The Institute of Chartered Accountants of Pakistan

Financial Accounting

Intermediate Examination	5 September 2013
Autumn 2013	100 marks - 3 hours
Module C	Additional reading time - 15 minutes

Q.1 During the year ended 30 June 2013, Uzair Limited (UL), a listed company, undertook the following transactions:

(i) All the raw materials were supplied by Hamid Limited for Rs. 180 million.
(ii) Goods costing Rs. 15 million were sold by UL for Rs. 18 million to its subsidiary Tania (Pvt.) Limited as against its normal policy of adding 30% margin on cost. At the year end, the amount receivable in respect of this sale was Rs. 5.5 million.
(iii) A machine costing Rs. 20 million was purchased from Perveen Limited, one of whose executive director is a director in UL.
(iv) UL's approved gratuity fund is administered by the trustees appointed by the company. During the year, contribution made to the approved gratuity fund amounted to Rs. 3.2 million.
(v) During the year, UL sold goods amounting to Rs. 12 million to Gohar Limited, which is controlled by the uncle of Mr. Haris, a key shareholder and a member of UL's board of directors.
(vi) An interest free loan of Rs. 4 million was granted to the Chief Financial Officer (CFO) of the company under the terms of employment. During the year, Rs. 0.5 million were repaid by the CFO.

Required:
In the light of International Financial Reporting Standards:
(a) Comment as to whether or not the above entities are related parties of Uzair Limited. **(06)**
(b) Prepare a note on related party transactions for inclusion in Uzair Limited's financial statements for the year ended 30 June 2013. ***(Ignore corresponding figures)*** **(07)**

Q.2 French Power Limited (FPL) uses the revaluation model for subsequent measurement of its property, plant and equipment and has a policy of revaluing its assets on an annual basis using the net replacement value method.

The following information relates to FPL's plant:
(i) The plant was purchased on 1 July 2009 at a cost of Rs. 360 million.
(ii) It is being depreciated on straight line basis, over 10 years.
(iii) The details of previous revaluations carried out by the independent valuers are as follows:

Revaluation date	Fair value Rupees in million
1 July 2010	400
1 July 2011	280
1 July 2012	290

(iv) FPL transfers the maximum possible amount from the revaluation surplus to retained earnings on an annual basis.
(v) There is no change in the useful life of the plant.

Required:
Prepare journal entries to record the above transactions from the date of acquisition of the plant to the year ended 30 June 2013. ***(Ignore deferred tax)*** **(16)**

Q.3 The following balances were extracted from the financial statements of Spanish Limited for the years ended 30 June 2012 and 2013.

	2013	2012
	---------Rs. in 000---------	
Sales	60,000	40,000
Interest expense	27	30
Profit after tax	7,800	4,800
Property, plant and equipment – cost	10,000	9,000
– accumulated depreciation	1,000	900
Stock in trade	6,970	6,800
Trade debtors	9,000	8,000
Provision for doubtful debts	500	360
Trade creditors	5,000	4,700
Accrued expenses	300	-
Interest payable	12	14
Current tax payable	40	30
Deferred tax liability	15	8

Additional information

- New machine costing Rs. 1,800,000 was purchased during the year. A machine with a carrying amount of Rs. 200,000 was sold for Rs. 250,000
- The tax rate applicable to the company is 35%.

Required:
Prepare operating activities section of the statement of cash flows for the year ended 30 June 2013 using the **Direct Method**. Show all necessary workings.
(Ignore corresponding figures) **(15)**

Q.4 The directors of Arabic Industries Limited (AIL) has set a sales target of Rs. 600 million for the year ending 31 August 2014 and has asked the chief financial officer to prepare AIL's forecasted financial statements for the year 2014.

Based on prior years' experience, the financial ratios for the year 2014 are estimated as follows:

Current ratio	1.5 : 1
Quick ratio	1.1 : 1
Gross profit (% of sales)	10%
Fixed assets as % of shareholders' equity	60%

Other related estimates are as follows:

(i) Average collection period for trade debtors would be 45 days.
(ii) Closing value of inventory is estimated to increase by 25% as compared to opening inventory.
(iii) Working capital and bank overdraft would be maintained at Rs. 100 million and Rs. 15 million respectively.

Shareholders' equity as on 1 September 2013 is as follows:

	Rs. in million
Share capital	150
Retained earnings	75
	225

AIL does not intend to issue any further shares, during the year ending 31 August 2014.

