StudentBounty.com

The Institute of Chartered Accountants of Pakistan

Financial Accounting

Intermediate Examinations – Autumn 2010 | September 2, 2010
Module C | 100 marks - 3 hours

Q.1 Attock Technologies Limited (ATL) manufactures five hi-tech products, each on a different plant. It is in the process of preparing its financial statements for the year ended June 30, 2010. As the CFO of the company, the following matters are under your consideration:

(i) Inventory carried at Rs. 25 million on June 30, 2010 was sold for Rs. 15 million after it had been damaged in a flood, in July 2010.

(ii) On July 5, 2010 one of ATL's corporate customers declared bankruptcy. The liquidator announced on August 25, 2010 that 20% of the debt would be paid on liquidation.

(iii) A new product introduced by a competitor on August 1, 2010 had caused a significant decline in the market demand of one of ATL's major products. As a result, ATL is considering a reduction in price and a cut in production.

(iv) On August 18, 2010 the government announced a retrospective increase in the tax rate applicable to the company.

(v) The directors of ATL declared a dividend of Rs. 3 per share on August 28, 2010.

Required:
State how the above events should be treated in ATL's financial statements for the year ended June 30, 2010. You may assume that all the above events are material to the company. ***(11 marks)***

Q.2 Scientific Pharma Limited (SPL) is a manufacturer of pharmaceutical products. In January 2010, one of its plants suffered a major break down. It was repaired at a cost of Rs. 1.5 million but the production capacity was reduced significantly. The plant was ready for production on June 30, 2010. At that time the company's engineers advised that the plant could be used at a reduced level for 3 years only. Net cash inflows from the plant for the next three years are budgeted as under:

Year ending June 30, 2011	Rs. 9 million
Year ending June 30, 2012	Rs. 7 million
Year ending June 30, 2013	Rs. 5 million

Assume that cash flow would occur on the last day of each year and applicable discount rate is 10%.

Other related information is as under:

(i) The plant was imported at FOB price of US$ 800,000. The payment was made at the time of shipment on July 1, 2000 at Rs. 52 per US$. Other charges including installation cost amounted to Rs. 7 million. Installation of the plant was completed on December 31, 2000 and commercial production commenced from April 1, 2001.

(ii) The company uses straight line method of deprecation. Depreciation is charged from the month the asset is available for use upto the month prior to disposal. At the time of purchase, the estimated useful life of the plant was estimated at 15 years whereas the salvage value was estimated at Rs. 2.0 million.

(iii) Based on the report of a professional independent valuer, the plant was revalued on July 1, 2005 at Rs. 45 million. There was however, no change in estimated useful life of the plant.

(iv) The factory remained closed from April 1, to June 30, 2007 due to law and order situation.

(v) The salvage value has not changed since it was first estimated at the time of purchase.

Required:
Prepare accounting entries for the year ended June 30, 2010. Give all the necessary calculations.
(Ignore taxation) ***(20 marks)***

www.StudentBounty.com
Homework Help & Pastpapers

Q.3 Following is the trial balance of Shaheen Limited (SL) as at June 30, 2010:

	Rupees in '000	
Sales revenue		200,000
Manufacturing costs	100,000	
Selling and distribution costs	35,000	
Administrative costs	30,000	
Opening inventories	23,000	
Interest on borrowings	5,000	
Provision for income tax		2,000
Advance income tax paid	6,000	
Property, plant and equipment	86,000	
Accumulated depreciation on property, plant and equipment		12,000
Export licence	6,000	
Trade receivables	37,800	
Cash and bank balances	4,725	
Other receivable and prepayments	14,000	
Trade payables		12,000
Provisions for litigation		5,000
Long term borrowings		31,525
Deferred tax		5,000
Share capital (Rs. 10 each and fully paid)		60,000
Retained earnings		20,000
	347,525	**347,525**

Additional information:

(i) Last year's sale includes goods invoiced at Rs 10 million which were sent to a customer on June 25, 2009 under sale or return agreement, at cost plus 20%. The goods were returned on August 25, 2009. No correction has been made in this respect in either year.

(ii) The export licence has been obtained for exporting a new product and is effective for five years upto December 31, 2014. However, the exports commenced from July 1, 2010.

(iii) Closing inventories are valued at Rs. 30 million.

(iv) Details of property, plant and equipment are as follows:

	Land	Buildings	Plant and equipment
	Rupees in '000		
Cost as at June 30, 2009	20,000	36,000	30,000
Fully depreciated amounts included in cost			3,000
Estimated useful life at the date of purchase		20 years	10 years

The company uses straight line method for charging depreciation. Depreciation is allocated to manufacturing, distribution and administrative costs at 75%, 15% and 10% respectively.

(v) Current maturity of long term borrowings is Rs. 6 million.

(vi) During the year Rs. 5 million was paid in full and final settlement of income tax liability against which a provision of Rs. 7.0 million had been made in the previous year. Current year's taxable income exceeds accounting income by Rs. 5 million of which 0.8 million are permanent differences. Applicable tax rate for the company is 35%.

(vii) On July 30, 2010 the board of directors proposed a final dividend at 15% for the year ended June 30, 2010 (2009: at 20%)

Required:

In accordance with the requirements of the Companies Ordinance, 1984 and International Financial Reporting Standards, prepare:

(a) The statement of financial position as of June 30, 2010

(b) The statement of comprehensive income for the year ended June 30, 2010

(c) The statement of changes in equity for the year ended June 30, 2010.

