THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations Summer 2006

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ADVANCED ACCOUNTING & FINANCIAL REPORTING

(MARKS 100)
(3 hours)

Q.1 Millennium Enterprises Limited (MEL) has 80% shareholding in Century Petroleum Limited (CPL) which it had acquired on April 1, 2003. On April 1, 2005, it acquired whole of A Limited's equal (50%) share in the joint venture A Limited had with B Limited in a pipeline project. The operations of the project are jointly controlled. The purchase was made at book value.

The balance sheets of the above entities as at March 31, 2006 are given hereunder:

	MEL	CPL	Joint Venture
	Rupees in thousand		
Non-current assets			
Property, plant and equipment	416,250	153,600	63,000
Investment	160,000	12,800	---
	576,250	166,400	63,000
Current assets			
Inventory	41,440	20,480	21,000
Accounts receivable	35,150	12,160	11,200
Bank	6,660	--	9,800
	83,250	32,640	42,000
Total assets	659,500	199,040	105,000
Equity and liabilities			
Capital and reserves			
Ordinary shares of Rs.10 each	185,000	64,000	35,000
Reserves			
Accumulated profits	405,680	76,800	52,500
	590,680	140,800	87,500
Current liabilities			
Accounts payable	48,100	43,200	14,000
Taxation	20,720	11,200	3,500
Overdraft	--	3,840	--
	68,820	58,240	17,500
Total equity and liabilities	659,500	199,040	105,000

The following information is relevant:

(i) CPL was acquired at a cost of Rs.120 million. Its accumulated profits at that date were Rs. 28 million.

At the date of acquisition, i.e. April 1, 2003, CPL owned an item of plant that had a fair value of Rs.20.0 million in excess of its book value. The plant had a remaining useful life of five years. All plant and equipment is depreciated on the straight-line basis.

The fair value of CPL's remaining net assets and all of the Joint Venture's net assets were equal to their book values at the relevant dates of acquisition.

(ii) On October 1, 2005 MEL purchased some equipment from the Joint Venture for a consideration of Rs.7.0 million. It was sold at a mark up of 25% on cost. The equipment is in use by MEL and is included in property plant and equipment and being depreciated over a four-year life.

(iii) During the year ended March 31, 2006, the books of account of the Joint Venture showed a profit of Rs.15.0 million.

(iv) The share of profit for the year in CPL and the Joint Venture has not yet been recorded in the books of MEL.

(v) All inter company current account balances were settled prior to the year-end.

Required:
Prepare the consolidated balance sheet of MEL as at March 31, 2006. **(20)**

Q.2 Mughals Limited, a firm of civil contractors, specialize in construction of highways. They entered into a contract with the National Highway Authority (NHA) in the year 2003 for construction of National Highway covering 1500 kilometers and having 6 lanes. However, it was agreed that work shall commence on February 1, 2004. The agreed price was Rs.3.6 billion. The company closes its accounts on May 31.

On February 1, 2005 the NHA requested the company for extending the highway by adding two further lanes. NHA was of the view that the price of this extension shall be in the same proportion i.e. Rs. 1.2 billion, as there has been no significant increase in costs since the signing of the contract in 2003. However Mughals Limited refused to accept this price. Their board of directors was of the view that their company was in a position to sign another contract if they forego the offer by NHA. After extensive negotiations, the price of the extended work was agreed at Rs. 1.6 billion. It was also agreed that the work on additional lanes will be carried out simultaneously and will be completed on November 30, 2006.

The following data is available in respect of the above contract:

	As at May 31		
	2004	**2005**	**2006**
Original Contract	**Rupees in million**		
Progressive billing to date	800	2,500	3,400
Amount received to date	600	2,400	3,240
Mobilization advance (included in the above)	180	180	180
Actual cost to date	600	2,000	2,680
Value of work certified by NHA	300	2,000	3,300
Profit (latest estimate)	600	900	720
Additional Work			
Progressive billing to date	--	200	1,100
Amount received to date	--	80	800
Mobilization advance (included in the above)	--	80	80
Actual cost to date	--	100	580
Value of work certified by NHA	--	--	1,000
Profit (latest estimate)	--	700	600

