THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations   Winter 2006

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ADVANCED ACCOUNTING & FINANCIAL REPORTING

(MARKS 100)

Module E **(3 hours)**

Q.1 GIF Holdings Limited (GIF) held 75% shares of JPG Limited (JPG) and 30% shares of BMP Limited (BMP). Their summarized balance sheets as at June 30, 2005 are as follows:

	GIF	**JPG**	**BMP**
	-------Rupees in million -------		
Investments at cost in:			
JPG Limited	450	-	-
BMP Limited	250	-	-
Other Net assets	1,690	1,000	800
	2,390	**1,000**	**800**
Share capital (Rs.10 per share)	100	100	50
Accumulated profits	2,290	900	750
	2,390	**1,000**	**800**

Following additional information is also available:

(a) GIF acquired the shares of JPG many years ago when the reserves of JPG were Rs. 500 million. The reserves of BMP were Rs. 650 million when GIF bought its 30% holding on July 01, 2004.

(b) The following transactions have taken place from July 01, 2005 to June 30, 2006:
- On January 01, 2006, GIF acquired a further 2,500,000 shares in BMP for Rs. 705 million.
- On April 01, 2006 GIF sold its entire interest in JPG for Rs. 1.1 billion in cash. Tax arising on this transaction was Rs. 83 million.
- The draft results of the individual companies in the period since July 01, 2005 are as follows:

	GIF	**JPG**	**BMP**	
	For the year ended		**For the six months ended**	
	June 30, 2006		**Dec. 31, 2005**	**June 30, 2006**
	Rs. in million		**Rs. in million**	
Turnover	4,000	5,400	2,500	3,000
Profit before tax	400	320	300	340
Tax	(140)	(112)	(105)	(119)
Profit after tax	260	208	195	221

(c) While preparing the results for the year ended June 30, 2006, GIF have not given effect to the disposal of its holding in JPG.

(d) Directors of GIF have indicated that costs of Rs. 70 million incurred and charged by BMP in its draft results for the six-months ended June 30, 2006 had been incurred prior to its acquisition by GIF, whereas they were recorded after January 1, 2006.

(e) BMP has now decided to write off a debtor balance of Rs. 40 million of which Rs. 30 million had been outstanding since December 31, 2005. For the purpose of consolidation, Rs. 30 million will be considered to have been written off prior to January 1, 2006.
(f) GIF is a regular supplier to BMP, and makes a pre-tax profit of 20% on sales. Sales by GIF to BMP in the six-months ended June 30, 2006 were Rs. 800 million. Goods invoiced at Rs. 450 million were still in BMP's stock as at June 30, 2006.
(g) Goods invoiced by GIF to BMP in June 2006 at Rs.150 million were not reflected in BMP's accounts as at June 30, 2006 as they had not been delivered to BMP till then.
(h) The management of GIF tested the goodwill amount by comparing it with its recoverable amount and decided to reduce its value by 2.5% at June 30, 2006.
(i) Applicable tax rate is 35%. Ignore deferred tax.

Required:
Prepare the consolidated profit and loss account of GIF Holdings Limited for the year ended June 30, 2006 and the consolidated balance sheet as at June 30, 2006. **(22)**

Q.2 PDF Steel Manufacturing Company Ltd. purchased a building for its proposed research and development laboratory at a cost of Rs. 75.8 million. The building was placed in service on July 10, 2005. The estimated useful life of the building for depreciation purpose is 20 years. The company uses straight-line method for calculating depreciation and there is no estimated net salvage value.

The laboratory has been designed to carry out research on various projects and will also help the company in the production of a highly technical tool which has a wide use in the manufacturing of ammunition. A summary of the number of projects and the cost incurred on research and development for the year ended June 30, 2006 are as follows:

	No. of projects	**Salaries and employee benefits**	***Other directly attributable expenses**	**Training of staff**
Completed projects with long term benefits	15	5,400,000	3,000,000	1,000,000
Abandoned projects or projects that benefit the current period only	10	3,900,000	900,000	300,000
Projects in process – results indeterminate	5	2,400,000	720,000	320,000
Total	30	11,700,000	4,620,000	1,620,000

*** excluding depreciation**

In view of the importance of some of the projects, the Government of Pakistan (GoP) provided the company a team of experts to support the research and development activities of the company. This team of experts worked on five projects which were successfully completed and have long term benefits to the company. It was worked out that had the company hired such team of experts, it would have cost them Rs. 7.5 million.