(Comparative figures and notes to the financial statements are not required) ***(25 marks)***

www.StudentBounty.com
Homework Help & Pastpapers

Q.4 On July 1, 2009, Qureshi Steel Limited (QSL) signed an agreement with Pak Construction Limited for construction of a factory building at a cost of Rs. 100 million. It was agreed that the factory would be ready for use from January 1, 2011. The terms of payments were agreed as under:

(i) 10% advance payment would be made on signing of the agreement. The advance paid would be adjusted at 10% of the quarterly progress bills.
(ii) 5% retention money would also be deducted from the progress bills. Retention money will be refunded one year after completion of the factory building.
(iii) Progress bills will be raised on last day of each quarter and settled on 15th of the next month.

The under mentioned progress bills were received and settled by QSL as per the agreement:

Invoice date	Amount (Rs.)
September 30, 2009	30 million
December 31, 2009	20 million
March 31, 2010	10 million
June 30, 2010	15 million

On April 30, 2010 an invoice of Rs. 1.5 million was raised by the contractor for damages sustained at the site, on account of rains. After negotiations, QSL finally agreed to make additional payment of Rs. 1.0 million to compensate the contractor. The amount was paid on May 15, 2010. It is expected that 75% of the payment would be recovered from the insurance company.

The cost of the project has been financed through the following sources:
(i) Issue of right shares amounting to Rs. 15 million, on September 1, 2009. The company has been following a policy of paying dividend of 20% for the past many years.
(ii) Bank loan of Rs. 25 million obtained on December 1, 2009. The loan carries a markup of 13% per annum. The principal is repayable in 5 half yearly equal instalments of Rs. 5 million each alongwith the interest, commencing from May 31, 2010. Loan processing charges of Rs. 0.5 million were deducted by the bank at the time of disbursement of loan. Surplus funds, when available, were invested in short term deposits at 8% per annum.
(iii) Cash withdrawals from the existing running finance facility provided by a bank. Average running finance balance for the year was Rs. 60 million. Markup charged by the bank for the year was Rs. 9 million.

Required:
Compute cost of capital work in progress for the factory building as of June 30, 2010 in accordance with the requirements of relevant IFRSs.
(Borrowing costs calculations should be based on number of months) ***(18 marks)***

Q.5 Noman Engineering Limited (NEL) manufactures auto parts. On July 1, 2009 it finalized a lease agreement with a bank for sale and leaseback of one of its plants costing Rs. 18.75 million.

Relevant information is as under:
(i) Proceeds from the bank amounting to Rs. 20 million which represent the prevailing market value of such type and age of plant, were received on July 1, 2009.
(ii) The plant had a book value of Rs. 15 million at the time of commencement of the lease.
(iii) The remaining life of the plant on July 1, 2009 was estimated at 8 years.
(iv) The lease period is 6 years. Lease installments of Rs. 2.5 million each are payable semi-annually in arrears from December 31, 2009.
(v) NEL has the option to purchase the plant at market value at the end of the lease term. No final decision has yet been made by NEL, in this regard.
(vi) The rate of interest implicit in the lease is 13.731% per annum.

Required:
Pass journal entries in respect of the lease, for the year ended June 30, 2010. ***(12 marks)***

www.StudentBounty.com
Homework Help & Pastpapers

Q.6 The following information pertains to Qallat Industries Limited (QIL) for its financial year ended June 30, 2010:

(i) QIL sells all its products on one-year warranty which covers all types of defects. Previous history indicates that 2% of the products contain major defects whereas 10% have minor defects. It is estimated that if major defects were detected in all the products sold, repair cost of Rs. 150 million would result. If minor defects were detected in all products sold, repair cost of Rs. 70 million would result. Total sales for the year are amounted to Rs. 830 million.

(ii) QIL has two large warehouses, A and B. These were acquired under non-cancellable lease agreements. Details are as follows:

	Warehouse A	Warehouse B
Effective date of agreement	July 1, 2005	January 1, 2008
Lease period	10 years	8 years
Rental amount per month	Rs. 450,000	Rs. 300,000

On account of serious operating difficulties, QIL vacated both the warehouses on January 1, 2010 and moved to a warehouse situated close to its factory. On the same day QIL sub-let Warehouse A at Rs. 250,000 per month for the remaining lease period. Warehouse B was sub-let on March 1, 2010 for Rs. 350,000 per month for the remaining lease period.

(iii) On July 18, 2010, QIL was sued by an employee claiming damages for Rs. 6 million on account of an injury caused to him due to alleged violation of safety regulations on the part of the company, while he was working on the machine on June 15, 2010. Before filing the suit, he contacted the management on June 29, 2010 and asked for compensation of Rs. 4 million which was turned down by the management. The lawyer of the company anticipates that the court may award compensation ranging between Rs. 1.5 million to Rs. 3 million. However, in his view the most probable amount is Rs. 2 million.

(iv) On November 1, 2009 a new law was introduced requiring all factories to install specialized safety equipment within four months. The Equipment costing Rs. 5.0 million was ordered on December 15, 2009 against 100% advance payment but the supplier delayed installation to July 31, 2010. On August 5, 2010 the company received a notice from the authorities levying a penalty of Rs. 0.4 million i.e. Rs. 0.1 million for each month during which the violation continued. QIL has lodged a claim for recovery of the penalty from the supplier of the equipment.

Required:
Describe how each of the above issues should be dealt with in the financial statements for the year ended June 30, 2010. ***Support your answer in the light of relevant International Accounting Standards and quantify the effect where possible.*** ***(14 marks)***

(THE END)

www.StudentBounty.com
Homework Help & Pastpapers