There is a clause in the agreement that NHA will pay an early completion bonus of Rs.5.0 million per week. However in case of delay it will levy a penalty of Rs.10.0 million for each week the completion is delayed. In case of the original agreement the company has always been confident that the contract will be completed two weeks ahead of time and was actually completed accordingly. In case of additional work the chances of delay at year-end were considered as:

	2005	**2006**
Delay of two weeks	Possible	Probable
Delay of three weeks	Remote	Possible
Delay of four weeks	--	Remote

Required:

(a) Discuss whether the contract for additional work shall be treated as a separate contract or a part of the original contract, according to IAS-11 (Construction Contracts) **(04)**

(b) Prepare extracts of the Income Statement and Balance Sheet of Mughals Limited for the years to May 31, 2005 and 2006 in respect of the above contract along with necessary disclosures regarding treatment of bonus and penalty as discussed above. **(16)**

Q.3 Following are some of the balances which have been extracted from the trial balance of EZ General Insurance Company Limited for the year ended December 31, 2005:

	Rs. in '000'	
	Dr.	**Cr.**
Premium receivable	17,000	
Accrued income	300	
Prepayments	2,400	
Premium received in advance		3,523
Amounts due to other insurers/re-insurers		3,891
Accrued expenses		765
Other creditors and accruals		7,631
Retained earnings		4,630
Other revenue reserves		8,300
Premiums written during the year		74,471
Unearned premium reserve – opening		27,700
Reinsurance expense (after adjusting prepayments)	27,058	
Claims paid	43,706	
Outstanding claims – opening		4,354
Reinsurance recoveries against claims (after all adjustments)		14,751
Commissions paid	7,549	
Unpaid commissions – opening		4,360
Commissions from re-insurers		11,919
Management expenses	6,986	
General and administration expenses	6,678	
Investment income		6,521
Rental income		124
Other income		2,891

Further breakdown of some of the above figures is as follows:

	Rs. in '000'			
	Fire	**Marine**	**Motor**	**Misc.**
Premiums written during the year	27,386	15,645	21,568	9,872
Unearned premium reserve – opening	11,200	1,200	10,500	4,800
Reinsurance expense (after adjusting prepayments)	11,567	6,781	4,587	4,123
Claims paid	18,567	4,567	16,897	3,675
Outstanding claims – opening	1,254	875	1,567	658
Reinsurance recoveries against claims (after all adjustments)	7,894	1,852	3,423	1,582
Commissions paid	2,854	1,857	1,785	1,053
Unpaid commissions – opening	1,750	510	1,700	400
Commissions from re-insurers	5,405	2,975	1,587	1,952

Following additional information is available:

(i) The unearned premium reserve as at December 31, 2005 calculated in accordance with the rules shall be as under:

	Rs. in '000'
Fire	12,300
Marine	890
Motor	11,300
Miscellaneous	4,650

(ii) Provision for unpaid claims and claims incurred but not reported at the date of balance sheet are estimated as under:

	Rs. in '000'
Fire	1,680
Marine	610
Motor	1,800
Miscellaneous	450

(iii) Commission due to agents, as on December 31, 2005 was as follows:

	Rs. in '000'
Fire	1,560
Marine	820
Motor	1,850
Miscellaneous	580

(iv) Management expenses represent those expenses which are attributable to underwriting business. These are to be allocated to various classes of business on the basis of premium earned during the year.

(v) Expenses not allocable to underwriting business are charged as general and administrative expense.

(vi) For the purpose of tax provision, rate of tax is to be assumed at 35%.

Required:
Draw up the Profit and Loss Account of EZ General Insurance Company Limited for the year 2005. Notes to the accounts are not required, however appropriate workings should be prepared. **(14)**

Q.4 Durable Electronics Limited is a manufacturing concern specializing in the manufacturing and marketing of home appliances. The trading results for the year ended December 31, 2005 are as follows:

	Rupees in million
Profit before taxation	60
Income Tax	12
Profit after taxation	**48**

The details of movement in the share capital of the company during the year are as follows:

- As on January 1, 2005, 10 million ordinary shares of Rs. 10 each were outstanding having a market value of Rs. 350 million.

