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ISQ Examination - Winter- 2012
Accounting for Financial Services - Stage- II

Q. Following data pertains to Awami Bank. Identify which of the following transactions shall be classified as Operating, Investing and Financing activities.

Exhibit: Business Transactions		
Sl. #	Transactions	Classification
1	Repurchased own outstanding stock	
2	Purchased additional machinery	
3	Fixed capital expenditure	
4	Dividend income received	
5	Dividend paid to stock holders	
6	Net investments in securities, associates and joint venture	
7	Lending to financial institutions	
8	Proceeds from sale of fixed assets	
9	Exchange adjustments	
10	Borrowings from financial institutions	

Q. Identify FIVE contingent liabilities for financial institutions.

Q. Casa super market, one of the larger super markets in Karachi, is located at Clifton. In order to promote sales, Casa sells goods on credit for maximum duration of 3 months. Wasim, the owner of the store, is concerned about the collection of accumulated accounts receivable. He asks the store manager to make a schedule of the age of accounts receivable in order to estimate the amount of likely uncollectable accounts. The store manager extracts the outstanding accounts receivable data from books of accounts, presented in the table below:

Data (2009)	Amount (Rs)
Total outstanding accounts receivables as on 31 December 2009	1,136,830.00

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Data (2010)	Amount (R
Total outstanding accounts receivables as on 31 December 2010	1,333,333.00
Past due for 15 days	37.5%
Past due for two months	22.5%
Past due for 65 days	30%
Past due over three months	10%

Past record reveals that the following has been the bucket-wise default rates for last 3 years on average.

Bucket	Default Rate
(1-30 days)	1%
(31-60 days)	1.65%
(61-90 days)	2%
(over 91 days)	4%

Accumulated accounts receivable balance as on 31 December 2010 is Rs. 20,000.

Required:

a. Create an ageing of accounts receivable schedule as on 31 December 2010.

b. Estimate the amount of doubtful accounts receivable for past due over 90 days as at 31 December 2010.

c. Calculate the amount of adjusted accumulated doubtful accounts receivable as on 31 December 2010.

Q. The following data pertains to company A:

Acquisition cost of asset	Rs 60,000
Salvage value	Rs 5,000
Useful life	5 years
Cash flow per year	Rs 10,000
Accumulated depreciation	Rs 6,000
Expected output of machine	20,000 units

Use the above data to answer the following:

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a. Calculate the first year's depreciation expense based on straight li method (SLM) and double declining method (DDM)?

b. Is there any effect on cash flow statement because of the use of two methods mentioned above? Briefly justify your answer.

c. Compare how the equity would be affected under both depreciation methods.

Q. Sultan, is the senior accountant at Yekjheti Bank. Tanvir, his immediate supervisor, asks him to prepare a presentation on bank's financial performance and trend analysis for last two years for the bank's board of directors meeting. Tanvir likes to read financial and economic reviews to keep himself abreast with the changing dynamics of the Pakistani banking industry and to predict the probable performance of the industry in foreseeable future.

Tanvir tells Sultan that the complexion of Pakistani banking industry has changed entirely in the last decade and it has become resilient to external shocks, which is evident from its profitability despite the worldwide financial meltdown. The main factors contributing to its growth are extraordinary foreign remittances which have recently crossed the $11 billion mark and conservative stance adopted by banks. He adds, unabated inflation, high interest rate, unstable law and order situation, burgeoning fiscal deficit and declining exports have impacted the economy in general and banking industry in particular. Banks have lesser lending avenues and profitable investment vehicles than before which have changed the composition of banks' financial statements.

Sultan extracts selected information from 2009 and 2010 Annual Reports of the Yakjehti Bank for analysis, which is presented in the table below. He uses different ratios and year on year growth percentage to make the presentation. He calculates Net Advance to Deposit Ratio, Investments to Deposits Ratio, Investments to Total Assets Ratio, NPLs to Gross Advances Ratio, Net Interest to Total Interest Ratio and Non-Interest Income to Total Income Ratio.

Year Ended December 31	(Amount in Rs)	
Income Statement	2010	2009
Net Interest Income	125	100
Non Interest Income	66	52
Gross Interest income	145	125
Total Income	191	152
Balance Sheet	2010	2009
Lending to Financial institutions	28	23
Gross Advances	435	420
Deposits	812	500
Investments	900	300

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Accumulated Non Performing Loans	155	[illegible]
Total Assets	1500	123[illegible]
Un-appropriated Profit	62	55
Borrowing from financial institutions	48	26

Required:-

a. Calculate the ‘net advances to deposit ratio’ and ‘growth in deposits and advances’ for both years. Comment on the deposit and advances performance.

b. Calculate the ‘Investment to deposit ratio’ and ‘Investments to total assets ratio’. Discuss the trend in these ratios.

c. Explain the impact of rising NPLs on the banks’ financial position and profitability.

d. Calculate ‘net interest to total Interest ratio’ and ‘non-interest income to total income ratio’. Comment on the trend.

