Professional Examination Summer 2003

June 03, 2003

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

Q.1 Foreign Investment Ltd., has "Investment Held for Trading" in 1,000 shares of Y Ltd. which was purchased at Rs.20. The fair value of shares on January 01, 2002 was Rs.30 and on December 31, 2002 was Rs.35. The shares were indicated at cost in the accounts for the year ending December 31, 2001. The shares were sold at Rs. 32 on March 27, 2003.
Show the working in the books for the year ending December 31, 2002 and on disposal in accordance with IAS 39. Explain the term "Held for Trading" and describe the disclosure in the financial statements for the year ending December 31, 2002. **(10)**

Q.2 Ammar Limited holds 80% of the ordinary shares of Crescent Ltd which it purchased five years ago, on July 1, 1998, for Rs 175,000. On July 1, 2003 Ammar Limited sold all of these shares and used the proceeds (Rs 212,000) to purchase 65% of the ordinary shares of Ebrahim Ltd on the same date. Share capital of Crescent Ltd and Ebrahim Ltd has remained constant for many years at Rs 100,000 and Rs 200,000 respectively. Net assets of Crescent Ltd and Ebrahim Ltd were as follows.

	Crescent Ltd		Ebrahim Ltd
	At acquisition	At January 1, 2003	At January 1,2003
	Rs	Rs	Rs
Net assets	187,000	150,000	280,000

Profit and loss accounts for all three companies for the year ended December 31, 2003 were as follows.

	Ammar Limited		Crescent Ltd		Ebrahim Ltd
	Rs		Rs		Rs
Turnover	1,926,500		521,600		792,400
Cost of sales	(1,207,200)		(386,200)		(405,900)
Gross profit	719,300		135,400		386,500
Distribution costs	(207,500)		(79,200)		(198,200)
Administrative expenses	(192,600)		(26,100)		(107,100)
Income from shares in group undertakings	8,000		-		-
Profit before tax	327,200		30,100		81,200
Taxation	(110,000)		(9,500)		(27,500)
Profit after tax	217,200		20,600		53,700
Dividends:					
Paid (May 1,.2003)		(50,000)	(10,000)		(25,000)
Proposed		-	(5,000)		-
Retained profit		167,200	5,600		28,700
Retained profit at January 1,2003		671,300	50,000		80,000
Retained profit at December 31,2003		838,500	55,600		108,700

No entries have been made in Ammar Limited's profit and loss account relating to the sale of Crescent Ltd. All the companies have a marginal tax rate of 33%.

Group policy is to amortize goodwill over ten years, on a monthly basis.

Required

(a) Prepare the consolidated profit and loss account for Ammar Limited for the year ended December 31, 2003. Ignore disclosure requirements. **(20)**

(b) Calculate the profit on disposal that would be shown in the individual accounts of Ammar Limited and explain how and why this differs from group profit. **(05)**

Q.3 Investor Limited holds the following investments.

(a) 8,000 of the 20,000 Rs 10 ordinary shares in Alpha Ltd, an engineering company with seven members on the board, five of whom are appointed by Investor Limited. Of the remaining shares, 4,000 are held by Epsilon Ltd. Investor Limited is a major supplier to Epsilon Ltd and the board of Epsilon Ltd have agreed to vote with Investor Limited on all matters concerning Alpha Ltd.

(b) 30,000 shares of the 100,000 ordinary shares of Rs 10 each in Beta Ltd, and 80% of its Rs 10 preference shares. The remaining shares are held by other companies in sizeable blocks, but none hold more than Investor Limited. Each member of Beta Ltd appoints one person to the board of directors.

(c) 6,000 of the 20,000 ordinary shares of Rs 10 in Gamma Ltd. These were recently acquired, as the directors of Investor Limited believe that Gamma Ltd has excellent growth potential in the future. However, the market in which Gamma Ltd operates is very specialized and Investor Limited has decided to take no part in the running of Gamma Ltd. Investor Limited intends to hold its shares for several years, but not to influence the board in any way.

(d) 5000 of the 24,000 equity shares of Rs 10 in Theta Ltd. Theta Ltd was established ten years ago and made considerable profits in the first eight years after its existence. During this time Investor Limited appointed two members to the board of directors and was actively involved in developing operating and financial policies.

Last year one of the directors on the board of Investor Limited resigned through ill health and the other directors decided by a majority of 5 to 1 not to appoint a replacement. Since then Investor Limited has been pressing for Theta Ltd to pay the highest possible dividend; apart from this it has taken a more passive role in the business. Investor Limited believes that it should no longer account for this investment as an associate.

