THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Winter 2005

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ADVANCED ACCOUNTING & FINANCIAL REPORTING

(MARKS 100)
(3 hours)

Q.1 T Limited, a public listed company, entered into an expansion programme on July 1, 2004. On that date, the company purchased 80% of the share capital of Alpha Ltd and 40% of the share capital of Beta Ltd. For Alpha, T Ltd paid total consideration of Rs.25 million. This was settled by signing a loan agreement of Rs.20 million carrying interest at 7% payable semi-annually and the balance by issuing 200,000 ordinary shares of T Limited. Shares of Beta Ltd., were acquired by a 1 for 1 share exchange. The market value of T Limited's share at the date of acquisition was Rs 25. The year end of all the companies is June 30.

Extracts from their balance sheets at June 30, 2005 are as under:

	T Ltd Rs 000	Alpha Ltd Rs 000	Beta Ltd Rs 000
Fixed Assets:			
Land	5,000	4,000	3,500
Building	8,000	6,000	5,500
Plant	22,400	14,000	12,000
Current Assets:			
Stocks	10,000	9,000	16,200
Trade debts	9,200	7,000	2,800
Cash	Nil	3,000	4,300
Share Capital and Reserves:			
Ordinary shares of Rs.10 each	10,000	20,000	25,000
Unappropriated profits	20,000	15,000	4,500
Current liabilities:			
Creditors	12,000	5,300	13,600
Running finance	3,000	Nil	Nil
Taxation	9,600	2,700	1,200

The following further information is available:

- T Ltd. has not recorded the acquisition of the above investments nor the issue of new shares at the time of preparing the above balance sheet. However interest on loan of Rs.20 million has already been account for.
- The book values of the assets of Alpha Ltd. and Beta Ltd., at the date of acquisition, were considered to be a reasonable approximation of their fair values with the exception of fixed assets of Alpha Ltd. These were considered to have the following fair values.

Land	Rs. 5.0 million
Plant	Rs.16.0 million

The plant had a remaining life of 4 years at the time of acquisition.

- The profits of Alpha Ltd. and Beta Ltd., for the year ended June 30, 2005, as reported in their financial statements, were Rs.8 million and Rs. 2 million respectively. No dividends have been paid by any of the companies during the year.

Required:

Prepare the Consolidated Balance Sheet of T Ltd. as at June 30, 2005. **(18)**

Q.2 One of your clients has contacted you to prepare cash flow statement as per the requirements of IAS-7 and has provided you the following information:

	2005	**2004**
	Rupees in 000	
Cash and bank	21,750	17,000
Trade & other receivables	17,000	13,400
Stocks	14,000	12,000
Investments	-	4,000
Building	28,000	35,000
Equipments	40,000	20,000
Preliminary expenses	5,000	6,250
Provision for doubtful debts	3,000	4,500
Accumulated depreciation – Equipments	3,500	6,000
Accumulated depreciation – Building	8,500	12,000
Creditors	12,000	10,000
Dividend payable	-	6,000
Current maturity of long term loans	3,000	4,000
Long term loans	33,000	29,000
Issued, subscribed & paid up capital	40,000	28,000
Unappropriated profits	22,750	8,150

Additional data relating to the accounts for the year ended June 30, 2005 is as follows:

- Equipment that had cost Rs.11 million and was 40% depreciated at the time of disposal was sold for Rs.2.5 million
- Investments were sold at Rs.2.5 million above their cost. The company has made similar sales and investments in normal course of business.
- Rs.12 million of the long term loan was settled by issuing 1,200,000 ordinary shares of Rs.10 each.
- Cash dividend of Rs.6.0 million was paid on September 1, 2004.
- A long term loan of Rs. 16 million was obtained to finance the purchase of equipment.
- On July 1, 2004, a portion of the building was completely destroyed by fire. Insurance claim of Rs.15 million was received from the insurance company. The additions to the building during the year amounted to Rs.10.5 million and depreciation provided during the year was Rs.2.0 million.
- Interest and income taxes paid during the year were Rs.2 million and Rs.5 million respectively.

Required:

Prepare cash flow statement for the year ended June 30, 2005 showing necessary disclosures. **(15)**

Q.3 DJ Products deals in large office machines. It also offers such machines on lease. One such machine was leased to a customer on July 1, 2004. Its particulars are as follows:

Purchase cost of DJ Products	Rs.	150,000
Useful life		8 years
Lease period		6 years
Unguaranteed residual value	Rs.	10,000
Annual rental payable at beginning of each year	Rs.	36,500

The customer's incremental borrowing rate is 10% whereas the discounting rate implicit in the lease is 8%.

The present values of a single payment of Re.1 and the present values of annuities of Re.1 received at the end of the year, are as follows:

	Present value of Re.1			
Year	**Single payment**		**Annuities**	
	8%	**10%**	**8%**	**10%**
1	0.926	0.910	0.926	0.910
2	0.857	0.826	1.783	1.736
3	0.794	0.751	2.577	2.487
4	0.735	0.683	3.312	3.170
5	0.681	0.621	3.993	3.791
6	0.630	0.564	4.623	4.355
7	0.583	0.513	5.206	4.868
8	0.540	0.467	5.747	5.335

Required:

(a) Compute the following for DJ Products as at July 1, 2004:
   (i) Gross investment in the lease;
   (ii) Unearned finance income.

