Certificate in Accounting and Finance Stage Examinations

The Institute of Chartered Accountants of Pakistan

12 March 2016
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 The summarized trial balances of Oscar Limited (OL) and United Limited (UL) as at 31 December 2015 are as follows:

	Oscar Limited (OL)		United Limited (UL)	
	Debit	Credit	Debit	Credit
	------------ Rs. in million ------------			
Sales		835		645
Cost of sales	525		396	
Operating expense	115		102	
Tax expense	65		48	
Share capital (Rs. 10 each)		600		250
Share premium		150		60
Retained earnings as at 1 January 2015		265		179
Current liabilities		115		105
Property, plant and equipment	390		350	
Cost of investment	500			
Stock-in-trade	125		115	
Trade receivables	140		125	
Cash and bank	105		103	
	1,965	**1,965**	**1,239**	**1,239**

Additional information:

(i) On 1 May 2015, OL acquired 80% shares of UL. UL has not recognised the value of brand in its books of account. At the date of acquisition, the fair value of brand was assessed at Rs. 45 million. The remaining useful life of the brand was estimated as 15 years.

(ii) OL charged Rs. 2.5 million monthly to UL for management services provided from the date of acquisition and has credited it to operating expenses.

(iii) On 1 October 2015, UL sold a machine to OL for Rs. 24 million. The machine had been purchased on 1 October 2013 for Rs. 26 million. On the date of acquisition the machine was assessed as having a useful life of ten years and that estimate has not changed. Gain on disposal was erroneously credited to sales account.

(iv) Other inter-company transactions during the year 2015 were as follows:

	Sales	Included in buyer's closing stock-in-trade	Profit %
	------------ Rs. in million ------------		
OL to UL	60	20	25% of cost
UL to OL	30	5	20% of sales

UL settled the inter-company balance as on 31 December 2015 by issuing a cheque of Rs. 30 million. However, the cheque was received by OL on 1 January 2016.

(v) The non-controlling interest is measured at the proportionate share of UL's identifiable net assets.

It may be assumed that profits of both companies had accrued evenly during the year.

Required:
Prepare consolidated statement of comprehensive income for the year ended 31 December 2015 and consolidated statement of financial position as at 31 December 2015. **(18)**

Q.2 Abid Limited (AL) uses the revaluation model for subsequent measurement of its property, plant and equipment and has a policy of revaluing its assets on an annual basis using the net replacement value method.

The following information pertains to AL's buildings:

(i) Four buildings were acquired in same vicinity on 1 January 2012 at a cost of Rs. 300 million. The useful life of the buildings on the date of acquisition was 20 years.
(ii) AL depreciates buildings on the straight line basis over their useful life.
(iii) The results of revaluations carried out during the last three years by Premier Valuation Service, an independent firm of valuers, are as follows:

Revaluation date	**Fair value Rs. in million**
1 January 2013	323
1 January 2014	252
1 January 2015	272

(iv) On 30 June 2015, one of the buildings was sold for Rs. 80 million.

Required:
Prepare a note on "Property, plant and equipment" (including comparative figures) for inclusion in AL's financial statements for the year ended 31 December 2015 in accordance with International Financial Reporting Standards. ***(Ignore taxation)*** **(13)**

Q.3 Ali and Bashir are chartered accountants and have been working as Managing Director (MD) and Chief Financial Officer (CFO) in a listed company. In a recent meeting of the Board, the directors have decided to expand the business within six months by opening 20 retail outlets. This expansion would require financing of Rs. 300 million which may be arranged through bank loan.

The following information has been extracted from latest draft financial statements of the company:

	Rs. in '000
Sales	1,700
Gross profit	545
Tax expense	23
Profit after tax	40
Total assets	2,500
Non-current assets	900
Inventories	850
Trade receivables	600
Share capital	800
Reserves	152
Long term debt @ 9%	750

Following additional information is also available:
- 80% of the sales are on credit.
- Opening inventory was Rs. 100 million.
- 40% of current liabilities comprise of trade payables.

MD has advised the CFO to arrange the loan from MN Bank. He has also informed that the President of the bank is his good friend and the loan can be arranged on a fast track basis at a mark-up of 15% per annum, subject to the following conditions:
- current ratio and quick ratio should be at least 2:1 and 1:1 respectively;
- gearing ratio should not exceed 40%; and
- interest cover should be at least 3.

CFO is not comfortable with this deal as the mark-up offered by the bank is much higher than the rate on the existing loan and it is difficult for the company to meet the gearing requirements of the bank. However, MD has asked him to make certain changes in the draft financial statements before submission to the bank; which according to the CFO are not in accordance with the IFRSs.

Required:

(a) Compute liquidity, working capital and debt ratios of the company. **(06)**

(b) Briefly explain how the MD may be in breach of the fundamental principles of ICAP's code of ethics. Also state the potential threats that CFO may face under the circumstances, along with available safeguards (if any). **(06)**

Q.4 Following are the relevant extracts from the financial statements of Floor & Tiles Limited (FTL) for the year ended 31 December 2015:

	Rs. in million
Profit before tax	80
Provision for gratuity for the year	12
Bad debts expense for the year	10
Capital gain (exempt from tax)	5

The following information is also available:

(i) Opening balances of deferred tax liability, provision for bad debts and provision for gratuity were Rs. 5.28 million, Rs. 2 million and Rs. 13 million respectively.

