The Institute of Chartered Accountants of Pakistan

Financial Accounting

Intermediate Examination — 8 March 2012
Spring 2012 — 100 marks - 3 hours
Module C — Additional reading time - 15 minutes

Q.1 Pistachio, Cashew and Almond are partners sharing profits and losses in the ratio of 5:3:2 respectively. Following is the summarized **trial balance** of the partnership firm for the year ended 31 December 2011:

All amounts in million rupees

	Debit Balances		Credit Balances
Land	50.0	Accumulated Depreciation:	
Building	14.0	Building	5.5
Vehicles	22.3	Vehicles	11.5
Equipment	14.0	Equipment	5.0
Trade debts	38.0	Trade creditors	53.0
Cash at bank	44.0	Partners' capital account – opening:	
Purchases	325.0	Pistachio	36.0
Stock-in-trade - opening	42.7	Cashew	24.0
Administrative expenses	120.0	Almond	20.0
		Sales	515.0
	670.0		670.0

On 31 December 2011, the partners decided to convert the firm into a limited company under the name of DF Company Limited (DFC). The Scheme of Conversion was executed as under:

(i) Three vehicles were sold to the partners at the following prices:

	Cost	Accumulated depreciation	Selling price
	--------------Rs. in million--------------		
Pistachio	1.8	0.6	1.4
Cashew	1.6	0.5	1.2
Almond	1.6	0.8	0.9

(ii) Land was revalued at Rs. 70 million.
(iii) Stock-in-trade as on 31 December 2011 was valued at Rs. 48 million.
(iv) 90% of trade debts are considered recoverable.
(v) Trade creditors taken over by DFC amounted to Rs. 30 million. The balance amount was paid by the partners in their existing capital ratio.
(vi) Cash balance of Rs. 12 million was transferred to DFC whereas the remaining cash available with the firm was used to settle the partners' balances in the partnership account.
(vii) All other assets and liabilities were taken over by the company at book values.
(viii) The purchase consideration was discharged by DFC in the following manner:
- Debentures which carry mark-up at the rate of 20% were issued to the partners in such a way as to enable them to receive the same amount of interest which they received on their capital in 2011. The interest on capital in the partnership was 10%.
- The balance amount was settled through issuance of ordinary shares at Rs. 12 per share (at a premium of Rs. 2 per share) in proportion to the partners' profit sharing ratio.

Required:
(a) Realization account
(b) Partners capital accounts
(c) Opening statement of financial position of DFC *(23 marks)*

Q.2 Figs Pakistan Limited is a listed company engaged in the business of manufacturing and marketing of personal care and food products. Following is an extract from its trial balance for the year ended 31 December 2011:

	Debit	Credit
	Rs. in million	
Sales - Manufactured goods		56,528
Sales - Imported goods		1,078
Scrap sales		16
Dividend income		12
Return on savings account		2
Sales tax - Imported goods	53	
Sales tax - Manufactured goods	10,201	
Sales discount	2,594	
Raw material stock as on 1 January 2011	1,751	
Work in process as on 1 January 2011	73	
Finished goods (manufactured) as on 1 January 2011	1,210	
Finished goods (imported) as on 1 January 2011	44	
Purchases - Raw material	22,603	
Purchases - Imported goods	658	
Stores and spares consumed	180	
Salaries, wages and benefits	2,367	
Utilities	734	
Depreciation and amortization	1,287	
Stationery and office expenses	230	
Repairs and maintenance	315	
Advertisement and sales promotion	4,040	
Outward freight and handling	1,279	
Legal and professional charges	71	
Auditor's remuneration	13	
Donations	34	
Workers Profit Participation Fund	257	
Worker Welfare Fund	98	
Loss on disposal of property, plant and equipment	10	
Financial charges on short term borrowings	133	
Exchange loss	22	
Financial charges on lease	11	

Additional information:

(i) The position of inventories as at 31 December 2011 was as follows:

	Rs. in million
Raw material	2,125
Work in process	125
Finished goods (manufactured)	1,153
Finished goods (imported)	66

(ii) The basis of allocation of various expenses among cost of sales, distribution costs and administrative expenses are as follows:

	Cost of sales	Distribution costs	Administrative expenses
	%	%	%
Salaries, wages and benefits	55	30	15
Depreciation and amortization	70	20	10
Stationery and office expenses	25	40	35
Repairs and maintenance / Utilities	85	5	10

(iii) Salaries, wages and benefits include contributions to provident fund (defined contribution plan) and gratuity fund (defined benefit plan) amounting to Rs. 54 million and Rs. 44 million respectively.
(iv) Auditor's remuneration includes taxation services and out-of-pocket expenses amounting to Rs. 4 million and Rs. 1 million respectively.
(v) Donations include Rs. 5 million given to Dates Cancer Foundation (DCF). One of the company's directors, Mr. Peanut is a trustee of DCF.
(vi) The tax charge for the current year after making all related adjustments is estimated at Rs. 1,440 million. The timing differences related to taxation are estimated to increase by Rs. 3,120 million, over the last year. The applicable income tax rate is 35%.
(vii) 274 million ordinary shares were outstanding as on 31 December 2011.
(viii) There is no other comprehensive income for the year.

