THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examinations   Summer 2007

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ADVANCED ACCOUNTING & FINANCIAL REPORTING

(MARKS 100)
(3 hours)

Q.1 Murree Food Limited, a public company, was sued by an employee claiming damages for Rs 4,000,000 on account of an injury caused to him as a result of alleged negligence on the part of the company while he was working on the machine on December 18, 2006. Before filing the suit on January 18, 2007, he contacted the management of the company on December 28, 2006 and asked for compensation of Rs 2,500,000 which was denied.

The legal advisor of the company fears that the company may lose the suit and the court may award compensation which may range from Rs 400,000 to Rs 2,000,000. However, in his view the most probable amount is estimated at Rs 800,000.

Required:
(a) Describe the accounting treatment in respect of the above in the financial statements of Murree Food Limited for the year ended December 31, 2006. Explain your viewpoint with reasons based on relevant International Accounting Standards.
(b) Draft a suitable note for presenting the information in the financial statements. **(10)**

Q.2 Gilgit Company Limited holds 800,000 shares of a listed company namely Hunza Foods Limited, which were purchased for Rs 84,400,000 as a long-term investment. On January 15, 2007, Hunza Foods Limited announced the issuance of one right share for every 5 shares held by the shareholders of the company. Face value of the shares is Rs 100 per share. On the date of book closure, market value of the share (cum right) was Rs 106 per share. The initial quoted price of the right was Rs 4 per right.

Required:
Suggest the necessary journal entries in the books of Gilgit Company Limited in case of each of the following options:

Option # 1 If the rights are not exercised but are sold at Rs 6 per right.

Option # 2 If the rights are not exercised and are allowed to expire.

Option # 3 If the following transaction take place:
- 200,000 shares are sold at cum right price for Rs 23,000,000;
- The right to purchase 120,000 additional shares at Rs 100 per share is exercised. Immediately after the book closure, the shares were quoted at Rs 103 per share (ex-right); and
- 100,000 shares originally held are sold at Rs 107 per share, after the exercise of the rights. **(16)**

Q.3 Skardu Limited is preparing its consolidated financial statements for the year ended December 31, 2006. During the year 2006, it acquired shares in three companies. The details are given hereunder:

(a) **Balakot Limited**
43% shares were acquired on May 1, 2006. Balakot Limited is a major supplier of Skardu Limited. Skardu Limited also has a written agreement with Mr. Saleem who owns 30% of the share capital of Balakot Limited. According to the agreement, Mr. Saleem will always vote in the same way as Skardu Limited. Skardu Limited has also made a substantial loan to Balakot Limited after acquisition of its shares, which is repayable on demand. Balakot Limited is currently not in a position to repay the loan.

(b) **Mangora Textile (Pvt.) Limited**
The whole of the share capital was acquired on April 1, 2006. The directors of Skardu Limited have displayed their clear intentions to sell the subsidiary within a year. At the date of acquisition, the estimated fair value of assets was Rs 54 million and the fair value of the liabilities was Rs 16 million. At year-end, the estimated fair value of assets is Rs 52 million and the fair value of the liabilities is Rs 15 million.

(c) **Mansehra Limited**
47% of the voting shares of Mansehra Limited were acquired on June 1, 2006. Rest of the shares are owned by two financial institutions i.e. A (20%) and B (33%). Each financial institution has nominated three directors on the board whereas four directors are nominated by Skardu Limited. The effective power to set Mansehra's operating policies lies with the four directors appointed by Skardu Limited. However, according to the articles of association of Mansehra Limited, any change in the capital structure requires that all the ten directors must vote in favor of the proposal.

Required:
Discuss how these investments should be treated in the consolidated financial statements of Skardu Limited for year ended December 31, 2006. **(08)**

Q.4 One of your clients has contacted you to calculate earnings per share in accordance with the requirements of International Accounting Standards and has provided you the following information:

(i) At the beginning of the year 2006 the company's share capital was Rs 50 million consisting of 5,000,000 ordinary shares of Rs 10 each. Ten percent bonus shares were issued on April 1, 2006. Market price of ordinary shares at the beginning of the year was Rs 33 per share. On June 30, 2006 the price was Rs 38 per share and at the end of the year, the price was Rs 36 per share.

(ii) Profit attributable to ordinary shareholders of the company for the year 2006 is Rs 20 million.

(iii) The company had issued convertible Term Finance Certificates (TFCs) of Rs 120 million carrying markup at the rate of 13 percent per annum. The certificate holders have the option to convert TFCs into ordinary shares in the ratio of 25 ordinary shares for each TFC of Rs 1,000.

(iv) The company is subject to income tax at the rate of 35%.

Required:
Calculate the basic and diluted earnings per share for the year 2006 in each of the following situations:

(a) if none of the TFC holders opt to convert TFCs into ordinary shares;
(b) if a TFC holders who owns 40% of the total TFCs exercises his right of conversion on the first day of July 1, 2006. **(15)**

Q.5 Swat Limited is in the business of manufacturing and selling of biscuits. It sells biscuits through its authorized partners appointed in all major cities of Pakistan.

The company accounts for taxation and deferred taxation in accordance with the provisions of IAS 12. The relevant information relating to accounting year ended December 31, 2006 is summarized hereunder:

	Rupees in "000"
Accounting income before tax	797,000
Accounting WDV of fixed assets as at December 31, 2006	565,500
Tax WDV of fixed assets as at December 31, 2006	243,000
Dividend income (subject to final tax at 5%)	35,000
Capital gain (exempt from tax)	135,000
Turnover for the year	3,165,500
Total turnover tax paid during the last three years	65,000
Liabilities older than 3 years, disallowed in previous years.	65,000
Provision for gratuity as at December 31, 2006	138,500
Provision for Gratuity for the year (net of payments)	33,000
Donations to unapproved institutions	5,000
Effect of prior year's assessments finalized during the current year	6,400
Accounting depreciation for the year	103,000
Tax depreciation for the year	85,000
Fixed assets additions during the year	123,000

All the liabilities are less than three years old except for those disclosed in the above table. No payment was made in respect of liabilities disallowed earlier.

