THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Professional Examinations Winter 2002

December 11, 2002

ADVANCED FINANCIAL ACCOUNTING **(MARKS 100)**
PE-1 Paper 1 **(3 hours)**

Q: 1 M Ltd obtained control over net assets and operations of N Ltd in exchange for cash of Rs 1,200,000. N Ltd balance sheet at the date of acquisition was as follows:

	Rs
Issued subscribed and paid up capital	1,500,000
General reserves	200,000
Unappropriated profits	100,000
Current liabilities	1,000,000
	2,800,000
Property, plant and equipment	500,000
Current assets	
Trade debts	2,000,000
Cash and bank balances	300,000
	2,800,000

Carrying values of assets and liabilities on balance sheet date are equal to their fair values.

Required: Under IAS 22 (r 1998) 'Business Combinations'

(a) Calculate goodwill or negative goodwill in acquisition of N Ltd

(b) Record the above acquisition through journal entry giving special attention to goodwill or negative goodwill in the books of M Ltd.

(c) State the policy for differential between the cost of acquisition and M Ltd interest in N Ltd.

(10)

Q 2 C Ltd was an old customer of a leasing Co. namely L Ltd. C Ltd faced liquidity problem and therefore approached L Ltd and made following arrangements effective July 1, 2001.

a) Under a finance lease, a sale and lease back transaction of a plant having carrying value of Rs 900,000 had been made for Rs 990,000. Repayments were to be made over remaining life of the plant of three years starting from second year. Rate of interest was 10% per annum.

b) C Ltd acquired a car on operating lease on a three-year term for that following twelve quarterly payments were to be made.

	Rs
1st year quarterly payments aggregating to	200,000
2nd year quarterly payments aggregating to	300,000
3rd year quarterly payments aggregating to	400,000

Before giving effect of the above arrangements, profit before taxation of C Ltd was Rs 460,000.

Required:
Prepare a reconciliation statement of profit before taxation of C Ltd before and after giving effects of the arrangements as required by IAS 17 (r 1997) "Leases". **(10)**

Q 3 IAS 21 (r 1993) 'The Effects of Changes in Foreign Exchange Rates' deals with recognition of exchange differences. Under allowed alternative treatment, it states that exchange difference may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset invoiced in a foreign currency.

Required:

a) What is the time period in relation to the words "recent" used in the above paragraph?
b) What accounting entry you will suggest to record above exchange difference under allowed alternative treatment?
c) What is the proviso to record the entry in (b) above? **(10)**

Q 4 K Private Ltd. purchased two plants on July 1, 1990 at a cost of Rs 1,000,000 each with a useful life of ten years. According to accounting policy of the company, depreciation was charged on straight line method from the month of purchase to the month of sale. On July 1, 1995, the management revalued the plant and increase of Rs 500,000 in each plant was recorded by writing up the carrying value of respective plant. On June 30, 1999, one of the plants was sold for Rs 200,000. The accountant did not record the disposal of the plant and the proceeds was credited to suspense account. Following further information was extracted from the books as at June 30, 1999.

	Rs
Issued, subscribed and paid up capital	1,500,000
Fixed assets including plants – net of depreciation	400,000
Suspense account	200,000
Revaluation reserve	1,000,000
Current assets	1,000,000
Current liabilities	500,000
Long term investments	2,500,000
Unappropriated profit	200,000
Sales	3,000,000
Cost of goods sold	2,000,000
Administration and selling expenses	500,000

Required:
Prepare balance sheet and profit and loss account as at June 30, 1999 giving special attention to placing revaluation reserve under appropriate head of account in the balance sheet and clearly showing treatment of revaluation reserve realized as required under the Companies Ordinance, 1984. Ignore income-tax and do not use any assumption. **(10)**

Q 5 P Ltd established a factory in an under developed area of the country and therefore received government grant to the extent of 50% of the cost of a plant. Cost of the plant was Rs 1,000,000. The company's policy was that government grants related to assets was presented by deducting the grant in arriving at the carrying amount of the plant. Plant was depreciated over useful life of 10 years on straight line method. After two years, the management of P Ltd decided to move the factory to another location and therefore the company had to repay the government grants in full. Third year's profit before transaction was Rs 250,000 without charging third year's depreciation on the plant.

