The Institute of Chartered Accountants of Pakistan

Advanced Accounting and Financial Reporting

Final Examination	4 June 2013
Summer 2013	100 marks - 3 hours
Module E	Additional reading time - 15 minutes

Q.1 Qudsia Limited (QL) has investments in two companies as detailed below:

Manto Limited (ML)

- On 1 January 2010, QL acquired 40 million ordinary shares in ML, when its retained earnings were Rs. 150 million.
- The fair value of ML's net assets on the acquisition date was equal to their carrying amounts.

Hali Limited (HL)

- On 30 November 2012, QL acquired 16 million ordinary shares in HL, when its retained earnings stood at Rs. 224 million.
- The purchase consideration was made up of:
  - Rs. 190 million in cash, paid on acquisition; and
  - 4 million shares in QL. At the date of acquisition, QL's shares were being traded at Rs. 15 per share but the price had risen to Rs. 16 per share by the time the shares were issued on 1 January 2013.
- The fair value of the net assets of HL on the date of acquisition by QL was equal to their carrying amounts, except a building whose fair value exceeded its carrying amount by Rs. 28 million. The building had a remaining useful life of seven years on 30 November 2012.

The draft summarised statements of financial position of the three companies on 31 December 2012 are shown below:

	QL	ML	HL
	---------Rs. in million---------		
Assets			
Property, plant and equipment	5,000	550	500
Investment in ML	630	-	-
Investment in HL	190	-	-
Current assets	5,480	400	350
	11,300	**950**	**850**
Equity and liabilities			
Ordinary share capital (Rs.10 each)	6,000	500	400
Retained earnings	2,900	100	240
Current liabilities	2,400	350	210
	11,300	**950**	**850**

The following additional information is available:

(i) QL considers ML as a cash-generating unit (CGU). As on 31 December 2012, the recoverable amount of the CGU was estimated at Rs. 700 million.

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

(iii) On 1 October 2012, ML sold a machine to QL for Rs. 24 million. The machine had been purchased on 1 October 2010 for Rs. 26 million. The machine was originally assessed as having a useful life of ten years and that estimate has not changed.

(iv) In December 2012, QL sold goods to HL at cost plus 30%. The amount invoiced was Rs. 52 million. These goods remained unsold at year end and the invoiced amount was also paid subsequent to the year end.

Required:
Prepare a consolidated statement of financial position for QL as on 31 December 2012 in accordance with the requirements of International Financial Reporting Standards. **(20)**

Q.2 Healthcare Limited (HCL) manufactures a large variety of nutrition products. In addition to its branded products, HCL produces a special food supplement for export to Childcare Centre (CCC) in the Middle East. Under the terms of the contract, HCL is liable to pay a compensation of Rs. 6 million per month to CCC, if HCL is unable to supply the supplement.

On 15 March 2013, a product of HCL was found to be contaminated. On receiving the complaint, the Health Department sealed the factory premises and initiated legal proceedings against the company.

As per the legal advice, it is highly probable that the case would be decided against HCL. It is expected that the decision would be announced in September 2013. The maximum fine payable under the law is Rs. 15 million. However, the legal adviser is of the opinion that the amount of the penalty would be Rs. 9 million approximately.

HCL has investigated the incident and the findings as reported on 5 April 2013 are as under:

- The contamination was caused due to the use of an ingredient supplied by Food Chemical Enterprises (FCE) which was close to the date of expiry. However, only one product was affected and various laboratory tests have confirmed that the contamination is not health hazardous.
- Production batches of the contaminated product were identified. The cost of contaminated inventory in hand on 15 March 2013 was Rs. 70 million. The cost of unsold inventory recalled from the customers amounted to Rs. 132 million. HCL earns a margin of 25% on all of its products.
- Due to closure of the factory, HCL would not be able to supply the supplement to CCC for three months.
- Cost of disposal of the contaminated inventory is estimated at Rs. 0.5 million.