On the recommendation of the research and development team, the company acquired a patent for manufacturing rights at a cost of Rs. 5.89 million. The patent was acquired on October 01, 2005, and has an economic life of 10 years.

Required:
How the above items relating to research and development activities would be reported on the company's financial statements. Show all necessary disclosures including the accounting policy. Assume that long term benefits mean 10 years on the average. **(12)**

Q.3 RTF Sugar Mills Ltd. has been incurring losses since last many years. The statutory audit of the company since 2004 has not yet been finalized. You have recently been appointed as Chief Accountant of the company and have been assigned the responsibility of finalizing the accounts for the years 2004, 2005 and 2006. As a first step, you have reviewed the draft accounts for the year 2004 which were prepared on August 1, 2004. You have also ascertained the following information about certain subsequent events that may have an impact on the financial statements for the year ended June 30, 2004:

(a) The Board of directors approved sale of a loss making segment of the company in December 2004, which was sold in April 2005 at a profit of Rs. 123 million. The profit has been computed on the basis of book value of assets as of April 2005;

(b) Benefits to employees under the gratuity scheme were reduced by the management on March 30, 2005 with retrospective effect which has resulted in 50 percent decrease in the liability for gratuity (projected benefit obligation). The original liability as of June 30, 2004 was estimated at Rs. 73 million;

(c) The government has increased the income tax rate by 5 percent in July 2006, which if taken into account, will result in an increase in deferred tax liability by Rs. 135 million;

(d) The company has issued a guarantee of Rs. 350 million against debts of one of its associates on September 15, 2004;

(e) A long-term financing arrangement was rescheduled on March 31, 2005. The current maturity of the said arrangement was Rs. 180 million as of June 30, 2004 out of which Rs. 30 million were paid before such rescheduling. After rescheduling the first payment becomes due in 2011;

(f) Certain inventories of a specific service line could not be sold till February 2006 when these were disposed off at a loss of Rs. 83 million. No other evidence is available regarding their net realizable value.

Required:
Consider each of the above event separately and explain briefly whether it:

- needs to be accounted for;
- needs to be disclosed; or
- does not effect the financial statements for the year 2004. **(14)**

Q.4 XLS Limited is a listed company and engaged in the assembling of electrical appliances. During the year, the company changed its accounting policies in respect of the following:

1. It has started to capitalize the borrowing costs directly attributable to the qualifying assets. Upto June 30, 2005, the company recognized the borrowing costs as an expense in the year in which they were incurred.
2. Provision for bad debts shall be provided at 3% instead of 2%.

The management feels that change of above policies will reflect a fair view of the company's financial position to the shareholders.

Extracts from the financial statements of the company before incorporation of above changes are given below:

	2006	2005
	Rs. in million	
Gross profit	486	410
General and administration expenses	(231)	(225)
Selling and distribution expense	(110)	(98)
Financial charges	(32)	(31)
Profit before tax	113	56
Income taxes	(30)	(14)
Profit after tax	83	42
Retained earnings – opening	452	410
Retained earnings – closing	535	452

Following additional information is also available:

1. Details of borrowing costs expensed out in current and prior periods which are directly attributable to the qualifying assets are as follows:

Year	Amount Rs. in million
June 30, 2006	16
June 30, 2005	12
June 30, 2004 and before	8

2. The change in the rate of provision for bad debts has been made on the recommendation of Recovery Department. The company has not yet made the provision as of June 30, 2006. The details of accounts receivables are as follows:

Accounts receivable as at June 30, 2005	Rs. 100 million
Accounts receivable as at June 30, 2006	Rs. 123 million

Provision as at June 30, 2004 was Rs. 1.6 million.

