Indus College of Business and Finance

Marks: 100

Financial Accounting **Time allowed: 3 hours**

Module C **Reading time: 15 minutes**

Q. 1 You have been asked to advise on the appropriate accounting treatment for the following situations arising in the books of various companies. The year end in each case can be taken as 31 December 2013 and you should assume that the amounts involved are material in each case.

(a) At the year end there was a debit balance in the books of a company for Rs. 15,000,000 representing an estimate of the amount receivable from an insurance company for an accident claim. In February 2014, before the directors had agreed the final draft of the published accounts, correspondence with lawyers indicated that Rs. 18,600,000 might be payable on certain conditions.

(b) A company has an item of equipment which cost Rs. 400,000,000 in 2010 and was expected to last for ten years. At the beginning of the financial year 2013 the carrying amount was Rs. 280,000,000. It is now thought that the company will soon cease to make the product for which the equipment was specifically purchased. Its recoverable amount is only Rs. 80,000,000 at 31 December 2013.

(c) On 30 November a company entered into a legal action defending a claim for supplying faulty machinery. The company's solicitors advise that there is a 20% probability that the claim will succeed. The amount of the claim is Rs. 500,000,000.

(d) An item has been produced at a manufacturing cost of Rs. 1,800,000 against a customer's order at an agreed price of Rs. 2,300,000. The item was in inventory at the year end awaiting delivery instructions. In January 2013 the customer was declared bankrupt and the most reasonable course of action seems to be to make a modification to the unit, costing approximately Rs. 300,000 which is expected to make it marketable with other customers at a price of about Rs. 1,900,000.

(e) At 31 December a company has a total potential liability of Rs. 1,000,400 for warranty work on contracts. Past experience shows that 10% of this cost is likely to be incurred, that 30% may be incurred but that the remaining 60% is highly unlikely to be incurred.

Required:

For each of the above situations outline the accounting treatment you would recommend and give the reasoning of principles involved. The accounting treatment should refer to entries in the books and/or the year-end financial statements as appropriate. **(15 marks)**

Q. 2 Afroz Enterprises conducts its activities from two properties, a head office in the city centre and a property in the countryside where staff training is conducted. Both properties were acquired on 1 April 2009 and had estimated lives of 25 years with no residual value. The company has a policy of carrying its land and buildings at current values. However, until recently property prices had not changed for some years. On 1 October 2011 the properties were revalued by a firm of surveyors. Details of this and the original costs:

	Land	**Buildings**
	Rupees	Rupees
Head office – cost 1 April 2010	500,000	1,200,000
– revalued 1 October 2012	700,000	1,350,000
Training premises – cost 1 April 2010	300,000	900,000
– revalued 1 October 2012	350,000	600,000

The fall in the value of the training premises is due mainly to damage done by the use of heavy equipment during training. The surveyors have also reported that the expected life of the training property in its current use will only be a further 10 years from the date of valuation. The estimated life of the head office remained unaltered.

Note: Afroz Enterprises treats its land and its buildings as separate assets. Depreciation is based on the straight-line method from the date of purchase or subsequent revaluation.

Required:

Prepare extracts of the financial statements of Afroz Enterprises in respect of the above properties for the year to 31 March 2013. ***(Total: 15 marks)***

Q. 3 Aqil, Danish and Shaoor are in partnership, sharing profit and loss in the ratio 4:2:1. The balance sheet of the partnership as at 31 December 2013 is as under:

ASSETS	Rs. '000'	CAPITAL & LIABILITIES	Rs. '000'
Non Current Assets		**Capital**	
Land	2,000	Aqil	3,200
Building	1,200	Danish	2,100
Plant & machinery	1,400	Shaoor	1,050
Vehicles	650		
		Non Current Liabilities	
		Long term loans	300
Current assets		**Current liabilities**	
Inventory	900	Trade creditors	1,400
Debtors	2,000	Bank over draft	4,500
Cash	350		
	8,500		**8,500**