Required:
After repayment of the government grant, compute carrying value of the plant and recalculate profit before taxation at the end of the third year in accordance with IAS 20 (r 1994) Accounting for Government Grants and Disclosure of Government Grants. **(10)**

Q. 6 The accountant prepared the following balance sheet of C Ltd for the year ended June 30, 2001 and 2002 which are not as per requirements of International Accounting Standards. He requested you to prepare cash flow statement.

<u>Balance Sheet</u>

	2002 Rs	2001 Rs
Property, plant and equipment		
Owned assets	1,000,000	900,000
Leased assets	200,000	-
Investments	800,000	500,000
Stocks	200,000	400,000
Trade debtors	100,000	300,000
Cash	100,000	100,000
Bank balances	200,000	100,000
	2,600,000	2,300,000
Issued, subscribed and paid up capital	1,500,000	1,000,000
Reserves	200,000	100,000
Unappropriated profits	200,000	100,000
Liabilities against assets subject to finance lease	200,000	-
Long-term loans	-	200,000
Short-term running finance utilized under markup arrangement	100,000	50,000
Creditors	400,000	850,000
	2,600,000	2,300,000

The accountant provided the following information:

a) The break up of the investment is as follows:-

	2002 Rs	2001 Rs
Investment in shares of listed companies		
Held for trading	150,000	200,000
Available for sale	450,000	300,000
Investment in Term Finance Certificates on June 15, 2002 maturing on August 31, 2002	100,000	-
On fixed deposit with a bank for month encashable on July 31, 2002	100,000	-
	800,000	500,000

Investment in shares of listed companies that was held for trading at June 30, 2001, was sold for Rs 250,000 during the year ended June 30, 2002.

b) Depreciation of Rs 100,000 was charged on property, plant and equipment during the year ended 2002 and as leased assets were acquired on June 30, 2002, no depreciation was charged according to the policy of the company.

c) Increase in issued, subscribed and paid up capital was as follows:
   i) Plant of Rs 100,000 acquired against issue of 10,000 ordinary shares of Rs 10 each
   ii) During the year 2002, long-term loans was settled by issue of 20,000 ordinary shares of Rs 10 each
   iii) For balance, the company issued right shares to the shareholders that were fully subscribed.

d) Short-term running finance was payable on demand

e) Net profit before taxation was Rs 200,000 and no tax was payable for the year.

Required:

i) Prepare a statement of cash and cash equivalent clearly showing each component for both the years ended June 30, 2001 and 2002.

ii) Prepare indirect method cash flow statement clearly showing cash flows from different activities. **(20)**

Q:7 Following statements are independent of each other:

(a) A Ltd used its premises as owner-occupied property having cost of Rs 1,000,000. The management evaluated various options and finally decided to rent-out the property because the bid received from open market was Rs 400,000 against the carrying value of Rs 300,000 of the property.

(b) B Ltd constructed properties and then sold them. A property that was built with an intention to sell, did not have gross profit in excess of 10% of cost. The cost of the property was Rs 500,000. The management decided to use the property as investment property.

(c) C Ltd had investment property. Tenant of the property made an offer of Rs 300,000 to buy the property otherwise the tenant would move out. In response to the company enquiry, a broker also confirmed the market value of the premises at Rs 300,000. The carrying value of the property was Rs 400,000, therefore, the company decided to use the property as owners occupied property.

Required: Prepare journal entries showing clearly how to record the above transfers in the books using fair value model for investment property as per IAS 40 (2000) 'Investment Property'. **(10)**

Q:8 IAS 37 (1998) 'Provisions, Contingent Liabilities and Contingent Assets' requires that the amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

Consider the following case.

P Ltd sold washing machines manufactured locally. The sales were made with a warranty clause that the company would remove manufacturing defects that was apparent and brought to the notice of the company within 90 days of the purchase. Removal of minor defect in all washing machines sold would cost to the company Rs 300,000 and major defect Rs 1,000,000. P Ltd past experience states that 80% of the customers do not report any defects; 15% report minor defects and 5% report major defects.

Required: Calculate the amount of provision that is required in the above case under IAS 37 (1998) **(10)**

Q: 9 T Ltd exchanged a plot of land having carrying value as well as market value of Rs 2 million with a machinery having a fair value of Rs 2.5 million. T Ltd also issued a cheque of Rs 200,000 as a part of the deal.

Required: Under IAS 16 (r 1998) 'Property, Plant and Equipment'

a) Calculate gain or loss, if any, on disposal of the land.

b) Record the above deal through journal entry.

c) Swap the value of the land with the machinery and answer both (a) and (b) above.

(10)

(THE END)