THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

**Final Examinations Winter 2009**

**December 8, 2009**

## ADVANCED ACCOUNTING AND FINANCIAL REPORTING

**(MARKS 100)**
**(3 hours)**

Q.1 The statements of financial position of Habib Limited (HL), Faraz Limited (FL) and Momin Limited (ML) as at June 30, 2009 are as follows:

| | HL | FL | ML |
|---|---|---|---|
| | **Rupees in million** | | |
| **Assets** | | | |
| *Non-current assets* | | | |
| Property, plant and equipment | 978 | 595 | 380 |
| Investments in FL - at cost | 520 | - | - |
| Investments in ML - at cost | 300 | - | - |
| | 1,798 | 595 | 380 |
| *Current assets* | | | |
| Stocks in trade | 210 | 105 | 125 |
| Trade and other receivables | 122 | 116 | 128 |
| Cash and bank | 20 | 38 | 37 |
| | 352 | 259 | 290 |
| **Total assets** | **2,150** | **854** | **670** |
| | | | |
| **Equity and liabilities** | | | |
| *Equity* | | | |
| Ordinary share capital (Rs. 10 each) | 800 | 360 | 100 |
| Retained earnings | 784 | 354 | 450 |
| | 1,584 | 714 | 550 |
| *Non-current liabilities* | | | |
| 12% debentures | 270 | - | - |
| *Current liabilities* | | | |
| Short term loan | 124 | - | - |
| Trade and other payables | 172 | 140 | 120 |
| | 296 | 140 | 120 |
| **Total equity and liabilities** | **2,150** | **854** | **670** |

Following additional information is also available:

(i) HL acquired 60% shares of FL on January 1, 2003 for Rs. 400 million when the retained earnings of FL stood at Rs. 250 million. On January 1, 2006, a further 20% shares in FL were acquired for Rs. 120 million. FL's retained earnings on the date of second acquisition were Rs. 400 million.

(ii) 70% shares of ML were acquired by HL for Rs. 300 million, on July 1, 2006 when ML's retained earnings stood at Rs. 260 million. On December 31, 2008, HL disposed off its entire holding in ML for Rs. 500 million. The disposal of shares has not yet been recorded in HL's financial statements.

(iii) On January 1, 2009, FL purchased a machine for Rs. 20 million and immediately sold it to HL for Rs. 24 million. However, no payment has yet been made by HL. The estimated useful life of the machine is 4 years and HL charges depreciation on the straight line method.

(iv) During the year, HL sold finished goods to FL at cost plus 20%. The amount invoiced during the year amounted to Rs. 75 million. 60% of these goods had been sold by FL till June 30, 2009.
(v) During the year ended June 30, 2009, FL and ML earned profits of Rs. 10 million and Rs. 50 million respectively. The profits had accrued evenly, throughout the year.
(vi) An impairment review at year end indicated that 15% of the goodwill recognised on acquisition of FL, is required to be written off.
(vii) HL values the non-controlling interest at its proportionate share of the fair value of the subsidiary's identifiable net assets.

**Required:**
Prepare the consolidated statement of financial position of HL as at June 30, 2009 in accordance with the requirements of International Financial Reporting Standards. ***(Ignore current and deferred tax implications.)*** **(25)**

Q.2 Being the financial consultant of Insha Chemicals Limited (ICL), a listed company, you have been approached to advise on certain accounting issues. Accordingly, you are required to explain how the following transactions should be disclosed in ICL's financial statements for the year ended June 30, 2009 in accordance with International Financial Reporting Standards:

(a) In a board meeting held on January 1, 2009, the board of directors showed concern over the poor results of one of the company's cash generating unit, Lahore Division (LD). It was principally decided in the meeting that this division should be discontinued.

ICL's CEO announced the closure of LD in a press conference held on February 15, 2009. He also informed that negotiations to sell the entire division are in progress and the sale is expected to be finalized within few months.

On June 14, 2009, the CEO reported to the board of directors that negotiations with Bashir Limited are proceeding well and the disposal of LD is expected to materialise before July 31, 2009. However, it is estimated that the assets would be sold at 95% of their fair value. **(08)**

(b) ICL operates a factory in an underdeveloped rural area. Most of the employees in the factory have been hired locally. On observing the positive effects of the project, the government had approved a grant of Rs. 100 million for ICL, on February 1, 2009 for development of a similar factory in another underdeveloped area. However, it had been agreed that disbursement would be made in three phases. The relevant details are as follows:

| Phases | Amount Rs. in million | Comments |
|---|---|---|
| Before commencement of the construction | 10 | No condition is attached to this phase of the grant and it was received on March 1, 2009. |
| During the construction of factory | 40 | Total cost of construction is estimated at Rs. 200 million. The construction was 30% complete, as of June 30, 2009. The estimated life of the property, plant and equipment is 15 years and it would be depreciated on the straight line basis. |
| When the factory becomes operational | 50 | It has been agreed that 400 local persons would be employed. The amount will be given in five equal annual installments. If employment drops below 400 at any time in any of the five subsequent years, no amount would be paid in that year. |

**(09)**

Q.3 Rahman Limited (RL) is a listed company engaged in the manufacture of leather goods. Its financial year ends on June 30. In a meeting held on July 1, 2009 its Board of Directors acknowledged the outstanding performance of the company's Chief Operating Officer (COO) and in recognition thereof, decided to allow him either of the following options:

**Option I** Receive a cash payment equal to the current value of 64,000 shares of RL.
**Option II** Receive 80,000 shares of RL.

