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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations   Spring 2009

March 5, 2009

FINANCIAL ACCOUNTING (MARKS 100)
Module C (3 hours)

Q.1 Zouq Inc. is a multinational company. As part of its vision to expand its business in South Asia, it purchased majority shares in a locally incorporated company, Momin Limited. Following are the brief details of the acquisition:

Date of acquisition	January 1, 2007
% of shares acquired by Zouq Inc.	90%
Total paid up capital of Momin Limited (Rs. 10 each)	500,000,000
Purchase price per share	Rs. 30
Net assets of Momin Limited (as per 2006 audited financial statements)	650,000,000
Fair value of net assets (other than intangible assets) of Momin Limited	1,100,000,000

Momin Limited has an established line of products under the brand name of "Badar". On behalf of Zouq Inc., a firm of specialists has valued the brand name at Rs. 100 million with an estimated useful life of 10 years at January 1, 2007. It is expected that the benefits will be spread equally over the brand's useful life.

An impairment test of goodwill and brand was carried out on December 31, 2007 which indicated an impairment of Rs. 50 million in the value of goodwill. However, impairment test carried out on December 31, 2008 indicated an increase of Rs. 30 million in the carrying value of goodwill and a decrease of Rs. 13.5 million in the carrying value of the brand.

Required:
(a) What are the requirements of International Accounting Standards relating to amortization of intangible assets having finite life?
(b) Prepare the ledger accounts of the Goodwill and the Brand, showing initial recognition and all subsequent adjustments. **(15)**

Q.2 Akber Chemicals (Pvt.) Limited is engaged in the business of manufacture and sale of different type of chemicals. The following transactions have not yet been incorporated in the financial statements for the year ended June 30, 2008:

(a) On June 15, 2008, one of its tankers carrying chemicals fell into a canal, thus polluting the water. The company has never faced such a situation before. The company has neither any legal obligation to clean the canal nor does it have any published environmental policy. In a meeting held on July 26, 2008 the Board of Directors decided to clean the canal, which is estimated to cost Rs. 5.5 million.
(b) During the second week of July 2008, a significant decline in the demand for company's products was observed which also led to a decrease in net realizable value of finished goods. It was estimated that goods costing Rs. 25 million as at June 30, 2008 would only fetch Rs. 23 million.
(c) On June 21, 2008, a customer lodged a claim of Rs. 2 million with the company as a consignment dispatched on June 1, 2008 was not according to the agreed specifications. The company's inspection team found that this defect arose because of inferior quality of raw materials supplied by the vendor. On June 28, 2008, the company lodged a claim for damages of Rs. 5.0 million, with its vendor, which include reimbursement of the

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cost of raw materials. The company anticipates that it will have to pay compensation to its customer and would be able to recover 50% of the amount claimed from the vendor.

Required:
Discuss how Akber Chemicals (Pvt.) Limited would deal with the above situations in its financial statements for the year ended June 30, 2008. Explain your point of view with reference to the guidance contained in the International Financial Reporting Standards. **(13)**

Q.3 Jalib Industries Limited is a listed company. The relevant information contained in the financial statements for the year ended December 31, 2008 is as follows:

Statement of Financial Position

	2008	2007
	Rupees in million	
Non Current Assets		
Property, plant and equipment	129.40	100.60
Capital work in progress	22.50	37.00
	151.90	137.60
Current Assets		
Stock in trade	531.80	451.00
Trade debts	28.50	24.70
Advances and other receivables	37.40	42.00
Cash and bank	12.00	3.00
	609.70	520.70
	761.60	**658.30**
Equity		
Issued, subscribed and paid-up capital	396.00	300.00
Share premium	45.00	12.00
Unappropriated profit	142.60	163.00
	583.60	475.00
Long Term Liabilities		
Deferred liabilities	40.80	27.50
Long term loans	80.00	100.00
	120.80	127.50
Current Liabilities		
Current portion of long term loans	18.00	20.00
Creditors, accrued and other liabilities	36.20	34.40
Dividend payable	3.00	1.40
	57.20	55.80
	761.60	658.30

