THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Intermediate Examinations   Autumn 2008

September 4, 2008

FINANCIAL ACCOUNTING

(MARKS 100)

Module C

(3 hours)

Q.1 Aay and Bee are partners in a firm and share profits and losses in the ratio of 3:2 respectively. The firm's summarized balance sheet as on December 31, 2007 is as under:

	Rs. in million			**Rs. in million**
Capital Accounts:			Land and building	110
Aay	170		Machines	116
Bee	140			
			Inventories	64
Accounts payable	130		Accounts receivable	168
Accrued liabilities	55		Cash and bank	37
	495			495

Effective from January 1, 2008, the partners have decided to convert the partnership into a private limited company and have agreed to admit Cee into the business. All partners agree on the following terms and conditions:

(i) The name of the company will be Akbar (Private) Limited.
(ii) The company will acquire all the assets and liabilities of the firm at their fair values, including recognition of goodwill based on discounted cash flow method. The fair values and goodwill will be determined by an Independent Evaluator.
(iii) The company will issue shares at par value to Aay and Bee against the net assets (including goodwill) acquired from the firm.
(iv) Cee will invest Rs. 200 million in cash, on the date of incorporation of the company in consideration for 20 million shares of Rs. 10 each.

The Independent Evaluator provided the following information about the firm's net assets as on December 31, 2007:

- Land and building have a fair value of Rs. 210 million.
- Machines have a fair value of Rs. 105 million.
- Based on age-analysis, a provision of 10% has been suggested against accounts receivable.
- An adjustment of Rs. 10 million is required against slow moving and obsolete inventory.
- Liabilities of Rs. 35 million have not been accounted for in the partnership accounts.
- The goodwill is estimated at Rs. 150 million.

Required:
(a) Work out the number of shares to be issued to Aay and Bee.
(b) Prepare the opening balance sheet of Akbar (Private) Limited. **(15)**

Q.2 (a) On July 1, 2005, Humayun Chemicals Limited acquired a machine at a cost of Rs. 10 million. The useful life of the machine and its salvage value was estimated at 5 years and Rs. 3.0 million respectively. The cost of machine is being depreciated under the straight line method.

Based on the practice followed by similar type of companies, the company has determined that the remaining useful economic life of the machine is six years. It has also been established that the residual value at the end of the useful life will be equal to 10% of the cost of machine.

Required:
Compute the depreciation expenses and other adjustments (if any) required to be made in the financial statements of the company for the year ended June 30, 2008 under each of the following assumptions:

(i) the review of useful life and residual value was carried out on June 30, 2008;
(ii) the review of useful life and residual value was carried out on June 30, 2007 but in the financial statements for the year then ended the depreciation expense was erroneously recorded on the previous basis. **(11)**

(b) Discuss the requirements of International Accounting Standard(s) in respect of estimation and revision of useful life of an item of property, plant and equipment. **(04)**

Q.3 Lodhi Textile Mills Limited is facing severe financial difficulties. To improve the cash flows, the management has decided to sell and lease back three power generators of the company under three different sale and lease back arrangements which were signed on August 15, 2008. The company has assessed that all the leases shall qualify as finance leases.

The related information as on August 15, 2008 is given below:

	Cost	**Book Value**	**Fair Value**	**Value in Use**	**Amount of Financing**
	------------------Rupees in thousands------------------				
Generator A	10,000	7,500	6,000	6,500	6,000
Generator B	12,000	6,000	4,000	5,000	6,000
Generator C	10,000	7,000	10,000	12,000	8,000

Required:
Prepare the accounting entries that should be recorded by the company on August 15, 2008 in respect of the above transactions. **(13)**
Note: Ignore tax and deferred tax implications, if any.

Q.4 During the year ended June 30, 2008, Baber Limited (BL) has carried out several transactions with the following individuals/entities:

(i) AK Associates provides information technology services to BL. One of the directors of BL is also the partner in AK Associates.
(ii) SS Bank Limited is the main lender. By virtue of an agreement it has appointed a nominee director on the Board of BL.
(iii) Mr. Zee who supplies raw materials to BL, is the brother of the Chief Executive Officer of the company.
(iv) JB Limited is the distributor of BL's products and have exclusive distribution rights for the province of Punjab.
(v) Mr. Tee is the General Manager-Marketing of BL and is responsible for all major decisions made in respect of sales prices and discounts.
(vi) BL's gratuity fund is administered by the Trustees appointed by the company.

(vii) MM Limited is the leading supplier of BL and supplies 60% of BL's raw materials.

(viii) Ms. Vee who conducted various training programmes for the employees of the company, is the wife of BL's Chief Executive Officer.

