The Institute of Chartered Accountants of Pakistan

Financial Accounting

Intermediate Examination | 6 March 2014
Spring 2014 | 100 marks - 3 hours
Module C | Additional reading time - 15 minutes

Q.1 The following is the summarised trial balance as at 31 December 2013 of Hi-tech Limited (HL), a company listed at the Karachi Stock Exchange.

Description	Debit	Credit
	-------Rs. in million-------	
Sales revenue		21,100
Cost of sales	15,000	
Operating expenses	4,000	
Financial charges	45	
Taxation charge	620	
Property, plant and equipment	5,100	
Accumulated depreciation		1,745
Closing inventory	1,250	
Goods under sale or return (at cost)	65	
Cash and bank balances	13	
Trade receivables	1,490	
Provision for bad debts		85
Prepayments and other receivables	12	
12% Long term loan payable		500
Trade payables		1,782
Accruals and provisions		395
Deferred taxation (asset)	30	
Issued, subscribed and paid-up capital		1,200
Surplus on revaluation		150
Retained earnings 1 January 2013		668
	27,625	**27,625**

The following matters are required to be incorporated to finalise the financial statements of the company:

(i) Goods under sale or return include goods costing Rs. 26 million sent to a customer under sale or return agreement, at cost plus 50%. The last date of return of the goods was 30 December 2013. Sale of these goods has been accounted for in January 2014.

(ii) In January 2013, an operating software costing Rs. 20 million was purchased along with a processing plant. The cost of software is included in the cost of plant. HL depreciates the plant using straight line method. The useful life of the plant is 10 years and the software cost is to be amortised in two years.

(iii) Long term loan instalments of Rs. 62.5 million each are due for payment on 31 March and 30 September 2014.

(iv) On 18 January 2014, a customer lodged a claim of Rs. 10 million for the goods delivered in November 2013 being not according to the agreed specifications. HL's legal counsel anticipates that HL would be liable to pay approximately Rs. 3 million, to settle the claim.

(v) As at 31 December 2013, outstanding purchase orders and agreements for capital expenditure amounted to Rs. 65 million.

Required:
Prepare a statement of financial position as at 31 December 2013 along with a note on contingencies and commitments in accordance with the requirements of the Companies Ordinance, 1984 and the International Financial Reporting Standards. ***(Ignore tax adjustments and comparative figures)*** **(15)**

Q.2 (a) In the context of the International Financial Reporting Standards, explain the following terms:

(i) Events after the reporting period
(ii) Adjusting and non-adjusting events after the reporting period **(04)**

(b) The following events are under consideration for finalisation of the financial statements of Galaxy Super Stores Limited (GSSL) for the year ended 31 December 2013.

(i) 15% of the goods sold by GSSL in December 2013 were returned in January 2014. It was determined that the return was due to a manufacturing defect. Cost of removing the defect is recoverable from the manufacturer.
(ii) GSSL owns 150,000 shares of a listed company whose price on 31 December 2013 was Rs. 190 per share. In January 2014, after the government's announcement of new trade policy, the share price decreased by Rs. 40.
(iii) A customer who owed Rs. 35 million as at 31 December 2013 was declared bankrupt on 10 January 2014.
(iv) In January 2014, after the introduction of a new version of a mobile phone, GSSL reduced the prices of the previous versions significantly.
(v) In March 2013, GSSL issued a guarantee against a loan obtained by its subsidiary, RAY Limited (RL) amounting to Rs. 40 million. In January 2014, the factory of RL was destroyed in a fire and RL will not be able to repay the loan amount.

Required:
Describe how each of the above issues should be dealt with in the financial statements for the year ended 31 December 2013. Support your answer in the light of relevant International Financial Reporting Standards. **(10)**

Q.3 The following information pertains to a listed company, Sky-tech Limited (SL).