On 6 April 2013, HCL lodged a claim for damages of Rs. 211.5 million against FCE for the cost of contaminated inventory, cost of disposal thereof and the amount of the penalty that HCL is likely to incur. However, no response has been received from FCE so far and HCL is considering to file a suit for recovery of the amount.

Required:
Explain the accounting treatment and the disclosure requirements in respect of the above in HCL's financial statements for the year ended 31 March 2013 in accordance with the International Financial Reporting Standards. **(13)**

Q.3 The following information pertaining to Krishna Limited (KL) has been extracted from its financial statements for the year ended 31 December 2012.

(i) Total comprehensive income for the year:

	Rs. in '000
Profit from continuing operations - net of tax	200,000
Profit from discontinued operations - net of tax	10,000
Fair value gain on investments available for sale - net of tax	16,000
Total comprehensive income	**226,000**

(ii) Share capital as on 1 January 2012:

- 8,000,000 Ordinary shares of Rs. 10 each.
- 500,000 Convertible preference shares of Rs. 100 each entitled to a cumulative dividend at 12%. Each share is convertible into two ordinary shares and the dividend is paid on 28 February, every year.

(iii) 20% bonus shares being the final dividend for the year ended 31 December 2011 were issued on 31 March 2012.

(iv) On 30 April 2012, holders of 80% convertible preference shares converted their shares into ordinary shares.

(v) On 1 July 2012, KL issued 20% right shares to its ordinary shareholders at Rs. 70 per share. The market price prevailing on the exercise date was Rs. 80 per share.

(vi) On 1 August 2011, KL granted 2,500 share options to each of its twenty technical managers. The managers would become eligible to exercise these options on completion of further five years of service with KL. By 31 December 2012, two managers had already left and it is expected that a further six managers would leave KL before five years. As of 31 December 2012 estimated fair value of each share option was Rs. 40.

Required:
Prepare a note relating to basic and diluted earnings per share for inclusion in KL's financial statements for the year ended 31 December 2012, in accordance with International Financial Reporting Standards. **(15)**

Q.4 Ashfaq General Insurance Limited (AGIL) is engaged in general insurance business. The following information is available for the year ended 31 December 2012:

			2012
			Rs. in '000
(i)	**Information extracted from statement of cash flows:**		
	Profit received on bank deposits		4,000
	Profit / interest received on investments		
	held for trading		28,000
	held to maturity		9,000
	available for sale		16,000
	Dividend received from investments		
	held for trading		6,000
	available for sale		5,000
	Proceeds from disposal of investments		
	held for trading		39,000
	available for sale		43,000
(ii)	**Information extracted from profit and loss account:**		
	Loss on sale of investments held for trading		12,000
	Unrealized loss on revaluation of investments held for trading		1,000
	Provision for impairment in the value of investments available for sale		2,000
	Amortisation of premium on investments available for sale		3,000
	Gain on sale of investments available for sale		15,000
	Investment related expenses		7,000
(iii)	**Information extracted from statement of financial position:**		
		1-1-2012	**31-12-2012**
	Accrued profit/interest on:	**--------Rs. in 000--------**	
	- Term deposits	2,000	1,500
	- Investments - held for trading	11,400	13,000
	- Investments - held to maturity	600	1,800
	- Investments - available for sale	2,700	3,000

Required:
Prepare the statement of investment income for inclusion in AGIL's financial statements for the year ended 31 December 2012. **(10)**

Q.5 On 1 January 2009 Qasmi Investment Limited (QIL) purchased 1 million 12% Term Finance Certificates (TFCs) issued by Taj Super Stores (TSS), which operates a chain of five Super Stores. The terms of the issue are as under:

- The TFCs have a face value of Rs. 100 each and were issued at a discount of 5%. These are redeemable at a premium of 20% after five years.
- Interest on the TFCs is payable annually in arrears on 31 December each year.

Effective interest rate calculated on the above basis is 16.426% per annum.

Due to a property dispute, TSS had to temporarily discontinue operations of two stores in 2010. Consequently, TSS was unable to pay interest due on 31 December 2010 and 31 December 2011.