3. Income tax rate was 25% for both years.

Required:

(a) Present the above changes in the Profit and Loss Account and Statement of Changes in Equity in accordance with the requirements of IAS-8 “Accounting Policies, Changes in Accounting Estimates and Errors”.

(b) Draft an accounting policy about the borrowing costs for disclosure in the financial statements. **(17)**

Q.5 DOC Industries is engaged in manufacturing and export of cotton and linen bed sheets to USA and Middle East. The company operates an approved funded gratuity scheme for all eligible employees. The last actuarial valuation of the scheme was carried out using the Projected Unit Credit Method. Following are the extracts of relevant information from the actuarial report for valuation carried out in line with IAS – 19, as of June 30, 2006:

	Rupees
Present value of projected benefit obligations – June 30, 2005	1,930,650
Current service cost for the year	350,200
Interest cost for the year	135,650
Gratuity paid by the fund to the retiring employees	165,200
Actuarial loss on obligations, during the year	650,300
Expected return on plan assets	275,350
Contribution paid by the company to the fund during the year	425,000
Fair value of plan assets – June 30, 2005	1,420,350
Actuarial gain on plan assets during the year	135,000

Following information is also available:

1. Additional gratuity amounting to Rs. 55,500 was paid to a retiring employee as ex-gratia by the company which is included in both, the payments made by the company to the fund, as well as, the payments made by the fund to the retiring employees;
2. During the year, the management introduced a change in the plan, which has resulted in increase in benefits. Past service cost, amounting to Rs. 273,000 against such plan changes has not been separately disclosed in the actuarial report. When the actuary was consulted again in this respect, he responded that such effect is included in the actuarial loss for the year. He further informed that 70% of such benefit is vested. It is expected that non-vested benefit will become vested over a period of 4 years.
3. Average remaining service life of the employees was 23 years, as of June 30, 2005.
4. Discount rate of 10%, rate of return on plan assets of 10% and expected rate of increase of salaries of 12% have been used for valuation purposes.
5. Net unrecognized actuarial loss, as at June 30, 2005 was Rs. 350,450.
6. 40% of cost of gratuity is chargeable to administrative expenses and 60% to cost of goods sold.
7. The company follows the corridor approach for accounting of net actuarial gains and losses.

Required:
Prepare all necessary disclosures to be incorporated in the financial statements including accounting policy, in respect of the defined benefit gratuity scheme. Show all necessary workings. **(20)**

Q.6 TMP Trust Fund is an open ended mutual fund, listed on Lahore Stock Exchange. Units are offered for public subscription on a continuous basis and can be redeemed by surrendering them to the fund.

Following financial information is available for the year ended June 30, 2006:

1. During the year, the fund received amounts of Rs. 210,290,408 (2005: Rs. 152,870,421) against issuance of 1,546,253 units (2005: 1,377,211 units). The issued units include bonus units issued to unit holders.
2. 1,434,644 units (2005: 1,213,560 units) were redeemed during the year against which an amount of Rs. 194,394,262 (2005: Rs. 133,491,600) was paid / payable by the fund.
3. Undistributed income brought forward from previous year is Rs. 5,638,924.
4. It is the policy of the fund to recognize the distribution of cash dividend and bonus in the year in which it is declared. The fund has announced at the year end, bonus units of 15% (2005: 10%) and 10% cash dividend (2005: Nil).
5. No cash dividend or bonus has been distributed prior to June 30, 2005.
6. Net income of the fund is Rs. 15,532,600 (2005: Rs. 8,511,744).
7. The element of income and capital gains included in prices of units sold less those in units redeemed representing accrued income and realized capital gains, amounted to Rs. 1,536,360 (2005: Rs. 965,458). This amount was transferred to profit and loss account.
8. The value of net assets at the beginning of the year was Rs. 39,674,912.
9. 550,215 units of Rs. 100 each are outstanding as at June 30, 2006.

Required:
Prepare the following statements of TMP Trust Fund for the year ended June 30, 2006 and 2005:

(i) Distribution Statement
(ii) Statement of movement in unit holders' funds. **(15)**

(THE END)