Required:
Comment as to whether the above individuals/entities are 'related parties' of the company or not. Support your arguments with references from International Accounting Standards. **(15)**

Q.5 The **post closing trial balance** of BSZ Limited, a listed company, as at June 30, 2008 is given below:

	Dr.	Cr.
	Rupees in million	
Cash at banks – current accounts	7	
Cash at banks – in saving accounts	22	
Stocks in trade – closing	90	
Accounts receivable	60	
Provision for bad debts		3
Advances to suppliers	16	
Advances to staff	6	
Short term deposits	11	
Prepayments	4	
Sales tax receivable	12	
Freehold land – at revalued amount	375	
Furniture and fixtures - cost	27	
Accumulated depreciation – Furniture and fixtures		8
Machines - cost	85	
Accumulated depreciation – Machines		27
Building on freehold land – cost	150	
Accumulated depreciation – Building		26
Computer software – cost	10	
Accumulated amortization – Computer software		2
Deferred taxation		40
Short term loan		85
Accounts payable		75
Accrued liabilities		7
Provision for taxation		17
Issued, subscribed and paid up capital (Rs. 10 each)		400
Surplus on revaluation of fixed assets		120
Accumulated profits		65
	875	875

Additional Information:

(i) The first revaluation of freehold land was carried out in 2004 and resulted in a surplus of Rs. 120 million. The valuation was carried out under market value basis by an independent valuer, Mr. Dee, Chartered Civil Engineer of M/s SSS Consultants (Pvt.) Ltd., Islamabad.

(ii) The details relating to additions, disposal and depreciation/amortization of fixed assets, during the year 2008 are given below:

- The company uses straight line method for charging depreciation/ amortization. Building is depreciated at the rate of 5% whereas 10% depreciation/amortization is charged on machines, furniture and fixtures and computer software.
- Construction on third floor of the building commenced on March 1, 2008 and is expected to be completed on September 30, 2008. The cost incurred during the year i.e. Rs. 20 million was capitalized on June 30, 2008.
- Furniture and fixtures worth Rs. 8 million were purchased on April 1, 2008.
- A machine was sold on February 29, 2008 to NJ Enterprise at a price of Rs. 13 million. At the time of disposal, the cost and written down value of the machine was Rs. 15 million and Rs. 10 million respectively.

(iii) 50% of the accounts receivable were secured and considered good. 10% of the unsecured accounts receivable were considered doubtful. Bad debts expenses for the year amounted to Rs. 1.0 million. An amount of Rs. 1.4 million was written off during the year.

(iv) All advances given to suppliers are considered good and include an amount of Rs. 4.0 million paid for goods which will be supplied on December 31, 2009.

(v) Cash at banks in saving accounts carry interest / mark-up ranging from 3% to 7% per annum.

(vi) The authorized share capital of the company is Rs. 500 million.

Required:
Prepare the balance sheet as at June 30, 2008 along with the relevant notes showing all possible disclosures as required under the International Accounting Standards and the Companies Ordinance, 1984.
(Comparative figures and the note on accounting policies are not required.) **(22)**

Q.6 (a) What do you understand by the terms “adjusting events” and “non-adjusting events”? Give three examples of each. **(05)**

(b) J-Mart Limited, a chain of departmental stores has distributed its operations into four Divisions i.e. Food, Furniture, Clothing and Household Appliances. The following information has been extracted from the records:

(i) The company allows the dissatisfied customers to return the goods within 30 days. It is estimated that 5% of the sales made in June 2008 will be refunded in July 2008.

(ii) On June 2, 2008, three employees were seriously injured as a result of a fire at the company’s warehouse. They have lodged claims seeking damages of Rs. 2.0 million from the company. The company’s lawyers have advised that it is probable that the court may award compensation of Rs. 400,000.

(iii) Under a new legislation, the company is required to fit smoke detectors at all the stores by December 31, 2008. The company has not yet installed the smoke detectors.

(iv) On June 20, 2008, the board of directors decided to close down the Household Appliances Division. However, the decision was made public after June 30, 2008.

(v) The company has a large warehouse in Lahore which was acquired under a three-year rent agreement signed on April 1, 2007. The agreement is non-cancelable and the company cannot sub-let the warehouse. However, due to operational difficulties, the company shifted the warehouse to a new location.

(vi) A 15% cash dividend was declared on July 5, 2008.

Required:
Describe how each of the above issue should be dealt with in the financial statements for the year ended June 30, 2008. Support your point of view in the light of relevant International Accounting Standards. **(15)**

(THE END)