(b) Extracts of profit and loss account and balance sheet including notes thereon, as at June 30, 2005 including all necessary disclosures as required under IAS-17. **(16)**

Q.4 3S Service Limited has an asset that is being reviewed for possible impairment in value. The cost of the asset is Rs.26 million with a salvage value of Rs.2 million and a remaining useful life of 4 years. The asset was being depreciated applying straight line method and estimated useful life of 6 years. This asset is a cash generating asset with the following expected cash flows:

Year	**Rs.**
2005 – 06	6.0 million
2006 – 07	5.0 million
2007 - 08	4.0 million
2008 – 09	3.0 million

The company uses a discount rate of 10% and presently, the asset has a market value of Rs.15 million. It is expected that the cost of disposal will be Rs.0.8 million.

Calculate impairment loss as at June 30, 2005 under each of the following assumptions:

(a) The company will continue to use this asset in the future.

(b) The company intends to dispose of the asset in the coming year. **(08)**

Q.5 Following is the trial balance of Executive Bank Limited as at June 30, 2005:

Trial Balance

	Dr.	Cr.
	Rs. in '000'	
Cash in hand - local currency	167,800	
- foreign currency	257,000	
Current account # 23512 with SBP	480,000	
Current accounts in \$, £ and € with SBP	360,000	
Deposit account in \$ with Central Bank of Oman	35,000	
Current account with United Bank Limited, Karachi	73,000	
Current account with National Bank of Pakistan	100,000	
Deposit account with Citibank New York	837,000	
Investment in COIs of NBFIs	200,000	
Lending to NBFIs under Reverse Repo	935,000	
Treasury bills	500,000	
Investments in subsidiaries	200,000	
Ordinary shares of listed companies	7,000	
Term finance certificates	75,000	
Advances	3,500,000	
Miscellaneous current assets	150,000	
Fixed assets	1,245,000	
Surplus on revaluation of fixed assets		120,000
Deferred tax	27,000	
Bills payable		300,000
Borrowing from SBP under export re-finance		175,000
Overdrawn nostro accounts - unsecured		71,000
Borrowing under repo with local banks		275,000
Deposits from customers - fixed		1,200,000
- savings		2,600,000
- current		350,000
- miscellaneous		182,450
Payable to a leasing company under finance lease		46,000
Payable to a leasing company under operating lease		2,000
Payable to suppliers		2,000
Withholding tax payable		350
Markup payable		175,000
Share capital		1,200,000
General reserves		1,500,000
Reserve for issue of bonus shares		150,000
Statutory reserve		800,000
	9,148,800	9,148,800

Following further information is available:

1. 30% of investment in treasury bills have been given as collateral.
2. Investment in ordinary shares is primarily used for trading on stock exchange.
3. 40% TFCs will mature in January 2006 whereas the rest will mature in January 2007. However the bank intends to dispose all of them in January 2006.

Required:

Prepare the balance sheet of the bank as at June 30, 2005 alongwith the following notes to the extent the information is available, in accordance with the laws applicable in Pakistan:

- Cash and bank balances
- Investments (investment by segments are not required)
- Borrowings from financial institutions **(15)**

Q.6 As a credit analyst in a bank, you have been given the following summarized profit and loss statement and balance sheet of XYZ Limited:

Profit and loss account
For the year ended September 30, 2005

	Rs. '000'
Sales	62,400
Cost of goods sold	51,090
	11,310
Selling and administrative expenses	1,560
Profit before interest and tax	9,750
Interest expense	1,755
Profit before tax	7,995
Tax	3,198
Profit after tax	4,797

Balance Sheet
As on September 30, 2005

	Rs. '000'
Capital and liabilities	
Paid up capital 1,365,000 shares of Rs.10 each	13,650
Retained earnings	4,680
Debentures	29,250
Creditors	7,020
Bills payable	780
Other current liabilities	3,120
	58,500
Assets	
Net fixed assets	31,200
Inventory	15,600
Debtors	7,825
Marketable securities	1,925
Cash	1,950
	58,500

Current market price per share is Rs.22/-

Industry's averages are as follows:

− Current ratio	2.3
− Quick ratio	1.6
− Sales to inventory	7.0
− Average collection period	32 days
− Price per share / book value of the share	1.4
− Debt to assets ratio	38%
− Time interest earned	7
− Profit margin	8%
− Price to earning ratio	10
− Return on total assets	10%

Required:

(i) XYZ Limited has applied for a short term loan of Rs.20 million. You are required to evaluate the financial position of XYZ Limited and advise whether the loan may be sanctioned.

(ii) What will be your evaluation if sales to inventory ratio and average collection period are reduced to the industry average? **(12)**

Q.7 You are required to draft revenue recognition policies as required by IAS-18 in respect of the following companies:

(a) Airline, which earns revenue through carrying passengers and cargo, receives money on tickets and airway bills some of which remain unutilized at the year end.

(b) Manufacturing concern, which earns revenue from sale of goods, return on bank deposits, scrap sales, commission from sale of subsidiary company's products and dividend income which include dividend on shares of a subsidiary company.

(c) Natural gas supply company, engaged in transmission and distribution of natural gas, sale and rental of gas meters and sale of gas condensate as a by-product. Late payment surcharge is also levied on long outstanding bills.

(d) Leasing company which earns revenue from finance lease, operating lease and other income incidental thereto. **(16)**

(THE END)