The Institute of Chartered Accountants of Pakistan

Financial Accounting

Intermediate Examination	8 September 2011
Autumn 2011	100 marks – 3 hours
Module C	Additional reading time – 15 minutes

(All questions are compulsory)

Q.1 Clay Pakistan Limited (CPL), a public listed company is in the process of finalizing its accounts for the year ended 30 June 2011. The following information is available:

(i) The profit after tax and other comprehensive income for the years ended 30 June 2009, 2010 and 2011 (based on draft financial statements) are as follows:

	2011	2010	2009
	Rs. in million		
Profit after tax	5,240	4,120	3,710
Other comprehensive income			
Exchange difference on translation of foreign operations	155	120	110
Total comprehensive income	5,395	4,240	3,820

(ii) CPL changed the method of valuation of inventories from weighted average to first-in first out (FIFO), for the year ended 30 June 2011. The impact of this change on inventory valuation is given in the following table.

Year ended	Impact on inventory valuation
30 June 2009	Increased by Rs. 20 million
30 June 2010	Decreased by Rs. 30 million
30 June 2011	Increased by Rs. 20 million

The above change has not been incorporated in the financial statements.

(iii) Incremental depreciation for the year ended 30 June 2010 and 2011 amounting to Rs. 1,769 million and Rs. 1,483 million respectively was directly transferred from surplus on revaluation of property, plant and equipment to retained earnings.

(iv) Cash dividend and bonuses declared/paid during the three years are as follows:

	Cash dividend		Bonus	
	Interim	Final	Interim	Final
For the year ended 30 June 2009	15%	25%	-	-
For the year ended 30 June 2010	-	20%	10%	10%
For the year ended 30 June 2011	20%	30%	-	-

(v) CPL follows a policy of transferring 30% of its profit after tax to general reserve.

(vi) Share capital and reserves as at 30 June 2009 and 2010 were as follows:

	2010	2009
	Rs. in million	
Share capital	10,340	9,400
Capital reserve	3,210	3,210
Translation reserve	870	750
General reserve	10,141	8,905
Un-appropriated profit	6,242	5,410

(vii) Tax rate applicable to the company is 30%.

Required:
Prepare Statement of Changes in Equity for the year ended 30 June 2011 in accordance with the requirements of Companies Ordinance, 1984 and International Financial Reporting Standards.

(20 marks)

Q.2 On 1 March 2010, Granite Corporation (GC) started the construction of a new plant to meet the growing demand for its products. The new plant was completed at a cost of Rs. 100 million on 31 May 2011.

GC financed the cost of the project from the following sources:

(i) On 1 March 2010, a 7-year loan of Rs. 70 million was obtained specifically for the construction of the plant. The loan carried mark up @ 13% per annum payable semi-annually. An arrangement fee @ 1% of the loan amount was paid to the bank.

Two installments, each comprising of repayment of principal of Rs. 5 million with interest, were paid on 31 August 2010 and 28 February 2011.

(ii) GC also has a running finance facility of Rs. 100 million carrying mark-up @ 14% per annum. Average utilization of this facility, prior to commencement of construction was Rs. 10 million. Any additional amount required for the project was provided through this facility.

(iii) Surplus funds were used to reduce the running finance utilization or invested in savings account @ 8% per annum.

Payments made to the contractor were as follows:

Payment date	Rs. in million
01 March 2010	25
31 January 2011	65
30 September 2011	10

The construction work was suspended from 1 February 2011 to 28 February 2011. The suspension was caused due to delay in shipment of essential components for the installation of the plant.

Required:
Calculate the amount of borrowing costs that may be capitalized during the years ended 30 June 2010 and 2011 in accordance with the requirements of International Financial Reporting Standards. ***(20 marks)***

Q.3 On 1 July 2009, Metal Limited (ML) acquired 80% shareholdings in Copper Limited (CL), 90% shareholdings in Zinc Limited (ZL) and 55% shareholdings in Steel Limited (SL). The following transactions took place among these companies, during the period up to 30 June 2011:

(i) On 1 May 2010, ML sold a machine to CL at 20% above the carrying amount of Rs. 16 million. CL paid the entire amount on 15 July 2010. The useful life of the machine is 10 years.