Required

(a) Discuss the nature of each holding, and state the method of accounting in the group accounts. **(16)**

(b) Is it possible for a company to be a subsidiary to two independent parent undertakings? If so, should the company be consolidated in two sets of separate group accounts? **(04)**

Q.4 You are a Chartered Accountant and have just been appointed CFO and Company Secretary of Glamour Fabric Limited, a company listed on the Karachi Stock Exchange. It is August 2002 and the audit for the year ended on June 30, 2002 is underway. This is expected to be completed by the first week of September. In the meantime, a general meeting of the shareholders is to take place in the last week of August in which the directors of the company are to be elected. The Chief Executive has informed you that the old CFO was sacked partly because to date, he had not taken a single measure to implement the new code of corporate governance issued by the Securities and Exchange Commission of Pakistan. The Chief Executive has requested you to immediately submit to him a 1-2 page action plan summarizing the steps that you plan to take to ensure that all steps that are mandatorily required by the Code of Corporate Governance to be implemented within the next three months are brought to his notice.

Required:

Draft a summarized action plan for the CEO of the company. **(11)**

Q.5 Southern Ltd has recently decided to introduce a Non-contributory Defined Benefit Pension Scheme to cover all of its full time employees. A separate pension fund has now been set up.

The following information has been obtained from various sources including the results of actuarial calculations.

(i) on the recommendations of the actuary, the company intends to make payments to trustees in respect of regular pension costs. Payments to be made on December 31, 2000 and 2001 amount to Rs 350,000 and Rs 410,000 respectively.

(ii) in addition the company agrees to make four annual payments of Rs 200,000 each year (payments to be made on December 31, 2000, 2001, 2002 and 2003 respectively). These payments relate to retroactive changes in benefits (past service costs) as no pension scheme previously existed.

You ascertain that the expected average remaining service lives of employees in the scheme is ten years.

Required:

(a) State the main assumptions required in order to determine an appropriate charge to profit and loss account under a Defined Benefit Scheme. **(05)**

(b) Explain and justify the treatment in respect of the past service costs referred to in (ii) above. **(04)**

(c) Provide the relevant extracts from the balance sheets for 2000 and 2001. **(04)**

Q.6 It was agreed that, with effect from 1 Jan. 2000, Nexus Ltd would acquire the whole of the net assets of Forte Ltd and the fixed assets, stocks and goodwill of Motiwala & Palkiwala, a partnership, by the issue of ordinary shares of Rs 10 each fully paid at their then market value of Rs 12.50 per share.

In computing the number of shares to be issued for each business:

(A) The fixed assets were to be taken at the value placed on them by an independent valuer.

(B) Stocks were to be taken at book value subject to a deduction of Rs.2,000 from the stocks of Motiwala & Palkiwala for obsolete stock.

(C) In the case of Forte Ltd, debtors, creditors and balance at bank were to be taken at book value less Rs 3,000 in respect of a bad debts.

(D) Goodwill was to be valued at two years' purchase of the average profits of the last three years subject only to the following adjustments:

In the case of Forte Ltd:

(i) The directors' remuneration charged in each year was to be reduced by Rs 5000.

(ii) The depreciation charged in each year on 'other fixed assets' was to be substituted with depreciation on those assets calculated at 10% of cost on a straight line basis.

In the case of Motiwala & Palkiwala:

(i) Notional salaries of Rs 10,000 per annum are to be charged for the partners.

(ii) Rs 4,000, being an exceptional items of expense, was to be added back to the profits in the year to 31 December 1999.

The summarized balance sheets of the three businesses at 31 December 1999 were:

	Nexus Ltd Rs	**Forte Ltd** Rs	**Motiwala & Palkiwala** Rs
Freehold premises at cost	100,000	36,000	24,000
Other fixed assets at costs less depreciation	316,000	74,000	40,000
Stocks at cost	270,000	36,000	22,000
Debtors	246,000	86,000	42,000
Balance at bank	42,000	24,000	11,000
	974,000	256,000	139,000
Ordinary shares of Rs 10 each, fully paid	600,000	100,000	
Capital account:			
Motiwala			61,000
Palkiwala			22,000
Profit and loss account	244,000	52,000	
Creditors	130,000	104,000	56,000
	974,000	256,000	139,000

You ascertain:

	Nexus Ltd **Rs**	**Forte Ltd** **Rs**	**Motiwala & Palkiwala** **Rs**
(a) The depreciation deducted from the cost of other fixed assets at 31 December 1999	124,000	50,000	20,000
(b) The independent valuations at 31 December 1999 were:			
Freehold premises		120,000	50,000
Other fixed assets		66,000	42,000

(c)	The profits for the last three years ending on:		
	31 Dec. 1997	18,000	18,000
	31 Dec. 1998	24,212	13,000
	31 Dec. 1999	26,200	19,000
	after charging depreciation amounting to (for the years ending):		
	31 Dec. 1997	10,500	
	31 Dec. 1998	8,916	
	31 Dec. 1999	9,072	
(d)	The other fixed assets at 31 Dec. 1999 at cost were:		
	before 31 Dec. 1996	104,000	
	purchased 1 Jan. 1998	20,000	

(E) Forte Ltd has disposed of ‘other fixed assets’ on 1 January 1999 which had cost Rs 16,000 on 1 January 1996.

Required:

(a) a statement showing the number of shares to be issued by Nexus Ltd to pay for the acquisition; and

(b) the balance sheet, as far as the required information is available, of Nexus Ltd on 1 January 2000 after giving effect to the issue of shares for the acquisitions. **(21)**

(THE END)