On January 01, 2014 the partnership was converted into a limited company and adopted the name Fahmo Farasat (Private) Limited, under the following terms and conditions:

1. Against a consideration of Rs. 7.1 million the company took over all the assets and liabilities of the partnership except for cash and the items mentioned below:
   - Vehicle was taken over by Aqil at market value of Rs. 850,000.
   - Shaoor agreed to discharge trade payable amounting to Rs. 250,000 from his personal resources
   - The partnership settled the outstanding long term loan
2. The company obtained the same overdraft facility for discharging the purchase consideration. It issued ordinary shares of Rs. 10 each at a premium of 20% to the partners in their profit and loss sharing ratio. The balance of Rs. 1,900,00was paid in cash.
3. The assets taken over by the company were valued as under:
   - Land and building were valued at Rs. 2,500,000 and Rs. 1,500,000 respectively
   - Plant and machinery was valued at Rs. 1,100,000
   - NRV of stocks was estimated at Rs. 750,000 and 95% of the trade debts are considered recoverable.
   - The trade payables were settled by the company by issuing 88,000 share at a premium of 20%.

Required:

a) Prepare partners' capital accounts on dissolution of the firm.

b) Prepare the statement of financial position as on January 01, 2014. **(20 marks)**

Q. 4 Ahmad has entered into the following transactions/agreements in the year to 31 March 2013:

(i) Goods, which had cost of Rs. 2,000,000, were sold to Wholesaler for Rs. 3,500,000 on 1 June 2012. Ahmad has an option to repurchase the goods from Wholesaler at any time within the next two years. The repurchase price will be Rs. 3,500,000 plus interest charged at 12% per year from the date of sale to the date of repurchase. It is expected that Ahmad will repurchase the goods.

(ii) Ahmad owns the rights to a fast food franchise. On 1 April 2012 it sold the right to open a new outlet to Mr Cody. The franchise is for five years. Ahmad received an initial fee of Rs. 5,000,000 for the first

year and will receive Rs. 500,000 per year thereafter. Ahmad has continuing service obligations on its franchise for advertising and product development that amount to approximately Rs. 800,000 per year per franchised outlet. A reasonable profit margin on rendering the continuing services is deemed to be 20% of revenues received.

(iii) On 1 September 2012 Ahmad received total subscriptions in advance of Rs. 2,400,000. The subscriptions are for 24 monthly publications of a magazine produced by Ahmad. At the year end Ahmad had produced and despatched six of the 24 publications. The total cost of producing the magazine is estimated at Rs. 1,920,000 with each publication costing a broadly similar amount.

Required:
Describe how Ahmad should treat each of the above examples in its financial statements in the year to 31 March 2013. **(10 marks)**

Q. 5 Khyber Limited (KL) is in the business of manufacturing and selling of confectionary. The company accounts for taxation and deferred taxation in accordance with the provisions of IAS 12. The relevant information relating to accounting year ended 31 December 2013 is summarized as under:

- Accounting WDV and tax WDV of fixed assets as at 31 December 2013 is Rs. 565.5 million and Rs. 243 million respectively.
- Accounting depreciation and tax depreciation for the year is Rs. 103 million and Rs. 85 million respectively.
- Only one fixed asset (a vehicle) was disposed off during the year 2013 against Rs. 1 million. Its accounting WDV was Rs. 700,000 while tax WDV was Rs. 465,000. No disposal of fixed assets took place in the year 2012. Fixed assets additions during the year is 123 million.
- Provision for gratuity as at 31 December 2013 is 138.5 million and provision for gratuity for the year (net of payment) is Rs. 33 million.
- Following information relates to income and expenses of the company for the year 2013:

	Rs. In million
Accounting profit before tax	797
Dividend income (Exempt from tax)	35
Capital gain (exempt from tax)	135
Turn over for the year	3,165
Total turnover tax paid during the last three years	65
Liabilities older than 3 years, disallowed in previous years	65
Donations to unapproved institutions	5

- All the liabilities are less than three years old except for those disclosed in the above table. No payment was made in respected of disallowed earlier.
- All expenses (except donations and timing differences) are considered to be allowable for tax purposes. Applicable tax rate is 35%

Required:

a) Compute the amount of deferred tax required to be reported in the statement of financial position for the years 2013 and 2012.

b) Prepare a note to the profit and loss account for the year 2013, giving appropriate disclosures related to tax expense. **(20 marks)**

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Q. 6 The following information relates to the draft financial statements of Tameer Limited.

Summarised statements of financial position as at:

	31 March 2013		**31 March 2012**	
	Rs.'000	**Rs.'000**	**Rs.'000**	**Rs.'000**
Assets				
Non-current assets				
Property, plant and equipment (note (i))		19,000		25,500
Current assets				
Inventory		12,500		4,600
Trade receivables		4,500		2,000
Tax refund due		500		nil
Bank		nil		1,500
Total assets		36,500		33,600
Equity and liabilities				
Equity				
Equity shares of Rs.1 each (note (ii))		10,000		8,000
Share premium (note (ii))	3,200		4,000	
Retained earnings	4,500	7,700	6,300	10,300
		17,700		18,300
Non-current liabilities				
10% loan note (note (iii))	nil		5,000	
Finance lease obligations	4,800		2,000	
Deferred tax	1,200	6,000	800	7,800
Current liabilities				
10% loan note (note (iii))	5,000		nil	
Tax	nil		2,500	
Bank overdraft	1,400		nil	
Finance lease obligations	1,700		800	
Trade payables	4,700	12,800	4,200	7,500
Total equity and liabilities		36,500		33,600

Summarised income statements for the years ended:

	31 March 2013	**31 March 2012**
	Rs.'000	**Rs.'000**
Revenue	55,000	40,000
Cost of sales	(43,800)	(25,000)
Gross profit	11,200	15,000
Operating expenses	(12,000)	(6,000)
Finance costs (note (iv))	(1,000)	(600)

Profit (loss) before tax	(1,800)	8,400
Income tax relief (expense)	700	(2,800)
Profit (loss) for the year	(1,100)	5,600

The following additional information is available:
(i) Property, plant and equipment is made up of:

As at:	**31 March 2013**	**31 March 2012**
	Rs'000	**Rs.'000**
Leasehold property	nil	8,800
Owned plant	12,500	14,200
Leased plant	6,500	2,500
	19,000	25,500

During the year Tameer Limited sold its leasehold property for $8·5 million and entered into an arrangement to rent it back from the purchaser. There were no additions to or disposals of owned plant during the year. The depreciation charges (to cost of sales) for the year ended 31 March 2013 were:

	Rs.'000
Leasehold property	200
Owned plant	1,700
Leased plant	1,800
	3,700

(ii) On 1 July 2009 there was a bonus issue of shares from share premium of one new share for every 10 held. On 1 October 2012 there was a fully subscribed cash issue of shares at par.
(iii) The 10% loan note is due for repayment on 30 June 2013. Tameer Limited is in negotiations with the loan provider to refinance the same amount for another five years.
(iv) The finance costs are made up of:

For year ended:	**31 March 2013**	**31 March 2012**
	Rs.'000	**Rs.'000**
Finance lease charges	300	100
Overdraft interest	200	nil
Loan note interest	500	500
	1,000	600

Required:
(i) Prepare a statement of cash flows for Tameer Limited for the year ended 31 March 2013 in accordance with IAS 7 Statement of cash flows, using the indirect method; ***(12 marks)***
(ii) Based on the information available, advise the loan provider on the matters you would take into consideration when deciding whether to grant Tameer Limited a renewal of its maturing loan note.
(8 marks)