Required:
Prepare the forecasted income statement for the year ending 31 August 2014 and a summarized balance sheet as at 31 August 2014. ***(Assume a 360 days year)*** **(11)**

Q.5 English Pharmaceutical Limited (EPL), a listed company, has provided you with the following information related to the year ended 30 June 2013:

(i) EPL has developed and patented two new vaccines A & B at a cost of Rs. 160 million and Rs. 120 million respectively. Based on market analysis, it is estimated that Vaccine A would generate revenue of Rs. 300 million per annum for next five years whereas Vaccine B would generate annual revenue of Rs. 80 million for an indefinite period. **(05)**

(ii) Rs. 6 million was paid for a television advertising campaign that will cover a period of 6 months from 1 May 2013 to 31 October 2013. The directors believe that the campaign would help to achieve the sales growth target of 8% for the next two years. **(02)**

(iii) Rs. 5 million were spent on training of technical staff. The training courses were conducted by leading experts of pharma production and are expected to improve the production quality significantly and reduce costs. **(01)**

Required:
In the light of International Financial Reporting Standard, explain how the above expenditure may be accounted for in EPL's financial statements for the year ended 30 June 2013.

Q.6 Comfort Housing Limited (CHL) is developing a housing scheme. The construction work is being carried out by Smart Engineers. An agreement in this respect was signed on 1 July 2012. The total cost of construction has been agreed at Rs. 250 million and the project is to be completed by 30 June 2014.

Other related information is as follows:

(i) On 1 April 2012, a running finance facility of Rs. 100 million carrying a mark-up at 14% per annum, was obtained from a local bank.

(ii) The receipts and payments from the above account, upto 30 June 2013 are as follows:

Receipts

Date	Description	Rs. in million
01-Apr-2012	12% Loan, repayable on 31 December 2013	30
01-Sep-2012	Down payment receipts from the customers	25
01-Jan-2013	Collection of the 1st installment	15
01-Apr-2013	Collection of the 2nd installment	18

Payments

Date	Rs. in million
30-Apr-2012	25
31-Jul-2012	35
31-Jan-2013	40
31-May-2013	48

(iii) Surplus funds were invested in a saving scheme @ 8% per annum.

(iv) Due to an objection raised by the Building Control Authority, construction work was suspended from 1 March 2013 to 31 March 2013.

Required:
Compute the amount of borrowing costs to be capitalised for the year ended 30 June 2013 in accordance with the requirements of the International Financial Reporting Standards. ***(Borrowing costs should be calculated based on number of months)*** **(10)**

Q.7 The following information has been extracted from the financial statements of Fine Fibre Limited (FFL) for the year ended 30 June 2013:

	2013	2012
	Rs. in million	
Profit before tax	140	128
Tax expense: Current	(39)	(36)
Deferred	(8)	(10)
Share capital (Rs. 10 each)	30	30
Retained earnings at the end of the year	186	105

Subsequent to preparation of the draft financial statements, an error has been detected in the financial statements for the year ended 30 June 2012 whereby the accounting depreciation on an assembly plant was mistakenly accounted for at Rs. 21.8 million instead of Rs. 12.8 million.

Other relevant information is as under:

(i) The assembly plant was installed on 1 July 2010 at a cost of Rs. 80 million and is depreciated at 20% per annum using the diminishing balance method.

(ii) The error has not affected the tax depreciation which has been worked out correctly.

(iii) Applicable tax rate is 35%.

(iv) Final cash dividend for the year ended 30 June 2012 was approved at the Annual General Meeting held on 25 September 2012 at Rs. 4 per share (2011: Rs. 5 per share).

Required:

Prepare the following extracts (including comparative figures) from FFL's financial statements for the year ended 30 June 2013 in accordance with the International Financial Reporting Standards:

(a) Retained earnings column as would appear in the statement of changes in equity; and **(08)**

(b) Correction of error note. **(04)**

Q.8 On 1 July 2012, Taqwa Limited (TL) entered into a sale and lease back agreement in respect of one of its plants having a carrying value of Rs. 25,000,000 and remaining useful life of 6 years.

Other information related to the sale and lease-back arrangement is given below:

Proceeds from the sale of the plant	Rs. 30,000,000
Lease period, commencing from 1 July 2012	5 years
Lease installment payable annually in advance	Rs. 7,500,000
Payment in case the lessee exercises the option to buy the plant at the end of the lease period	Rs. 1,000,000
Rate of interest implicit in the lease	13.88%

Required:

In respect of the above transactions:

(a) Prepare a note as would appear in TL's financial statements for the year ended 30 June 2013 in accordance with the International Financial Reporting Standards. **(12)**

(b) Compute the effect on TL's profit before tax for the year ended 30 June 2013. **(03)**

(THE END)