However, the above offer was subject to certain conditions. These conditions and other relevant information are as follows:

(i) The right is conditional upon completion of three years' service from the date the right was granted and the decision to select the option shall also be exercised on the completion of the said period.
(ii) The share price of RL on July 1, 2009 is Rs. 125 per share. It is estimated that the share price at the end of year 2010, 2011 and 2012 will be Rs. 130, Rs. 138 and Rs. 150 respectively.
(iii) If the COO chooses option II, he shall have to retain the shares for two years i.e. up to June 30, 2014 before being eligible to sell them. However, the fair value of the shares after taking into account the effects of the post vesting transfer restrictions is estimated at Rs. 110 per share.
(iv) RL does not expect to pay any dividend during the next three years.

**Required:**
Prepare the journal entries:
(a) to record the above transactions in the books of Rahman Limited for the year ending June 30, 2010, 2011 and 2012.
(b) to record the settlement of right on June 30, 2012 under:
- Option I
- Option II. **(15)**

Q.4 Sachal Limited (SL) is planning to acquire 100% shareholdings in Waris Limited (WL). Before submission of financial proposal, SL is carrying out an analysis of WL's financial and operating performance. The CFO of SL has gathered the following information which is based on the financial statements for the year ended December 31, 2008:

| Description | WL's Ratios | Industry Ratios | | |
|---|---|---|---|---|
| | | High | Low | Average |
| *Operating Performance Ratios* | | | | |
| Gross profit | 29% | 30% | 20% | 25% |
| Operating profit | 11% | 15% | 10% | 13% |
| Return on shareholders equity | 9% | 13% | 7% | 10% |
| *Working Capital Ratios* | | | | |
| Current ratio | 1.54 : 1 | 2 : 1 | 1 : 1 | 1.5 : 1 |
| Inventory turnover days | 83 days | 114 days | 81 days | 91 days |
| Receivables collection | 93 days | 95 days | 60 days | 74 days |
| *Gearing Ratios* | | | | |
| Debt equity ratio | 55 : 45 | 60 : 40 | 40 : 60 | 50 : 50 |
| Interest cover | 1.3 times | 3 times | 1.2 times | 2 times |
| *Investors Ratios* | | | | |
| Earnings per share | Re. 0.9 | Rs. 1.8 | Re. 0.75 | Rs. 1.2 |
| Dividend per share | Re. 0.2 | Re. 0.9 | Re. 0.25 | Re. 0.6 |

**Required:**
(a) Draft a report to the board of directors, on behalf of the CFO, analyzing the financial performance of Waris Limited by evaluating each category of ratios in comparison with the industry. ***(Do not write your name or any identification in the report)*** **(12)**
(b) List any four types of additional information which would have helped you in a better analysis. **(04)**

Q.5 Lateef Bank Limited (LBL) is listed on Karachi and Lahore Stock Exchanges and has 150 branches including 10 overseas branches. The LBL's lending to financial institutions as of September 30, 2009 comprised of the following:

(i) Call money lending at year end amounted to Rs. 850 million (2008: Rs. 1,200 million). The markup on these unsecured lendings ranged between 15% to 17% (2008: 10% to 12%) and they matured on various dates, in October 2009.

(ii) Short term lending on account of repurchase agreement (reverse repo) amounted to Rs. 2,100 million (2008: Rs. 2,850 million). These carried markup ranging from 9.5% to 13.2% (2008: 8% to 10.5%) and matured on various dates, in October 2009. These were secured against Market Treasury Bills of Rs. 1,650 million (2008: Rs. 1,850 million) and Pakistan Investment Bonds of Rs. 450 million (2008: Rs. 1,000 million). The market value of these securities held as collateral, on September 30, 2009, amounted to Rs. 2,250 million (2008: Rs. 2,930 million).

The above amounts include lendings in foreign currencies amounting to Rs. 110 million (2008: Rs. 150 million).

**Required:**
Prepare a note on "Lendings to Financial Institutions" for inclusion in LBL's financial statements for the year ended September 30, 2009 giving appropriate disclosures in accordance with the guidelines issued by State Bank of Pakistan. **(12)**

Q.6 Arif Industries Limited (AIL) owns and operates a textile mill with spinning and weaving units. Due to recurring losses, AIL disposed of the weaving unit for an amount of Rs. 100 million on July 1, 2007 and invested the proceeds in Pakistan Investment Bonds (PIBs).

Details of investment in PIBs are as follows:

(i) The PIBs were purchased through a commercial bank at face value. The bank initially charged premium and investment handling charges of Rs. 4,641,483. At the time of purchase, AIL had envisaged to liquidate the investment after four years and utilize the realized amount for expansion of its spinning business. The bank had agreed to repurchase the PIBs on June 30, 2011, at their face value.

(ii) The markup on PIBs is 15% for the initial two years and 20% for the remaining three years. The effective yield on investment at the time of purchase was 15.50%.

However, due to economic turmoil in the European and American markets, the existing spinning unit is working below its rated capacity. Therefore, on June 30, 2009 AIL decided to defer the expansion plan by one year. The bank agreed to extend the holding period accordingly but reduced the repurchase price by 2%.

**Required:**
Compute the amount of interest income (including the effect of revision of holding period, if any) to be recognized in the financial years ended(ing) 2009, 2010, 2011 and 2012. **(15)**

**(THE END)**