The Institute of
Chartered Accountants
of Pakistan

Certificate in Accounting and Finance Stage Examinations

6 September 2014
3 hours – 100 marks
Additional reading time – 15 minutes

Financial Accounting and Reporting-II

Q.1 The following balances have been extracted from the trial balance as at 30 June 2014 of Zee Trading Limited (ZTL):

Description	Debit	Credit
	------- Rs. in 000 -------	
Sales		80,000
Other income		5,300
Opening inventory	4,000	
Purchases	35,000	
Selling and distribution expenses	15,000	
Administrative expenses	9,700	
Financial charges	7,200	
Investment at cost (50,000 shares of Rs. 100 each)	6,800	
Trade receivables	10,000	
Provision for doubtful debts		380
Finance lease obligation		6,890

The following matters need to be considered in finalizing the financial statements of ZTL:

(i) As per store records, closing inventory as at 30 June 2014 amounted to Rs. 8,500,000. Physical inventory taken on 1 July 2014 revealed the following information:
- Value of goods found short by Rs. 1,500,000.
- Goods costing Rs. 860,000 are obsolete. Their estimated net realizable value is Rs. 600,000.

(ii) As per the memorandum record of third party stock, stock in ZTL's store 'on sale or return' as at 30 June 2014 amounted to Rs. 3,000,000. It also shows that previous year in June 2013, ZTL had sold goods held by it on sale or return basis for Rs. 2,000,000. However, purchase of these goods was accounted for in July 2013 on receipt of invoice amounting to Rs. 1,600,000.

(iii) Selling and distribution expenses include trade discounts allowed to customers amounting to Rs. 4,000,000.

(iv) Annual finance lease installment of Rs. 5,000,000 due on 30 June 2014 was paid and debited to finance lease obligation. However, interest thereon at 12.6% per annum due on the closing balance has not yet been booked.

(v) Accounting depreciation on the leased assets amounting to Rs. 3,750,000 has been accounted for.

(vi) Tax depreciation on the company's owned assets for the year ended 30 June 2014 exceeded the accounting depreciation by Rs. 3,000,000.

(vii) In June 2014, ZTL received 18% cash dividend on its investments. The amount received net of 10% tax was credited to other income.

(viii) Trade receivables as at 30 June 2013 amounted to Rs. 8,600,000. ZTL maintains a provision for doubtful debts at 5% of trade receivables.

(ix) Applicable tax rate for business income is 34%.

Required:

(a) Prepare ZTL's statement of comprehensive income for the year ended 30 June 2014 in accordance with the requirements of the Companies Ordinance, 1984 and the International Financial Reporting Standards. **(10)**

(b) Prepare a note to the statement of comprehensive income for the year ended 30 June 2014, relating to taxation expense and tax reconciliation. **(14)**

Q.2 Industrial Chemicals Limited (ICL) completed installation of its chemical plant on 30 June 2013. Costs incurred and debited to capital work in progress are summarized as under:

		Rs. in million
(i)	Landed cost of the plant, inclusive of refundable sales tax amounting to Rs. 15 million	850
(ii)	Contractor's billings net of tax deducted at 5%	57
(iii)	Cost of material and spare parts (Spares costing Rs. 6 million are in store and can be used for maintenance of the plant)	30
(iv)	Interest on loan acquired for installation work for the period 1 September 2012 to 30 June 2013. (The installation work commenced two months after the schedule date of 1 September 2012 and completed on 30 June 2013)	15
(v)	Interest income from investment of unutilized proceeds of the loan	(2)
(vi)	Allocated general and administration costs	6
	Capital work in progress as at 30 June 2013	**956**

Test run of the plant was successfully completed on 31 August 2013 at a cost of Rs. 5 million. Proceeds from sale of test production amounted to Rs. 3 million. Test run cost, net of sale proceeds, has been charged to profit and loss account. On commencement of commercial production i.e. 1 September 2013, the following estimates were worked out:

Useful life of the plant	10 years
Residual value at the end of useful life of the plant	Rs. 10 million
Present value of estimated cost of decommissioning/restoration of the site	Rs. 20 million

Interest rate prevailing in the market is 12%. ICL uses straight line method of depreciation which is charged from the month the asset is available for use and up to the month prior to disposal.

Required:
Prepare accounting entries from the above information for the year ended 30 June 2014 including correcting entries in accordance with the International Financial Reporting Standards. **(15)**

Q.3 Quality Garments Limited (QGL) is a manufacturer of readymade garments. During May 2014, a fire broke out in one of its units which resulted in deaths and severe injuries to a number of workers.

At the time of finalisation of QGL's financial statements for the year ended 30 June 2014, the following issues pertaining to the fire are under consideration:

(i) Families of certain deceased workers have filed compensation claims amounting to Rs. 60 million. A government agency has imposed a penalty of Rs. 35 million for negligence on the part of the company. QGL's lawyers anticipate that the company would have to pay Rs. 20 million and Rs. 10 million to settle the workers' claims and the penalty respectively.