Only one fixed asset (a vehicle) was disposed off during the year 2006 against Rs 1,000,000. Its accounting WDV was Rs 700,000 while tax WDV was Rs 465,000. No disposal of fixed assets took place in the year 2005.

All expenses (except donations and timing differences) are considered to be allowable for tax purpose. Applicable tax rate is 35%.

During last three years, the company was in a loss and was paying turnover tax which is adjustable in future under the provisions of the Income Tax Ordinance, 2001, within a period of five years. The company had always believed that such tax credit will be utilized in the near future.

Required:

(a) Compute the amount of deferred tax required to be reported in the balance sheets for the years 2006 and 2005.

(b) Prepare a note to the Profit and Loss Account for the year 2006, giving appropriate disclosures related to tax expenses. **(18)**

Q.6 Ayubia Limited is a public company engaged in the supply of locally assembled machinery used in the textile industry. The management of the company feels that the company's sales performance will be much improved if it provides in-house after sales services to its customers as well as prompt delivery of spare parts. For this purpose, on May 1, 2007 the management of the company decided to acquire 100% holding in the following companies:

– Kalam (Pvt.) Limited, an importer of spare parts used in textile machinery; and
– Ziarat (Pvt.) Limited, which provides repair and maintenance services related to textile machinery.

It has been agreed that the consideration for the acquisition will be ascertained by applying the agreed price earning ratios on the estimated profits for the year ending June 30, 2007. The price earning ratio for Kalam (Pvt.) Limited and Ziarat (Pvt.) Limited has been agreed at 15 and 10 respectively. The shares in Ayubia Limited will be issued to shareholders of both the companies on October 01, 2007 at a premium of Rs 3 per share.

The following relevant information is available:

Rupees in million

	Ayubia Limited	**Kalam (Pvt.) Limited**	**Ziarat (Pvt.) Limited**
Issued Share Capital: Ordinary Shares of Rs 10 each	*1,600	150	60
Estimated profits before taxation - for the year ending June 30, 2007 - for the year ending June 30, 2008	 *690 *780	 30 35	 12 18
Estimated net assets as on June 30, 2008	*4,890	250	70

*excluding the effect of acquisition transactions

Ayubia Limited anticipates that on May 01, 2008, it will provide a loan amounting to Rs 30 million to Kalam (Pvt.) Limited and Rs 15 million to Ziarat (Pvt.) Limited for restructuring and renovation of operations and working facilities. The loans will be repaid in March 2010 and will carry a simple mark up at the rate of 13% per annum which will be payable on quarterly basis. It also estimates that this acquisition will result in increase in its administration expenses by Rs 2,500,000 per annum.

It is also expected that following interim dividends will be paid on June 30, 2008:

Ayubia Limited	15.0%
Kalam (Pvt.) Limited	12.5%
Ziarat (Pvt.) Limited	8.0%

Tax rate applicable to business income of all the companies is 35% whereas dividends are taxed at 10%.

Required:
Prepare projected balance sheet and projected profit and loss account of Ayubia Limited relating to the year ending June 30, 2008. **(18)**

Q.7 Naran Bank Limited is a listed banking company which has 107 branches all over Pakistan and 2 overseas branches. Total advances by the bank at the end of the year 2006 amounted to Rs 75,350 million (2005: Rs 65,440 million). These include Rs 3,655 million (2005: Rs 2,373 million) placed under non performing status in accordance with the Prudential Regulations issued by State Bank of Pakistan. Details of classified advances and the provisions thereagainst are as follows:

Rupees in million

Category of Classification	**Classified Advances**		**Provision Required / Made**	
	2006	**2005**	**2006**	**2005**
Other Assets Especially Mentioned	3	2	-	-
Substandard	107	70	22	46
Doubtful	103	67	47	53
Loss	3,442	2,234	2,607	1,312

An additional provision of Rs 64 million was made during the year pursuant to the State Bank of Pakistan's advice. The 'Loss' category includes advances of Rs 25 million (2005: Rs 23 million) relating to overseas operations of the bank. The required provision of Rs 8 million (2005: Rs 7 million) has been made against such advances.

The movement in the provisions was as follows:

	Rupees in million	
	2006	**2005**
Opening balance	1,411	944
Charge for the year (net of reversal)	1,331	467
Amounts written off during the year	(2)	-
	2,740	**1,411**

In addition to the above, the bank has made the following provisions:

(i) During the year a general provision of Rs 121 million (2005: Rs 107 million) was made against consumer financing in accordance with the requirements of the Prudential Regulations (1.5% of secured financing and 5% of unsecured financing). However, no amount had been written off. The opening balance of provision against consumer financing as on January 1, 2006 amounted to Rs 242 million.

(ii) It is the bank's policy to make a general provision in addition to the amount determined under Prudential Regulations. Such provision is based on the judgment of the bank. The general provision as on January 1, 2006 was Rs 765 million. However, there was a net reversal of provision for the year 2006 amounting to Rs 47 million. In 2005, a net provision of Rs 65 million was made.

Required:
Prepare appropriate notes to the financial statements for the years 2005 and 2006 giving disclosures related to provisions made by the bank in accordance with the guidelines issued by State Bank of Pakistan. **(15)**

(THE END)