At the time of finalization of accounts for the year ended 31 December 2010, QIL was quite hopeful of recovery of the interest and therefore, no impairment was recorded. However, in 2011, after a thorough review of the whole situation, QIL’s management concluded that it would be able to recover the face value of the TFCs along with the premium on the due date i.e. 31 December 2013, but the interest for the years 2010 to 2013 would not be received. Accordingly, QIL recorded impairment in the value of the TFCs on 31 December 2011.

In 2012, TSS reached an out of court settlement of the property dispute and the stores became operational. Subsequently, QIL and TSS agreed upon a revised payment schedule according to which the present value of the agreed future cash flows on 31 December 2012 is estimated at Rs. 115 million.

Required:
Prepare journal entries in the books of QIL for the years ended 31 December 2011 and 2012. Show all the relevant computations. **(14)**

Q.6 Chughtai Limited (CL) has 75% share holdings in John Limited (JL) which is registered and operates in a foreign country. JL's functional currency is RAM. The following information has been extracted from JL's statement of changes in equity for the year ended 31 December 2012:

	Subscribed and paid-up capital	Unappropriated profit
	---------RAMs in million---------	
Balance as on 1 January 2012	50	85
Final dividend for the year ended 31 December 2011		
- Cash dividend at 10%	-	(5)
- Bonus shares at 20%	10	(10)
Profit after tax for the year ended 31 December 2012	-	40
Balance as on 31 December 2012	**60**	**110**

Other relevant information is as under:

(i) CL's profit after tax for the year ended 31 December 2012 amounted to Rs. 700 million which includes a cash dividend of Rs. 41 million received from JL.

(ii) On acquisition, JL’s goodwill amounted to RAMs 30 million. However, an impairment test carried out as at 31 December 2012 revealed that the goodwill has been impaired by RAMs 6 million.

(iii) CL values the non-controlling interest on acquisition at fair value.

(iv) JL has not issued any ordinary shares after acquisition by CL, except for the bonus issue as mentioned above.

(v) The following exchange rates are relevant to the financial statements:

31-Dec-2011	31-Dec-2012	Average for 2012
------------------Rs. to 1 RAM------------------		
10.00	11.00	10.20

Required:
Prepare the relevant extracts from the consolidated statement of comprehensive income of CL for the year ended 31 December 2012 in accordance with the requirements of International Financial Reporting Standards. **(16)**

Q.7 Financial statements of Niazi Company Limited (NCL) for the year ended 31 December 2012 are in the process of finalisation. In this respect, the following information has been gathered from the company's accounting and tax records.

(i) **Property, plant and equipment (PPE)**

	31-12-2012	31-12-2011
	--------Rs. in million--------	
Accounting WDV (at revalued amount)	2,700	2,000
Tax WDV	2,400	1,600

Details of the revaluation are as under:
- Revaluation of freehold land and buildings on 31 December 2005 resulted in a revaluation surplus of Rs. 15 million and Rs. 20 million respectively.
- Plant and machinery costing Rs. 150 million was commissioned on 1 January 2010 with an expected useful life of 10 years. It was revalued at Rs. 145 million on 31 December 2012.

(ii) **Provision for retirement benefits and doubtful debts**

	Rs. in million
Balance on 31 December 2011	50
Write offs during the year	5
Provision for the year, net of payments of Rs. 3 million	6

(iii) **Liabilities outstanding for more than three years**
NCL's tax assessment for the year ended 31 December 2010 was finalized on 30 April 2012 in which liabilities outstanding for more than three years and amounting to Rs. 8 million were added back to income.

A sum of Rs. 2 million included in the above liabilities was paid while a liability of Rs. 3 million was written back by NCL in 2012.

(iv) Applicable tax rate is 35%.

Required:
Prepare a note related to deferred tax liability/asset for inclusion in NCL's financial statements for the year ended 31 December 2012, in accordance with the International Financial Reporting Standards. **(12)**

(THE END)