The Institute of
Chartered Accountants
of Pakistan

Certificate in Accounting and Finance Stage Examinations

12 September 2015
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 The following information has been extracted from the draft financial statements of Himalaya Woods Limited (HWL) for the year ended 30 June 2015:

Statement of financial position as at 30 June 2015

Equity and liabilities	2015	2014	Assets	2015	2014
	Rs. in million			Rs. in million	
Share capital (Rs. 100 each)	2,500	2,500	Property, plant and equipment	4,261	3,773
Retained earnings	2,450	2,058	Stock in trade	835	795
Trade and other payables	740	560	Trade debts - net	650	585
Taxation	70	52	Cash and bank balances	14	17
	5,760	**5,170**		**5,760**	**5,170**

Statement of comprehensive income for the year ended 30 June 2015

	2015	2014
	Rs. in million	
Sales revenue	20,000	15,520
Cost of sales	(14,000)	(10,000)
Operating expenses	(5,406)	(4,764)
Taxation at 34%	(202)	(257)
Profit after taxation	**392**	**499**

Following matters are under consideration for finalisation of the financial statements:

(i) Previous year in June 2014, goods delivered on 'sale or return basis' were erroneously recorded as sale at Rs. 35 million (cost plus 40%). In July 2014, 35% of these goods were returned by the customers and debited to sales return account.

(ii) A customer owing Rs. 20 million as on 30 June 2015 was declared bankrupt on 1 August 2015. HWL estimates that 40% of the debt would be received on liquidation.

(iii) HWL maintains a provision for doubtful debts at 4% of trade debts.

(iv) Retained earnings balance as at 30 June 2013 amounted to Rs. 1,559 million.

Required:

In accordance with the requirements of International Financial Reporting Standards, prepare the following:

(a) Statement of financial position as at 30 June 2015
(b) Statement of comprehensive income for the year ended 30 June 2015
(c) Statement of changes in equity for the year ended 30 June 2015 **(18)**

(Show comparative figures. Ignore deferred tax implications and notes to the financial statements)

Q.2 Fortune Limited (FL) is quoted on the stock exchange, with revenue of over Rs. 5 billion per annum. During the year ended 30 June 2015, FL has incurred a loss of Rs. 26 million.

The Chief Executive is of the view that declaration of loss may result in the bankers' refusal to renew the credit facility. Therefore, he wants to incorporate certain adjustments in the books of account that will result in a net profit of Rs. 100 million. However, the Chief Financial Officer (CFO), who is a chartered accountant, is of the view that all possible adjustments allowable under the applicable accounting regulations have already been considered and incorporated.

Required:

Identify the categories of threats to the fundamental principles of objectivity or professional competence and due care, that may be created in the above situation and discuss the safeguards available to the CFO in this respect, under the ICAP's Code of Ethics. **(06)**

Q.3 QP Limited (QPL) commenced construction of a warehouse on 1 July 2013 and completed the work on 31 December 2014. In this respect the following information is available:

(i) Prior to commencement of construction, QPL incurred the following expenses:

	Rs. in million
Consultants fee	1.45
Preparation of land	0.95
Payment of outstanding government dues for the land	0.60

(ii) The agreed contract price is Rs. 70 million. Payments made to the contractor were as follows:

Invoice date	Date of payments	Description	Net payments (Rs. in million)
1-Jul-2013	16-Jul-2013	10% Advance: (Deductible from the progress bills)	7.00
30-Sep-2013	16-Oct-2013	1st progress bill	6.00
31-Dec-2013	16-Jan-2014	2nd progress bill	14.00
31-Mar-2014	16-Apr-2014	3rd progress bill	12.00
30-Jun-2014	16-Jul-2014	4th progress bill	10.00
30-Sep-2014	16-Oct-2014	5th progress bill	8.00
31-Dec-2014	16-Jan-2015	Final bill	13.00
			70.00

(iii) To finance the project cost, bank loans were acquired as follows:

Description	Loan amounts (Rs. in million)	Received on	Mark-up
Loan A	30.00	1-Jul-2013	10%
Loan B	40.00	1-Jan-2014	12%

Mark-up is payable semi-annually on 30 June and 31 December each year. The loans are repayable in five equal instalments, commencing from 1 January 2016.

(iv) Surplus funds, when available, were invested in short term deposits which provide a return of 8% per annum computed on a daily basis.

(v) The warehouse was available for use on 1 January 2015. Useful life of the warehouse is estimated at 25 years with no residual value.

Required:
Prepare accounting entries for the year ended 30 June 2015 in the books of QPL. **(16)**
(Ignore taxation. Accounting entries for the year ended 30 June 2014 are not required. Borrowing cost calculations should be based on 360 days a year basis)

Q.4 A factory worker of Industrial Chemicals Limited (ICL) was seriously injured on 10 June 2015 during a production process. Subsequent developments in this matter are as follows:

(i) On 26 July 2015, the worker filed a claim for Rs. 25 million and alleged violation of safety measures on the part of ICL. The lawyers of ICL anticipate that there is 60% probability that the court would award Rs. 12 million and 40% likelihood that the amount would be Rs. 8 million.