(ii) On 1 July 2010, ZL awarded a contract of Rs. 15 million to Iron Builders and Developers (IBD) for the extension of its existing factory. One of the directors of ML is also a partner in IBD.

(iii) Since the date of acquisition, ML has been providing management services to CL and ZL. ML did not charge management fee for its services during the first year. However, with effect from 1 July 2010, management fee has been charged from each company at the rate of Rs. 0.5 million per month. Payment is made on the 10^{th} day of the next month.

(iv) On 1 January 2011, ML sold goods amounting to Rs.10 million to Gold Limited (GL). The wife of chief financial officer of ZL is a major shareholder in GL.

Required:
Prepare a note on related party disclosure including comparative figures, for inclusion in the individual financial statements of ML, CL, ZL and SL, for the year ended 30 June 2011. ***(18 marks)***

Q.4 Quartz Auto Limited (QAL) is engaged in the business of manufacturing of trucks. Since a number of the prospective customers do not have adequate funds to purchase the vehicles against full payment, QAL provides lease financing facility to its customers. It expects to receive a return at the rate of 15% per annum on the amount of lease finance.

On 1 July 2010, QAL sold seven trucks to Emerald Goods Transport Company (EGTC) on lease. The terms of the lease and related information is as follows:

(i) The lease period is 4 years, extendable up to the expected useful life of the trucks i.e. 5 years.

(ii) EGTC has guaranteed a residual value of Rs. 360,000 for each truck, till the end of the fourth year. However, the guarantee would lapse if the lease term is extended to the fifth year. EGTC will return the truck at the end of the lease term.

(iii) Lease rentals amount to Rs. 2,715,224 per annum and are payable in arrears i.e. on 30 June.

(iv) The cost of each truck is Rs. 900,000. Price in case of outright sale is Rs. 1,350,000 per truck.

(v) The expected residual value of each truck at the end of the 4^{th} and 5^{th} year is Rs. 150,000 and Rs. 100,000 respectively.

Required:
Assuming that QAL and EGTC intend to extend the lease for a period of five years, prepare:
(a) Journal entries to record the transactions for the year ended 30 June 2011. ***(08 marks)***
(b) A note for inclusion in the financial statements, for the year ended 30 June 2011, in accordance with the requirements of IAS-17 'Leases'. ***(07 marks)***

Q.5 Mercury Water Limited (MWL) is a listed company and is engaged in the business of purifying and marketing of bottled water.

MWL purchased a bottling plant on 1 July 2006 at a cost of Rs. 90 million. The plant has a useful life of ten years with no residual value. Depreciation is provided on straight-line method over the plant's useful life. MWL revalues its plant at the end of every two years.

The revalued amounts determined by Jet Valuers, an independent firm of valuers, are as follows:

(i) On 30 June 2008: Rs. 64 million
(ii) On 30 June 2010: Rs. 60 million

However, there was no change in the expected useful life and residual value of the plant.

Profit before tax for the years ended 30 June 2011 and 2010 was Rs. 80 million and Rs. 60 million respectively. The tax authorities allow tax depreciation at 20% on reducing balance method. There are no temporary or permanent differences other than those apparent from the above information. The tax rate applicable on MWL is 40%.

Required:
(a) Prepare journal entries to record the effect of revaluation and deferred tax, at the end of each year, up to 30 June 2011. ***(14 marks)***
(b) Prepare a note on taxation for the year ended 30 June 2011 in accordance with International Financial Reporting Standards. ***(07 marks)***
(Comparative figures are required. Accounting policies are not required.)

Q.6 The following information pertains to Shale Distributors Limited (SDL):

	Rs. in million
Sales	300
Purchases	140
Cost of goods sold	150
Trade receivables	50
Trade payables	21
Inventories	30

All the purchases and sales are on credit.

Required:

(a) Calculate the cash operating cycle of SDL and explain briefly its significance. ***(04 marks)***
(Assume a 360-day year)

(b) Describe any two limitations of accounting ratios. ***(02 marks)***

(THE END)