Statement of Comprehensive Income

	2008
	Rupees in million
Sales	2,535.00
Cost of goods sold	(1,774.50)
Gross profit	760.50
Operating expenses	(554.00)
Financial charges	(10.50)
Loss on sale of fixed assets	(4.60)
	(569.10)
Profit before tax	191.40
Tax expense - Current	(104.60)
- Deferred	(2.20)
	(106.80)
Profit after tax	84.60

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The following supporting information is available:

(i) During the year, an amount of Rs. 42 million was transferred from capital work in progress to property, plant and equipment.

(ii) The company sold property, plant and equipment having book value of Rs. 15 million for Rs. 10.4 million.

(iii) Depreciation for the year amounted to Rs. 27.7 million.

(iv) Trade debts written off during the year amounted to Rs. 1 million. It is the policy of the company to maintain the provision for doubtful debts at 5% of trade debts.

(v) Advances and other receivables include advance tax of Rs. 3.6 million (2007: Rs. 2.2 million).

(vi) Deferred liabilities include deferred tax and provision for gratuity. There was no deferred tax liability at the beginning of the year. Provision for gratuity made during the year amounted to Rs. 15.5 million.

(vii) Creditors, accrued and other liabilities include accrued financial charges amounting to Rs. 5 million (2007: Rs. 6 million).

(viii) On January 15, 2009, the company declared final dividend for the year ended December 31, 2008 comprising 7.5% (2007: 25%) cash dividend and 12.5% (2007: 10%) bonus shares, for its ordinary shareholders.

Required:
Prepare a statement of cash flow for the year ended December 31, 2008 in accordance with the requirements of International Accounting Standards. Show all necessary workings. **(23)**

Q.4 Iqbal, Insha & Co. and Faiz, Faraz & Co. are two partnerships carrying on similar type of business. They agreed to merge the two businesses with effect from March 1, 2009 under the name of Khamis & Co. Partners of both firms were sharing profit and loss in their capital ratio. The respective statements of financial position as at February 28, 2009 were as under:

	Iqbal, Insha & Co.	Faiz, Faraz & Co.
EQUITY	**Rupees in '000'**	
Capital Accounts:		
Iqbal	20,000	-
Insha	40,000	-
Faiz	-	8,000
Faraz	-	24,000
	60,000	32,000
LIABILITIES		
Accounts payable	12,500	10,400
Loan from Iqbal	15,000	-
	87,500	**42,400**
ASSETS		
Land and building	20,200	12,500
Plant and machinery	17,600	7,400
Office equipment	6,500	3,500
	44,300	23,400
Stock in trade	20,300	7,200
Accounts receivable	21,200	10,800
Cash and bank	1,700	1,000
	87,500	**42,400**

The merger agreement contained the following provisions:

(i) A new partner, Mr. Ghalib, is to be inducted with a capital of Rs.15,000 thousand.

(ii) New profit sharing ratio will be as under:

Partner's Name	Iqbal	Insha	Faiz	Faraz	Ghalib
Profit Sharing Ratio	20%	30%	10%	30%	10%

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(iii) Goodwill of both firms is to be valued at 10% of their respective net realizable values (excluding cash).
(iv) The capital of Khamis & Co. will be Rs. 140,000 thousand. The partners will contribute additional cash if required, to bring their capital in proportion to their profit sharing ratio. Any capital which is in excess of a partner's (other than Mr. Ghalib) proportionate share, will be refunded to that partner. In the case of Mr. Ghalib, any additional contribution will be distributed among existing partners in their new profit sharing ratio.
(v) Loan from Iqbal was repaid. All other liabilities are to be taken at their book values.
(vi) Stock in trade and accounts receivable is to be recorded into the books of Khamis & Co. after making provisions of 10% and 5% respectively.
(vii) Plant and machinery of Iqbal, Insha & Co. having book value of Rs. 8,500 thousand were sold for Rs. 10,000 thousand. Office equipment of Faiz, Faraz & Co. were sold for Rs. 2,900 thousand. Both the transactions were completed on March 1, 2009. The remaining fixed assets were revalued as under:

	Iqbal, Insha & Co.	**Faiz, Faraz & Co.**
	Rupees in '000'	
Land and building	30,000	17,300
Plant and machinery	12,350	6,360
Office equipment	6,740	-

Required:
(a) Amount of cash to be contributed by the partners, if any.
(b) Opening statement of financial position of Khamis & Co. **(23)**

Q.5 Given below is the statement of comprehensive income of Shakir Industries for the year ended December 31, 2008:

	2008 **Rupees in million**
Sales	143.00
Cost of goods sold	(96.60)
Gross profit	46.40
Operating expenses	(28.70)
Operating profit	17.70
Other income	3.40
Profit before interest and tax	21.10
Financial charges	(5.30)
Profit before tax	15.80

Following information is available:

(i) Operating expenses include an amount of Rs. 0.7 million paid as penalty to SECP on non compliance of certain requirements of the Companies Ordinance, 1984.
(ii) During the year, the company made a provision of Rs. 2.4 million for gratuity. The actual payment on account of gratuity to outgoing members was Rs. 1.6 million.
(iii) Lease payments made during the year amounted to Rs. 0.65 million which include financial charges of Rs. 0.15 million. As at December 31, 2008, obligations against assets subject to finance lease stood at Rs.1.2 million. The movement in assets held under finance lease is as follows:

	Rupees in million
Opening balance – 01/01/2008	2.50
Depreciation for the year	(0.7)
Closing balance – 31/12/2008	1.80

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(iv) The details of owned fixed assets are as follows:

	Accounting	Tax
	Rupees in million	
Opening balance – 01/01/2008	12.50	10.20
Purchased during the year	5.30	5.30
Depreciation for the year	(1.10)	(1.65)
Closing balance – 31/12/2008	16.70	13.85

(v) Capital work-in-progress as on December 31, 2008 include financial charges of Rs. 2.3 million which have been capitalized in accordance with IAS-23 “Borrowing Costs”. However, the entire financial charges are admissible, under the Income Tax Ordinance, 2001.

(vi) Deferred tax liability and provision for gratuity as at January 1, 2008 was Rs. 0.55 million and Rs. 0.7 million respectively.

(vii) As at December 31, 2008, the company had assessed brought forward tax losses of Rs. 3.5 million.

(viii) Applicable income tax rate is 35%.

Required:
Based on the available information, compute the current and deferred tax expenses for the year ended December 31, 2008. **(15)**

Q.6 Mohani Manufacturing Limited is engaged in manufacturing of spare parts for motor car assemblers. The audited financial statements for the year ended December 31, 2007 disclosed that the profit and retained earnings were Rs. 21 million and Rs. 89 million respectively. The draft financial statements for the year show a profit of Rs. 15 million. However, following adjustments are required to be made:

(i) The management of the company has decided to change the method for valuation of raw materials from FIFO to weighted average. The value of inventory under each method is as follows:

	FIFO	Weighted Average
	Rupees in million	
December 31, 2006	37.0	35.5
December 31, 2007	42.3	44.5
December 31, 2008	58.4	54.4

(ii) In 2007, the company purchased a plant for Rs. 100 million. Depreciation on plant was recorded at Rs. 25 million instead of Rs. 10 million. This error was discovered after the publication of financial statements for the year ended December 31, 2007. The error is considered to be material.

Required:
Produce an extract showing the movement in retained earnings, as would appear in the statement of changes in equity for the year ended December 31, 2008. **(11)**

(THE END)

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