The Institute of Chartered Accountants of Pakistan

Advanced Accounting and Financial Reporting

Final Examination
Winter 2012
Module E

4 December 2012
100 marks - 3 hours
Additional reading time - 15 minutes

Q.1 Following are the extracts from the draft financial statements of three companies for the year ended 30 June 2012:

INCOME STATEMENTS

	Tiger Limited (TL)	Panther Limited (PL)	Leopard Limited (LL)
	-------------------Rs. in million-------------------		
Revenue	6,760	568	426
Cost of sales	(4,370)	(416)	(218)
Gross profit	2,390	152	208
Operating expenses	(1,270)	(54)	(132)
Profit from operations	1,120	98	76
Investment income	730	-	10
Profit before taxation	1,850	98	86
Income tax expense	(400)	(20)	(17)
Profit for the year	1,450	78	69

STATEMENTS OF CHANGES IN EQUITY

	Ordinary share capital of Rs. 10 each			Retained earnings		
	TL	PL	LL	TL	PL	LL
	--------------------------Rs. in million--------------------------					
As on 1 July 2011	10,000	800	600	2,380	270	70
Final dividend for the year ended 30 June 2011	-	-	-	(1,000)	-	(60)
Profit for the year	-	-	-	1,450	78	69
As on 30 June 2012	10,000	800	600	2,830	348	79

The following information is also available:

(i) Several years ago, TL acquired 64 million shares in PL for Rs. 1,000 million when PL's retained earnings were Rs. 55 million. Up to 30 June 2011, cumulative impairment losses of Rs. 50 million had been recognized in the consolidated financial statements, in respect of goodwill.

On 31 December 2011, TL disposed off its entire holding in PL for Rs. 1,300 million.

(ii) On 1 July 2011, 42 million shares of LL were acquired by TL for Rs. 550 million. An impairment review at 30 June 2012 indicated that goodwill recognized on acquisition has been impaired by Rs. 7 million.

(iii) During the year, LL sold goods costing Rs. 50 million to TL at a mark-up of 20% on cost. 40% of these goods remained unsold on 30 June 2012.

(iv) Investment income appearing in TL's separate income statement includes profit on sale of PL's shares and dividend received from LL.

(v) TL values the non-controlling interest at its proportionate share of the fair value of the subsidiary's identifiable net assets.

It may be assumed that profits of all companies had accrued evenly during the year.

Required:
Prepare TL's consolidated income statement and consolidated statement of changes in equity for the year ended 30 June 2012 in accordance with the requirements of International Financial Reporting Standards. ***(Ignore deferred tax implications)*** **(23)**

Q.2 The following information pertains to Crow Textile Mills Limited (CTML) for the year ended 30 June 2012:

(a) Stocks include 4,000 maunds of cotton which was purchased on 1 April 2012 at a cost of Rs. 6,200 per maund. In order to protect against the impact of adverse fluctuations in the price of cotton, on the price of its products, CTML entered into a six months futures contract on the same day to deliver 4,000 maunds of cotton at a price of Rs. 6,300 per maund.

At year end i.e. 30 June 2012, the market price of cotton (spot) was Rs. 5,500 per maund and the futures price for September delivery was Rs. 5,550 per maund.

All necessary conditions for hedge accounting have been complied with. **(05)**

(b) On 1 July 2011, 2 million convertible debentures of Rs. 100 each were issued. Each debenture is convertible into 25 ordinary shares of Rs. 10 each on 30 June 2014. Interest is payable annually in arrears @ 8% per annum. On the date of issue, market interest rate for similar debt without conversion option was 11% per annum. However, on account of expenditure of Rs. 4 million, incurred on issuance of shares, the effective interest rate increased to 11.81%. **(08)**

Required:
Prepare Journal entries for the year ended 30 June 2012 to record the above transactions.
(Show all necessary calculations)

Q.3 In order to pursue expansion of its business, Parrot Limited (PL) has made the following investments during the year ended 30 June 2012:

(a) On 1 July 2011, PL acquired 20% shares of Goose Limited (GL), a listed company, when GL's retained earnings stood at Rs. 250 million and the fair value of its net assets was Rs. 350 million. The purchase consideration was two million ordinary shares of PL whose market value on the date of purchase was Rs. 33 per share. PL is in a position to exercise significant influence in finalizing the financial and operational policies of GL.

The summarized statement of financial position of GL at 30 June 2012 was as follows:

	Rs. in million
Share capital (Rs. 10 each)	100
Retained earnings	280
	380
Net assets	380

Recoverable amount of GL's net assets at 30 June 2012 was Rs. 370 million. **(06)**

(b) Costs incurred for development and promotion of a brand are enumerated below:

		Rupees
(i)	Research on size of potential market	800,000
(ii)	Products designing	1,500,000
(iii)	Labour costs in refinement of products	950,000
(iv)	Development work undertaken to finalize the product design	11,000,000
(v)	Cost of upgrading the machine	18,000,000
(vi)	Staff training costs	600,000
(vii)	Advertisement costs	3,400,000

(06)

Required:
Discuss how the above investments/costs would be accounted for in the consolidated financial statement for the year ended 30 June 2012.

Q.4 Primate Mart Limited (PML) operates a network of several retail stores throughout the country. In order to retain its market share and achieve growth in revenue, PML has extended substantial credit facilities to its major customers. Consequently, PML's bank borrowings have increased substantially over the past few years. PML has recently requested its bank for further increase in its borrowing facilities.

