



PILOT PAPER

INTERNATIONAL FINANCIAL REPORTING STANDARDS

(Marks 100)

Paper - II

(3 hours)

Q.1 Following is the summarised trial balance of Faisal Limited (FL) and its subsidiaries, Saqib Limited (SL) and Ayaz Industries Limited (AIL) for the year ended December 31, 2007:

	FL	SL	AIL
	-----Rs. in million-----		
Cash and bank balances	4,920	660	2,700
Accounts receivable	6,240	2,460	6,580
Stocks in trade – closing	14,460	4,200	5,680
Investment in subsidiaries – at cost			
SL	9,000	-	-
AIL	10,500	-	-
Other investments	11,100	-	-
Property, plant and equipment	22,500	3,480	5,940
Cost of sales	49,200	18,000	21,000
Operating expenses	3,600	2,100	5,400
Accumulated depreciation	(5,760)	(420)	(1,260)
Ordinary share capital (Rs. 10 each)	(30,000)	(12,000)	(6,000)
Retained earnings – opening	(33,780)	-	(4,800)
Sales	(57,600)	(16,500)	(33,800)
Accounts payable	(2,760)	(1,980)	(1,440)
Gain on sale of fixed assets	(540)	-	-
Dividend income	(1,080)	-	-

Following information is also available:

- (i) On January 1, 2007, FL acquired 480 million shares of AIL from its major shareholder for Rs. 10,500 million.

At the time of acquisition, AIL owned several brand names which are highly regarded in the market. AIL had invested a significant amount in marketing these brand names and had expensed the costs. None of the brand names had been acquired externally and therefore the costs had not been capitalized in the statement of financial position of AIL. On the acquisition of AIL by FL, a firm of valuation experts valued the brand names at Rs. 500 million and this valuation had been taken into account by FL when offering for the purchase of AIL's shares. However, the valuation of the brand names is not included in the separate financial statements of AIL. It is the policy of the group to amortize intangible assets over ten years.

- (ii) SL was incorporated on February 1, 2007. 75% of the shares were acquired by FL at par value on the same date.
- (iii) The following inter company sales were made during the year 2007:

	Sales	Included in buyer's closing stocks in trade	Amount receivable/payable at year end	Gross profit % on sales
	-----Rs. in million-----			
FL to AIL	2,400	900	-	20
SL to AIL	1,800	600	800	10
AIL to FL	3,600	1,200	-	30

(2)

FL and its subsidiaries value stock in trade at the lower of cost or net realisable value. While valuing FL's stock in trade, the stock purchased from AIL has been written down by Rs. 100 million.

- (iv) On July 1, 2007, FL sold certain plants and machineries to SL. Details of the transaction are as follows:

	<b>Rs. in million</b>
Sales value	144
Less: Cost of plant and machineries	150
Accumulated depreciation	(60)
Net book value	90
Gain on sale of plant	54

The plants and machineries were purchased on January 1, 2005, and were being depreciated on straight line method over a period of five years. SL computed depreciation thereon using the same method based on the remaining useful life.

- (v) FL billed Rs. 100 million to each subsidiary for management services provided during the year 2007 and credited it to operating expenses. The invoices were paid on December 15, 2007.
- (vi) Details of cash dividend are as follows:

	<b>Dividend</b>		
	<b>Date of declaration</b>	<b>Date of payment</b>	<b>%</b>
FL	Nov 25, 2007	Jan 5, 2008	20
AIL	Oct 15, 2007	Nov 20, 2007	10

- (vii) An impairment test was carried out on December 31, 2007 for the goodwill of AIL appearing in the consolidated financial statements. The test indicated that goodwill was impaired by 10%.
- (viii) During the year, the directors of FL decided to form a defined benefit pension scheme for the employees of the parent and contributed cash of Rs. 500 million to the scheme. The following details relate to the scheme at December 31, 2007:

	<b>Rs. in million</b>
Present value of obligations	650
Fair value of scheme assets	620
Current service cost	550
Interest cost - scheme liabilities	100
Expected Return on pension scheme assets	50

The only entry made in the separate financial statements was in respect of the cash contribution which has been included in FL's accounts receivables. The directors wish to recognize immediately any actuarial gain/loss in profit or loss account.

**Required:**

- (a) Show how the defined benefit pension scheme should be disclosed in the consolidated financial statements.
- (b) Prepare consolidated statement of financial position and profit and loss account of FL and its subsidiaries for the year ended December 31, 2007. Show all necessary workings. Ignore tax, corresponding figures and notes to the consolidated financial statements.

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
<b>Original Contract</b>	<b>Rupees in million</b>		
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
<b>Additional Work</b>			
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 Statement of Financial Position 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 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:

	<b>Rupees in "000"</b>
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 statement of financial position for the years 2005 and 2006.
- (b) Prepare a note to the Profit and Loss Account for the year 2006, giving appropriate disclosures related to tax expenses.

(20)

(5)

Q.4 Ghalib Limited manufactures three products X, Y and Z. The management of the company considers plants relating to each product as a separate Cash-Generating Unit (CGU). The company has three Corporate Assets viz. a building, PABX system and a computer network. On June 30, 2007, the assets were valued as under:

	<b>Carrying Amount*</b>	<b>Recoverable Amount</b>
	<b>Rupees</b>	<b>Rupees</b>
Cash-Generating Units excluding Corporate Assets		
Plant 1 – for Product X	2,500,000	1,200,000
Plant 2 – for Product Y	5,000,000	7,000,000
Plant 3 – for Product Z	10,000,000	6,400,000
	17,500,000	14,600,000
Corporate Assets		
Building	2,800,000	
PABX system	1,400,000	
Computer network	2,100,000	
	6,300,000	
	23,800,000	

\* **Before impairment**

Based on a study carried out by the company which involved consideration of various factors, the management was able to determine that the building and the PABX system can be allocated to plant 1, 2 and 3 in the ratio of 2 : 3 : 5. However, the management was unable to determine a reasonable and consistent basis for allocating the cost of computer network.

**Required:**

Calculate the carrying amount of each CGU and Corporate Asset for reporting on the balance sheet as at June 30, 2007 in accordance with IAS-36 'Impairment of Assets'.

(18)

(THE END)