- The board of directors of the company announced an issue of right share in the proportion of 1 for 5 at Rs. 40 per share. The entitlement date of right shares was April 30, 2005. The market price of the shares immediately before the entitlement date was Rs. 40 per share.

- The company announced 20% bonus shares for its shareholders on June 1, 2005. The shareholders were informed that the share transfer books of the company will remain closed from July 1 to July 10, both days inclusive. Transfers received up to June 30, 2005 will be considered in time for entitlement of bonus shares. However, right shares issued in the month of April 2005 will not be entitled for the bonus shares. The ex-bonus market value per share was Rs. 32.

- A further right issue was made in the proportion of 1 for 4 on October 31, 2005 at a premium of Rs. 15 per share. The market value of the shares before the right entitlement, was Rs. 33 per share.

Required:
Calculate the basic and diluted earnings per share for the year ended December 31, 2005 in accordance with IAS 33 (Earnings per share). **(14)**

Q.5 You are the Chief Accountant of Rubab Enterprises Limited which is engaged in manufacturing iron and steel products. The company was set up in August 1998 and started commercial production in November 1998. The accounting year-end of the company is June 30.

While analyzing the company's books of accounts for the year ended June 30, 2005, you came across the following balances:

	Rs.
Provision for taxation (Gross)	2,410,000
Deferred tax liability	4,700,000

The assessments of the past four years although completed by the taxation officer but are still open due to appeals. The provision for taxation consists of the following:

Accounting year	Accounting Income	Assessed Income	Tax Rate	Provision for Taxation
2002	1,000,000	1,800,000	45%	810,000
2003	1,400,000	1,900,000	40%	760,000
2004	1,700,000	2,100,000	40%	840,000
2005	2,200,000	-	35%	-
				2,410,000

The deferred taxation is on account of the following:

	Dr / (Cr)
Depreciation	(4,000,000)
Leasing	(2,000,000)
Penalties and fines paid by the company	100,000
Provisions for gratuity	1,000 ,000
Provisions for bad debt	200,000
	(4,700,000)

The following information is also available:

(a) The accounting depreciation for the year ended June 30, 2005 amounted to Rs.20.50 million whereas tax depreciation as calculated by one of your sub-ordinates amounted to Rs. 15.50 million.

(b) The company operates an unfunded gratuity scheme. Gratuity of Rs.100,000 each was paid to two of the employees who had resigned during the year. The total provision required at year-end amounted to Rs. 3.5 million.

(c) Leased assets consisted of two machines only. In the accounting records of the company; one of the lease has been treated as operating lease. The machine under financial lease arrangement was sold during the year at a profit of Rs.400,000. The lease was cancelled with the consent of the leasing company.

(d) The company paid Rs. 1,000,000 on account of certain expenses. Your tax advisor has informed you that only 60% of this will be allowed for tax purposes and that too, over a period of five years (including the current year).

(e) Receivables of Rs.40,000 which were written off in the year 2002 were recovered during the year. The same had not been allowed by the tax authorities in the year in which they were written off.

During the year, the following decisions were made by various tax appellate authorities:

(a) While assessing the income for the year ended June 30, 2002 the value of closing stock had been increased by the taxation authorities by Rs. 4.0 million. Consequential effect on opening stock of next year had however been allowed. During the current year, add-back was declared invalid by the appellate authority.

(b) An expense incurred in the year 2003, amounting to Rs.0.5 million, which was disallowed then, was declared as allowable over a period of four years. Although the company had filed an appeal, it was of the view that the same would not be allowed, hence it has ignored it for the purpose of calculating deferred tax till last year.

Required:

(a) Among the transactions discussed above, identify those which give rise to permanent timing differences. **(02)**

(b) Calculate the following:

i). Provision for taxation – current
ii). Provision for taxation – prior years
iii). Deferred tax – current
iv). Deferred tax – prior years
v). Deferred tax liability **(18)**

Q.6 XYZ Limited is a subsidiary of MAG International Limited. It has been listed on the Karachi Stock Exchange for the past forty years.

Required:

Draft a Statement of Compliance for inclusion in the financial statements of XYZ Limited. **(06)**

Q.7 Explain the concept of 'Embedded Derivative' as discussed in International Accounting Standards 39 (Financial Instrument: Recognition and Measurement). **(06)**

(THE END)