(ii) According to the terms of the insurance policy, ICL filed a claim of Rs. 18 million which was principally accepted by the insurance company on 5 August 2015 to the extent of Rs. 14 million. ICL is negotiating with the insurance company and it is probable that ICL would recover a further sum of Rs. 2 million.

(iii) On representation by the Labour Union, the management is considering to pay to the affected worker an amount of Rs. 1.5 million, in addition to the compensation that may be awarded by the court.

Required:
Explain accounting treatment and the disclosure requirements in respect of the above matters in ICL's financial statements for the year ended 30 June 2015. Support your answer by referring to the relevant guidelines contained in International Financial Reporting Standards. **(12)**

Q.5 An investor wants to analyze the performance of Zee Limited for which he has collected the following information for the year ended 30 June 2015 and 2014:

	2015	2014
	Rs. in million	
Profit after interest and tax	100.00	75.00
Interest expense at 12% per annum on a long-term loan acquired on 1 January 2014	(9.60)	(4.80)
Current tax expense	(50.00)	(35.00)
Deferred tax credit/(expense)	6.00	(8.00)
Interim bonus issue	12%	10%
Final cash dividend (**2013**: 30%)	20%	25%

The break-up of shareholders' equity as at 1 July 2013 was as under:

	Rs. in million
Share capital (Rs. 10 each)	200
Share premium	20
Retained earnings	40
	260

Required:
Compute Return on Capital Employed and Return on Shareholders' Equity for the year ended 30 June 2015. **(07)**

Q.6 On 1 July 2014, Galaxy Limited (GL) acquired controlling interest in Beta Limited (BL). The following information has been extracted from the financial statements of GL and BL for the year ended 30 June 2015.

	GL	BL
	Rs. in million	
Share capital (Rs. 100 each)	100	50
Retained earnings – 1 July 2014	40	18
Profit for the year ended 30 June 2015	20	6
Shareholders' equity/Net assets	**160**	**74**
Investment in BL (300,000 shares)	50	-
Inter-company sales (at invoice value)	25	30
Inter-company purchases remained unsold at year-end	9	5
Inter-company current account balances	7	(4)

Other relevant information is as under:

(i) On the date of acquisition, fair value of BL's net assets was equal to their book value except for the following:
- Fair value of a land exceeded its carrying value by Rs. 20 million.
- The value of a plant was impaired by Rs. 10 million. The impairment was also recorded by BL on 2 July 2014
- BL measures its property, plant and equipment using cost model.

(ii) There is no change in share capital since 1 July 2014.

(iii) Inter-company sales are invoiced at cost plus 20%. The difference between the current account balances is due to goods dispatched by GL on 30 June 2015 which were received by BL on 5 July 2015.

(iv) GL values non-controlling interest at the acquisition date at its fair value which was Rs. 35 million.

(v) As at 30 June 2015, goodwill of BL was impaired by 10%.

Required:
Compute the amounts of goodwill, consolidated retained earnings and non-controlling interest as they would appear in GL's consolidated statement of financial position as at 30 June 2015. **(15)**

Q.7 (a) On 1 July 2013, Zeta Limited (ZL) acquired an industrial mixer for four years, under a non-cancellable operating lease. The rent was agreed at Rs. 2.5 million per annum payable in advance, with 5% annual increase.

Due to change in production plan, the mixer became surplus on 31 December 2014 and was sub-let on 1 January 2015 to Shan Enterprises for the period up to 30 June 2017. The rent was agreed at Rs. 2 million per annum payable in advance on 1 January each year.

Required:
Prepare accounting entries from the above information for the year ended 30 June 2015 in the books of ZL. ***(Accounting entries for the year ended 30 June 2014 are not required)*** **(08)**

(b) Last year, on 1 July 2013, ZL entered into a sale and lease back agreement in respect of one of its power generation plant. On the date of agreement, the power plant had a book value of Rs. 23 million and remaining useful life of 6 years.

Other information related to the sale and lease-back arrangement is given below:

Proceeds from the sale of plant	Rs. 25 million
Lease installment payable annually in arrears	Rs. 7 million
Lease period, commencing from 1 July 2013	5 years
Rate of interest implicit in the lease	12.38%

Required:
Prepare a note on finance lease liability, for inclusion in ZL's financial statements for the year ended 30 June 2015 in accordance with the International Financial Reporting Standards. ***(Comparative figures are not required)*** **(11)**

Q.8 Opal Limited (OL) commenced research work on a new product on 1 July 2013 and entered the development phase on 1 July 2014. In this respect, the following expenses were incurred and debited to capital work in progress.

	For the year ended	
	30 Jun 2015	**30 Jun 2014**
	-------- Rs. in million --------	
Research and development cost	12.00	8.00
Training of technical staff	0.90	-
Cost of laboratory equipment *	-	4.00
Cost of trial run	0.60	-
	13.50	**12.00**

**** Purchased on 1 January 2014, having estimated useful life of five years.***

Criteria for recognition of the internally generated intangible asset have been met. The commercial production was started from 1 January 2015. It is estimated that the related product would have a shelf life of 10 years.

Required:
Explain accounting treatment of the above in the financial statements for the year ended 30 June 2015 in the light of International Financial Reporting Standards. **(07)**

(THE END)