Q. Osaka manufacturing uses general journal to record its day to day business transactions. Osaka recently purchased a production plant to meet increasing demand. Sequence of the transactions relating to the plant is given below

a. On 1 January 2010, purchased a plant for cash Rs. 1,000,000

b. On 3 December 2010, recorded depreciation expense using straight line method with 10 years of useful life and zero salvage value estimated after ten years

c. On 1 January 2011, sold the plant for Rs. 1,000,000 cash

Required: Create the general journal entries using the above sequence of transactions.

Q. Ismail is a financial analyst. His manager has asked him to prepare a report on Essential Textile, a publicly traded company based in Faisalabad that complies with International Financial Reporting Standards for its financial reporting. As a part of his analysis, Ismail has compiled data from the footnotes of Essential’s 2009 and 2010 Annual Reports. Ismail is concerned about the possible effects on financial position and profitability of Essential‘s accounting classification for its Corporate Bond (TFC) investment portfolio.

Financial information about Essential’s investment portfolio for the years ended 2009 and 2010 is presented in exhibit given below.

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Exhibit : Essential's Investment (TFC) Portfolio

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Securities	Company A	Company B	Company C
Classification	Available For Sale	Held To Maturity	Held To Maturity
Purchased cost (at par value)	50,000.00	80,000.00	100,000.00
Purchased cost (at par value)	50,000.00	80,000.00	100,000.00
Market Value (as on 31 Dec 2009)	58,000.00	76,000.00	108,000.00
Market Value (as on 31 Dec 2010)	56,000.00	74,000.00	110,000.00

Required:

a. Calculate the balance sheet carrying value of Essentials' investment portfolio as on 31 December 2010?

b. Which securities, if classified as Held for Trading Security, would cause the balance sheet value to be higher?

c. Assume that the securities of Company B were purchased at below par value. How the interest income would be affected in this situation? Justify your answer.

Q. Furqan is a credit officer at Yakjehti bank. His main responsibilities are to analyze financial statements of firms seeking loans and make a recommendations report on their credit worthiness.

Furqan analyzes the statements of Coco Technologies and Fast Technologies, financial software solutions providers to financial institutions. He reviews his initial analysis on Coco technologies and Fast technologies, with Jibran, an intern at the bank. During their discussion, Jibran asks Furqan whether quick ratio or current gives better evaluation of firm's liquidity and which ratio should he use to assess the solvency of the firms. Furqan answers Jibran's questions using the information compiled from the two firms' annual resports. (Given in table below).

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Accounts	Coco Technologies (Rs)	Fast Technologies (Rs)
Cash	100	125
Inventory	169	89
Marketable securities	90	145
Current assets	359	359
Accounts payable	200	150
Accrued expense	100	150
Bonds issued	200	200
Equity	59	69
Sales	100	120

Furqan calculates current ratio, quick ratio, total debt to total asset ratio and asset turnover ratios to support his answer. After calculating, he makes the following statements;

Statement one: Current ratio and quick of Coco technologies are higher than Fast technologies

Statement two: Fast technologies is more liquid than Coco technologies

Statement three: Based on asset turnover ratio, Fast technologies is more solvent than Coco technologies

Jibran recently attended training on financial statement analysis; he remembers a few financial ratios taught during the training. In response, Jibran makes the following statements;

Statement four: Sales turnover is an activity ratio used to analyze the assets utilization of a firm

Statement five: Total debt to total asset ratio gives the true picture of firm's solvency. Therefore, Fast technology is more solvent than Coco technologies

Required:

a. Calculate current and quick ratios and state do you agree with statement one.

b. Calculate the asset turnover ratio for both firms and compare which is more attractive based on asset turnover ratio.

c. Explain statement four and interpret asset turnover ratio.

d. Calculate total debt to total assets ratio and state whether you agree or disagree with statement five.

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e. If you were in Furqan’s place, which company would you recommend for credit line approval? Summarize your answer using calculated ratios.

Q. Use the following data pertaining to Aquarius Manufacturing Company to answer the questions below:

Financial Ratios	2007	2008
Operating Margin	0.12	0.1
Return on Assets (%)	5.76%	5.13%
Assets to Equity ratio	1.2	1.53
Tax burden	0.5	0.51
Interest burden	0.6	0.61
Asset turnover	1.6	1.65

Required:

a. Calculate the return on equity for FY2007 and FY2008 using the above data.

b. How has the company’s Return on Equity (ROE %) changed between the two years?

c. Identify the factors that may have caused the ROE to change (or not change) as discussed in part “b”.

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