(ii) The cost and other details related to buildings (owned) included in property, plant and equipment are as follows:

	Rs. in million
Opening balance (purchased on 1 January 2013)	350
Cost of a building sold on 30 April 2015 (for Rs. 35 million)	30
Purchased on 1 July 2015	40

(iii) Accounting depreciation on buildings is calculated @ 5% per annum on straight line basis whereas tax depreciation is calculated @ 10% on reducing balance method. Accounting depreciation of all other owned assets included in property, plant and equipment is same as tax depreciation.

(iv) On 1 January 2015, a machine costing Rs. 120 million was acquired on finance lease. Some of the relevant information is as follows:

- The lease term as well as the useful life is 5 years.
- Annual lease rentals amounting to Rs. 30 million are payable in advance.
- The interest rate implicit in the lease is 12.59%.
- This machine would be depreciated over its useful life on straight line method.

(v) On 1 June 2015, an amount of Rs. 1 million was paid as penalty to the provincial government due to non-compliance of environmental laws.

(vi) The amount of gratuity paid to outgoing members was Rs. 10 million.

(vii) During the year, entertainment expenses and repair expenses amounting to Rs. 6 million and Rs. 8 million respectively, pertaining to year ended 31 December 2013 were disallowed. FTL has decided to file appeal only against the decision regarding repair expenses.

(viii) Applicable tax rate is 32%.

Required:

Prepare a note on taxation (expense) for inclusion in FTL's financial statements for the year ended 31 December 2015 giving appropriate disclosures relating to current and deferred tax expenses including a reconciliation to explain the relationship between tax expense and accounting profit. **(17)**

Q.5 The following information has been extracted from the draft financial statements of Alpha Limited for the year ended 31 December 2015.

Assets	2015	2014	Equity & Liabilities	2015	2014
	Rs. in million			Rs. in million	
Property, plant & equipment	223	193	Share capital (Rs. 10 each)	180	150
Intangible assets	68	23	Share premium	15	-
Trade receivables	45	33	Retained earnings	114	53
Advances and prepayments	84	70	Long term loan	40	-
Inventories	60	46	Deferred liabilities	15	10
Short-term investments	12	9	Trade payables	42	56
Cash at bank	8	7	Accrued expenses	60	70
			Tax payable	34	42
	500	**381**		**500**	**381**

Following relevant information is available:

(i) Depreciation has been provided on straight line basis. Estimated useful lives are as under:

Building	20 years
All other fixed assets	10 years

(ii) On 1 September 2015, the company purchased new machinery costing Rs. 65 million.

(iii) A portion of building costing Rs. 20 million which was purchased on 1 July 2013 was sold for Rs. 20 million on 30 June 2015.

(iv) Trade receivables written off during the year amounted to Rs. 5 million. It is the policy of the company to maintain the provision for doubtful debts at 5% of trade receivables.

(v) Advances and prepayments include advance tax of Rs. 8 million (2014: Rs. 6 million).

(vi) Long term loan was obtained on 1 August 2015. Interest on loan @ 13% is payable on 31st July each year. Interest payable for 5 months has been accrued.

(vii) Deferred liabilities comprise of unfunded gratuity of Rs. 6 million (2014: Rs. 3 million) and deferred tax of Rs. 9 million (2014: Rs. 7 million). During the year, the company paid gratuity of Rs. 6.5 million to outgoing employees.

(viii) Tax expense for the year was Rs. 17 million. (2014: Rs. 8 million).

(ix) Right shares were issued on 1 December 2015 at Rs. 15 per share in the ratio of 1 right share for every 5 shares held.

Required:
Prepare statement of cash flows for the year ended 31 December 2015 in accordance with the requirements of International Financial Reporting Standards using the indirect method. **(15)**

Q.6 Shalimar Industries (SI) is engaged in the manufacturing of tractors. The tractors are sold both on cash and finance lease basis. The cash selling price and cost of each tractor is Rs. 2.0 million and Rs. 1.6 million respectively.

On 1 January 2015, SI sold ten tractors to Caravan Transport (CT) on lease. The terms of the lease and related information are as follows:

(i) The lease period is 4 years, whereas useful life of each tractor is 5 years.

(ii) The total unguaranteed residual value at the end of lease term is Rs. 1 million.

(iii) Lease rentals amounting to Rs. 6,375,454 per annum are payable in arrears.

The rate implicit in the lease is 12%.

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

(a) Journal entries in the books of SI to record the transactions for the year ended 31 December 2015. **(08)**

(b) A note for inclusion in SI's financial statements, for the year ended 31 December 2015. **(07)**

Q.7 The following information has been taken from the financial statements of Asif Engineering Limited (AEL) for the year ended 31 December 2015:

	2015 (draft)	**2014**	**2013**
	---------- Rs. in million ----------		
Property, plant equipment	2,430	2,402	2,105
Stores and spares	73	80	70
Retained earnings as at 31 December	353	224	101
Net profit	129	123	112

In the above financial statements, AEL has recognised consumption of spare parts as expense. AEL has now decided to change its above policy and classify consumption of spares having useful life of more than one year as capital spares under property, plant and equipment.

Following information pertains to capital spares consumed during the past three years:

Year ended	**Parts issued during the year Rs. in million**	**Useful life of the issued parts**
31 December 2013	55	5 years
31 December 2014	39	3 years
31 December 2015	44	4 years

Depreciation on these parts is to be charged using straight line method over its useful life.

Required:
In accordance with the requirements of International Financial Reporting Standards, prepare the revised extracts (including comparative figures) of the following:
(a) Statement of financial position as at 31 December 2015 **(04)**
(b) Statement of comprehensive income for the year ended 31 December 2015 **(03)**
(c) Statement of changes in equity for the year ended 31 December 2015 **(03)**
(Ignore taxation)

(THE END)