year. Thereafter its impact will be insignificant.

v) Product 'T' is one of the top brands of the company and bears a good market reputation. The brand is currently being reported at zero value in the financial statements despite the fact that the company incurred Rs. 3 million on setting up a brand development department exclusively for the said item. This year company has a firm offer for the said brand amounting to Rs. 12 million from another financially sound company.

Required:

Suggest accounting treatment with brief reasons, in respect of each of the above information. **(14)**

Q.4 The books and other records of Sitara Constructions Limited, the contractor contain the following information:

Particulars	Contract A	Contract B
Date of commencement	1-Jan-05	1-Jul-04
Date of completion	31-Dec-05	31-Oct-05
Work certified by the surveyors	58%	Not available
	Rs. in '000'	
Contract Price	120,000	150,000
Cost incurred upto June 30, 2005		
Wages	49,140	64,800
Materials issued to site	17,640	52,920
Other costs	7,200	14,550
Machinery and equipment costs	12,000	18,000
Closing balance of material at site	3,900	675
Amount billed according to agreement	65,000	141,000
Expected additional cost to complete the projects		
Wages	28,860	2,700
Materials	7,560	1,080
Other costs	2,400	450

Some other information is as under:

i) According to the company’s policy, certification of work has primary importance in computing interim profits on a contract-in-process.

ii) The contracts signed with the respective customers contain a clause that prescribes that in case of delay, penalty equal to 2% of the contract price will be imposed on the contractor for each month. Whereas, in case of early completion the contractor will be given a bonus at the similar rate. Contractor is very much confident that both the contracts will be completed 30 days before schedule.

iii) According to the terms of the contracts, all machinery and equipment used for Contract A and B will be acquired by the respective customers at an agreed price of Rs. 8,400,000 and Rs. 12,000,000 respectively, at the end of the contract.

Required:

(a) Compute 'gross profit' and 'contract revenue earned' attributable to each contract for the year ended June 30, 2005. **(13)**

(b) Prepare separate contract accounts in the books of the contractor. **(08)**

Q.5 Following information is available from the financial records of Marreekh Limited:

i) The life of a plant purchased on July 01, 2003 for Rs. 24 million, was estimated by a valuation consultant at 4 years with no residual value. The depreciation for the year ended June 30, 2004 was provided accordingly. On June 30, 2005, in view of changed circumstances, the same consultant revised the previous estimates and suggested remaining life of 4 years and residual value at Rs. 2 million.

During the year 2004-05 certain equipments remained idle for ten months due to company's engagement in executing a profitable order of a product for which these equipments were not needed at all. These equipments have six years remaining life on July 01, 2004 and residual value of Rs. 0.5 million.

The accountant of the company has prepared the financial statements for the year ended June 30, 2005 alongwith the notes. An extract from the note related to fixed assets is given below:

(Rs. in million)

Particulars	**Cost as at June 30, 2005**	**Depreciation**			**WDV**
		Opening	**Current**	**Closing**	
Land	13.0	-	-	-	13.0
Building	25.0	4.0	0.5	4.5	20.5
Plant	24.0	*4.4	4.4	8.8	15.2
Equipments remained idle during the year	3.0	1.0	-	1.0	2.0
Other equipment	10.0	4.0	1.0	5.0	5.0
	75.0	13.4	5.9	19.3	55.7

*The accountant has credited the change in opening balance to other income.

(ii) The company was holding some stock of merchandise amounting to Rs. 5 million on behalf of its principal. Due to mishandling, quality of the said merchandise was significantly affected. The technical staff has not yet finalized its estimation of loss due to extra ordinary complexity involved in assessment of quality of the damaged merchandise. The financial statements are due for approval in the next few days. Therefore, accountant of the company has made provision for the whole amount, as the company acknowledges its default.

(iii) The company is also engaged in trading of certain products, which were valued at the year end, as follows:

Prod.	Quantity	Per unit			Net Realizable Value	Value	
		Cost	Freight in	Total		Per unit	Rs.
A	5,400	45	2	47	42	42	226,800
B	2,500	18	3	21	20	20	50,000
C	1,450	56	8	64	65	65	94,250
D	7,000	32	11	43	41	41	287,000
E	6,500	121	5	126	170	170	1,105,000
							1,763,050

During the year the accountant has debited the amount of transit insurance aggregating to Rs. 1.5 million to prepayments account. The rate of premium is 3% of the purchase price.

Required:

Pass necessary entries to rectify the errors, if any, according to the principles laid down in International Accounting Standards. Also submit necessary workings. **(15)**

Q.6 On January 1, 2005, partners of Chand & Company and Suraj & Company agreed to merge their businesses. The new firm is to be called CS & Company. The balance sheets as on December 31, 2004 showed the following position:

	Chand & Co.	Suraj & Co.
	Rs. in '000'	
Capital accounts		
- A / R	6,000	6,000
- B / S	4,500	3,000
- C	3,000	-
	13,500	9,000
Loan - R	-	3,000
Current accounts		
- A / R	1,200	25
- B / S	930	875
- C	270	-
	2,400	900
Creditors	1,350	1,650
	17,250	14,550
Fixed assets		
Land	2,250	2,625
Plant, equipment and fixtures	1,875	1,500
	4,125	4,125
Current assets		
Debtors	10,500	9,000
Stock in trade	1,350	1,125
Cash	1,275	300
	13,125	10,425
	17,250	14,550

For the purpose of merger the following was agreed:

i) The initial capital of new firm would be Rs. 27.0 million. 50% of the capital shall belong to partners of Chand & Co. and 50% to partners of Suraj & Co.

ii) 50% share belonging to partners of each firm shall be allocated between its partners in the ratio of their capital in the old partnership.

iii) No further cash is to be inducted in the new firm by the partners.

iv) Plant, equipment and fixtures are to be taken over by the new firm as follows:

- from Chand & Co.	Rs. 900,000
- from Suraj & Co.	Rs. 750,000

v) Debtors are to be taken at 95% of their book value. Stock in trade shall be valued at 10% below its book value. Liability towards the creditors of both firms and the liability in respect of loan from Mr. R shall be assumed by the new firm.

vi) Each partner in the firm shall receive a salary of Rs. 500,000 per month, interest on capital at 8% per annum and the remaining balance of profit shall be shared in proportion to their share in the capital.

The firms were merged according to the above agreement effective January 01, 2005.

During the year 2005 the firm earned a profit of Rs. 56,201,000 before salaries, interest and appropriations.

Each partner made monthly drawings of Rs. 450,000 per month and quarterly drawings equal to 5% of the capital.

Required:

a) Draw 'realization account' of each firm. **(05)**

b) Prepare the initial balance sheet of CS & Company i.e. immediately after the merger. **(10)**

c) Compute partners' current account balance of CS & Company for the year ended December 31, 2005. **(05)**

(THE END)