Required:
Prepare the statement of comprehensive income for the year ended 31 December 2011 along with the relevant notes showing required disclosures as per the Companies Ordinance, 1984 and International Financial Reporting Standards. ***Comparatives are not required.*** ***(24 marks)***

Q.3 Walnut Limited (WL) is engaged in the business of import and distribution of electronic appliances. The following events took place subsequent to the reporting period i.e. 31 December 2011:

(i) On 15 January 2012, one of WL's competitors announced launching of an upgraded version of DVD players. WL's inventories include a large stock of existing version of DVD players which are valued at Rs. 15 million. Because of the introduction of the upgraded version, the net realizable value of the existing version in WL's inventory at 31 December 2011 has reduced to Rs. 12.5 million.

(ii) On 20 December 2011, the board of directors decided to close down the division which imports and sells mobile sets. This decision was made public on 29 December 2011. However, the business was actually closed on 29 February 2012.

Net costs incurred in connection with the closure of this division were as follows:

	Rs. in million
Redundancy costs	1.50
Staff training	0.15
Operating loss from 1 July 2011 to closure of division	0.80
Less: Profit on sale of remaining mobile sets	(0.50)
	1.95

(iii) On 16 January 2012, LED TV sets valuing Rs. 3 million were stolen from a warehouse. These sets were included in WL's inventory as at 31 December 2011.

(iv) WL owns 9,000 shares of a listed company whose price as on 31 December 2011 was Rs. 22 per share. During February 2012, the share price declined significantly after the government announced a new legislation which would adversely affect the company's operations. No provision in this regard has been made in the draft financial statements.

(v) On 31 January 2012, a customer announced voluntary liquidation. On 31 December 2011, this customer owed Rs. 1.5 million.

(vi) On 15 February 2012, WL announced final dividend for the year ended 31 December 2011 comprising 20% cash dividend and 10% bonus shares, for its ordinary shareholders.

Required:
Describe how each of the above transactions should be accounted for in the financial statements of Walnut Limited for the year ended 31 December 2011. Support your answer in the light of relevant International Financial Reporting Standards. ***(16 marks)***

Q.4 (a) Discuss the criteria that should be used while recognizing intangible assets arising from research and development work. ***(05 marks)***

(b) Raisin International (RI) is planning to expand its line of products. The related information for the year ended 31 December 2011 is as follows:

(i) Research and development of a new product commenced on 1 January 2011. On 1 October 2011, the recognition criteria for capitalization of an internally generated intangible asset were met. It is estimated that the product would have a useful life of 7 years. Details of expenditures incurred are as follows:

	Rs. in million
Research work	4.50
Development work	9.00
Training of production staff	0.50
Cost of trial run	0.80
Total costs	**14.80**

(ii) The right to manufacture a well-established product under a patent for a period of five years was purchased on 1 March 2011 for Rs. 17 million. The patent has an expected remaining useful life of 10 years. RI has the option to renew the patent for a further period of five years for a sum of Rs. 12 million.

(iii) RI has acquired a brand at a cost of Rs. 2 million. The cost was incurred in the month of June 2011. The life of the brand is expected to be 10 years. Currently, there is no active market for this brand. However, RI is planning to launch an aggressive marketing campaign in February 2012.

(iv) In September 2010, RI developed a new production process and capitalized it as an intangible asset at Rs. 7 million. The new process is expected to have an indefinite useful life. During 2011, RI incurred further development expenditure of Rs. 3 million on the new process which meets the recognition criteria for capitalization of an intangible asset.

Required:
In the light of International Financial Reporting Standards, explain how each of the above transaction should be accounted for in the financial statements of Raisin International for the year ended 31 December 2011. ***(11 marks)***

Q.5 The following information relates to Apricot Limited (AL), a listed company, for the financial year ended 31 December 2011:

(i) The profit before tax for the year amounted to Rs. 60 million (2010: Rs. 45 million).
(ii) The accounting and tax written down value of fixed assets as on 31 December 2010 was Rs. 95 million and Rs. 90 million respectively. Accounting depreciation for the year is Rs. 10 million (2010: Rs. 9 million) whereas tax depreciation for the year is Rs. 8 million (2010: Rs. 7 million).
(iii) During the year, AL sold a machine for Rs. 3 million and recognized a profit of Rs. 0.5 million. The tax written down value of the machine as on 31 December 2010 was Rs. 2 million. There were no other additions/disposals of fixed assets in 2010 and 2011.
(iv) AL earned capital gain of Rs. 6 million (2010:Nil) on sale of shares of a listed company. This income is exempt from tax.
(v) Bad debt expenses recognized during the year was Rs. 5 million (2010: Rs. 7 million).
(vi) Bad debts written off during the year amounted to Rs. 3 million (2010: Rs. 4 million).
(vii) Deferred tax liability and provision for bad debts as on 31 December 2009 was Rs. 18.90 million and Rs. 9 million respectively.
(viii) The company's assessed brought forward losses up to 31 December 2009 amounted to Rs. 19.25 million.
(ix) Applicable tax rate is 35%.

Required:
Prepare a note on taxation for inclusion in AL's financial statements for the year ended 31 December 2011 giving appropriate disclosures relating to current and deferred tax expenses including comparative figures for 2010 and a reconciliation to explain the relationship between tax expense and accounting profit. ***(21 marks)***

(THE END)