(ii) To maintain goodwill of the company, the Board of Directors is considering additional payments to the families of the deceased workers amounting to Rs. 25 million.

(iii) Loss to fixed assets and inventories is estimated at Rs. 60 million. In this respect, a fire insurance claim has been lodged. Due to certain policy clauses, QGL’s consultant anticipates that the claim for Rs. 15 million may not be accepted. The matter is under negotiation with the insurance company.

(iv) Due to closure of the unit for repair, QGL would not be able to meet sales orders of Rs. 50 million. This will reduce QGL's profitability for the half year ending 31 December 2014 by Rs. 10 million.

Required:
Discuss how the above issues should be dealt with in the financial statements of QGL for the year ended 30 June 2014. Support your answers in the context of relevant International Financial Reporting Standards. **(13)**

Q.4 Sky Limited (SL) commenced its business on 1 July 2013 by purchasing the business of Moon Enterprises for a consideration of Rs. 60 million. The following information has been extracted from its financial statements for the year ended 30 June 2014.

Particulars	Debit	Credit
	Rs. in million	
Sales		172
Cost of sales	80	
Operating and selling expenses	40	
Bad debt expense	6	
Loss on settlement of insurance claim	2	
Finance charges paid	8	
Taxation expense net of deferred tax credit	15	
Closing stock in trade	10	
Trade receivables	28	
Provision for doubtful debts		6
Trade payables		20
Provision for taxation (net of payments)		5
Deferred tax asset	4	
Property, plant and equipment - WDV	105	

Additional information:

(i) At the time of acquisition, the assets and liabilities were valued as under:

	Rs. in million
Property, plant and equipment	52
Stock in trade	4
Trade receivables	8
Trade payables	12

(ii) During the year, SL incurred a capital expenditure of Rs. 70 million.

(iii) Loss on settlement of insurance claim relates to a car which was destroyed in an accident. Its cost and written down value at the time of accident was Rs. 5 million and Rs. 4 million respectively. There were no other disposals during the year.

Required:

Prepare **operating activities section** of the statement of cash flows for the year ended 30 June 2014 using the **direct method** in accordance with the International Financial Reporting Standards. **(11)**

Q.5 Galaxy Leasing Limited (GLL) has leased certain equipment to Dairy Products Limited on 1 July 2013. In this respect, the following information is available:

	Rs. in million
Cost of equipment	28.69
Amount received on 1 July 2013	3.00
Four annual installments payable in arrears on 30 June, each year	7.80
Guaranteed residual value on expiry of the lease	5.00

Useful life of the equipment is estimated at 5 years. Rate of interest implicit in the lease is 14%.

Required:

(a) Prepare accounting entries for the year ended 30 June 2014 in the books of GLL to record the transactions related to the above lease arrangement in accordance with the requirements of International Financial Reporting Standards. **(07)**

(b) Prepare a note for inclusion in GLL's financial statements for the year ended 30 June 2014, in accordance with the requirements of International Financial Reporting Standards. **(10)**

Q.6 The following summarised statements of financial position pertain to Alpha Limited (AL) and its subsidiary Delta Limited (DL) as at 30 June 2014.

	AL	DL
	----- Rs. in million -----	
Property, plant and equipment	460	200
Investment (2 million shares of DL)	340	-
Long term loan granted to DL	30	-
Current assets	595	400
	1,425	**600**
Share capital (Rs. 100 each)	600	250
Retained earnings	325	200
Long term borrowings	200	72
Current liabilities	300	78
	1,425	**600**

Following relevant information is available:

(i) AL acquired investment in DL on 1 July 2013 when retained earnings of DL were Rs. 140 million and the fair value of DL's net assets was equal to their carrying values.

(ii) Both the companies depreciate equipment at 10%, on straight line basis. On 30 June 2014, AL sold certain equipment to DL as detailed below:

	Rs. in million
Cost	40
Accumulated depreciation	30
Sale proceeds	25

(iii) Inter-company sales of goods are invoiced at a mark-up of 20%. The relevant details are as under:

	Rs. in million
AL's inventory includes goods purchased from DL	27
DL's inventory includes goods purchased from AL	24
Receivable from DL on 30 June 2014 as per AL's books	19
Payable to AL on 30 June 2014 as per DL's books	19

(iv) Long term loan was granted to DL on 1 July 2013. It is repayable after five years and carries interest at 12% per annum, payable on 30 June and 31 December, each year.

(v) AL values non-controlling interest at the acquisition date at its fair value which was Rs. 80 million.

Required:
Prepare a consolidated statement of financial position as at 30 June 2014 in accordance with the requirements of International Financial Reporting Standards. **(15)**

Q.7 List the fundamental principles as mentioned in the ICAP's Code of Ethics and describe the guidance expressed in respect of 'principle of integrity'. **(05)**

(THE END)