The bank is concerned about the increase in the quantum of loans extended to PML and has appointed you to analyse the financial performance of PML for the last three years. The information available in respect of the company is as follows:

(i) **Statement of financial position**

	2012	2011	2010
	------------- Rs. in million	-------------	
Property, plant and equipment	322	290	278
Stock-in-trade	620	540	440
Trade debts	443	385	344
Cash	15	12	12
	1,400	1,227	1,074
Share capital	90	90	90
Retained earnings	282	288	291
	372	378	381
Long term loans from bank	420	355	212
Short term running finance	320	200	200
Trade creditors	280	284	277
Tax payable	8	10	4
	1,400	1,227	1,074

(ii) **Income statement**

	2012	2011	2010
	------------- Rs. in million	-------------	
Sales – Cash	1,050	940	790
– Credit	450	380	320
Total sales	1,500	1,320	1,110
Cost of sales	(996)	(864)	(723)
Gross profit	504	456	387
Other operating costs	(384)	(341)	(288)
Profit from operations	120	115	99
Financial charges	(102)	(79)	(57)
Profit before taxation	18	36	42
Taxation	(6)	(12)	(14)
Profit for the year	12	24	28
Depreciation for the year	33	36	42
Proposed dividend	10%	20%	20%

(iii) The present borrowing limit sanctioned to PML is Rs. 750 million.

Required:
Prepare a report for the bank containing an analysis of the financial performance of the company for the period covered by the financial statements. Your report should focus on the particular concern of the bank regarding the rapidly increasing level of lending exposure to PML and suggest matters which the bank may discuss with the PML's management. ***(Assume your name is Bashir Ahmed)*** **(15)**

Q.5 Lion Engineering Limited (LEL) operates an approved pension scheme (defined benefit plan) for all its permanent employees who have completed one year's service. The details for the year ended 30 June 2012 relating to the pension scheme are as follows:

	Rs. in million
Present value of pension scheme obligation at 30 June 2011	100
Fair value of scheme's assets at 30 June 2011	70
Unrecognized actuarial loss at 30 June 2011	20
Current service cost	29
Contribution made during the year	30
Benefits paid during the year	45
Present value of pension scheme obligation at 30 June 2012	110
Fair value of scheme's assets at 30 June 2012	80

Additional information:

(i) With effect from 1 July 2011, LEL had amended the scheme whereby the employees' pension entitlement had been increased. The benefits would become vested after three years. According to actuarial valuation the present value of the cost of additional benefits at 1 July 2011 was Rs. 15 million.

(ii) The discount rate and expected rate of return on the plan assets on 30 June 2012 were as follows:

Discount rate	13%
Expected rate of return on plan assets	10%

(iii) LEL was required to pay Rs. 40 million to the scheme, during the year ended 30 June 2012. Because of cash flow constraints, LEL was able to contribute Rs. 30 million only.

(iv) Average remaining working lives of employees is 10 years.

(v) LEL uses the corridor approach to recognize actuarial gains and losses.

(vi) Last actuarial valuation was made on 30 June 2012 using the Projected Unit Credit Method.

Required:

Prepare the relevant extracts from the statement of financial position and the related notes to the financial statements for the year ended 30 June 2012. Show all necessary workings.

(Accounting policy note is not required. Deferred tax may be ignored) **(18)**

Q.6 Eagle Bank Limited (EBL) is listed on all the stock exchanges in Pakistan. At the year end, the total borrowings of the bank amounted to Rs. 29,761 million, which included borrowings outside Pakistan amounting to Rs. 11,712 million. Details of borrowings at the year-end were as follows:

(i) All local borrowings are in Pak Rupees.

(ii) Inter-bank call money borrowings amounted to Rs. 3,600 million. These borrowings were unsecured and carried mark-up ranging between 8.7% and 12.1% per annum.

(iii) EBL operates in several countries where it maintains nostro accounts. The overdrawn nostro accounts amounted to Rs. 456 million. Mark-up on overdrawn nostro accounts was charged by the foreign banks at the rates prevailing in the respective countries.

(iv) Outstanding loans from the State Bank of Pakistan (SBP) under the Export Refinance Scheme amounted to Rs. 14,182 million. These loans carried mark-up ranging between 9.7% and 11% per annum and were secured by EBL's cash and other securities held by SBP.

(v) The borrowings under repurchase agreements amounted to Rs. 11,523 million and carried mark-up ranging between 6.3% and 12.5% per annum. These borrowings are secured against government securities amounting to Rs. 24,802 million and are repayable latest by April 2013.

Required:

Prepare note on 'Borrowings' for inclusion in the Financial Statements of Eagle Bank Limited with appropriate disclosures in accordance with the State Bank of Pakistan guidelines. **(10)**

Q.7 Quail Pakistan Limited (QPL), a listed company, is reviewing the following transactions which have not yet been accounted for in the financial statements for the year ended 30 June 2012:

(a) On 1 July 2011, QPL announced a bonus of Rs. 30 million to its employees if they achieved the annual budgeted targets by 30 June 2012. The bonus would be paid in the following manner:

- 25% of the bonus would be paid in cash on 31 December 2012 to all employees irrespective of whether they are still working for QPL or not.
- The balance 75% will be given in share options, to those employees who are in QPL's employment on 31 December 2012. The exercise date and number of options will be fixed by the management on the same day.

The budgeted targets were achieved. The management expects that 5% employees would leave between 30 June 2012 and 31 December 2012. **(04)**

(b) On 30 June 2012, a plant having a list price of Rs. 50 million was purchased. QPL has allowed the following options to the supplier, in respect of payment thereagainst:

- To receive cash equivalent to price of 1.5 million shares of the company after 3 months; or
- To receive 1.7 million shares of the company after 6 months.

QPL estimates that price of its shares would be Rs. 35 per share after three months and Rs. 40 per share after six months. **(05)**

Required:
Discuss how the above share-based transactions should be accounted for in QPL's financial statements for the year ended 30 June 2012. Show necessary calculations.
(Journal entries are not required)

(THE END)