(a) An assembly plant costing Rs. 700 million having estimated useful life of 10 years was installed on 1 January 2011. On 31 December 2013, the plant was revalued to Rs. 550 million. Tax written down values of the plant as at 31 December 2012 and 2013 were Rs. 410 million and Rs. 370 million respectively. **(08)**

(b) A power plant was installed on 1 January 2013 at a cost of Rs. 850 million. Immediately thereafter, SL entered into a sale and lease back arrangement with its bank. Relevant information of the lease agreement is as under:

- Proceeds received amounted to Rs. 850 million and represent the fair value of the plant.
- The lease period is 9 years while estimated useful life of the plant is 10 years.
- Lease instalments of Rs. 159.5 million are payable annually, on 31 December each year.
- Interest rate implicit in the lease agreement is 12% per annum. **(08)**

SL depreciates its fixed assets using straight line method whereby carrying value of an asset is written-off over its estimated remaining useful life. Applicable tax rate for the company is 34%.

Required:
Prepare accounting entries to record the above transactions and resulting deferred tax thereon for the year ended 31 December 2013.

Q.4 Aye, Bee and Zee were partners in a firm, sharing profits and losses in the ratio of 40%, 30%, and 30% respectively. Balance sheet of the firm as at 31 December 2013 is as under:

Balance sheet as at 31 December 2013

	Rs. in million		**Rs. in million**
Aye capital	500	Land and buildings	300
Bee capital	380	Plant and equipment	520
Zee capital	370	Inventory	230
	1,250	Trade debtors	850
Trade creditors	670	Cash and bank balances	20
	1,920		**1,920**

Effective 1 January 2014, Bee decided to leave the firm while Aye and Zee agreed to continue the business by converting the partnership into a private limited company named Pioneer (Private) Limited (PL).

According to the arrangements among the partners, all the assets except cash and bank balances and trade debtors were acquired by PL. On the recommendation of a professional valuer, the value of the assets were determined as under:

- Goodwill of the firm at Rs. 35 million.
- Land and buildings at Rs. 345 million.
- Fully depreciated assets costing Rs. 15 million and still in use, at Rs. 4 million and remaining fixed assets at Rs. 540 million.
- An adjustment of 10% was made for slow moving and obsolete inventory.

Bee was asked to collect and settle the firm's debtors and creditors, on behalf of the firm. He was able to recover Rs. 800 million from the debtors in full and final settlement. All the creditors were paid after adjusting discount of Rs. 60 million. It was agreed that in lieu of this service, B would receive a commission of 0.05% of the amounts collected and 4% of the discount negotiated with the creditors.

The partners' balances were settled by PL as under:

- Bee was issued a cheque for balance due to him.
- Aye and Zee were issued ordinary shares of Rs. 100 each in lieu of their balances.

Required:
Partners' capital accounts and realisation account in the books of the firm. **(14)**

Q.5 Zain Pharma Limited (ZPL) owns patents of branded products A and B. ZPL uses cost model to account for its intangible assets. It is policy of the company to amortise the cost on the basis of total estimated revenue earned over the life of the patents. The following information is available:

	Product 'A'	**Product 'B'**
Date of acquisition of the patents	1-Jan-2011	1-Jul-1998
Patents' life	15 years	18 years
	-------- Rs. in million --------	
Acquisition cost of the patents	37.50	36.00
Sales upto 31-Dec-2012	800.00	11,200.00
Sales for the year ended 31-Dec-2013	600.00	1,600.00
Future estimated sales	6,100.00	3,200.00
Recoverable amount of the patents as at 31-Dec-2013	35.00	5.00

However, in 2013 the management identified that upto the year ended 31 December 2012, the cost of patents had erroneously been amortised on the basis of estimated useful life.

Required:
Prepare accounting entries relating to the patents, for the year ended 31 December 2013 in accordance with the International Financial Reporting Standards. **(14)**

Q.6 The following transactions pertain to Auto-tech Limited (ATL) which deals in trading of computers and printers. The company's accounting year ends on December 31.

(i) On 1 July 2013, a printer was sold to Shan Limited for Rs. 6 million on 30 days credit. As per the agreement, servicing and maintenance of the printer will be free of cost for the first year of sale. The cost of servicing and maintenance of the printer is estimated as under:

Jul–Dec 2013	Rs. 0.20 million
Jan–Jun 2014	Rs. 0.25 million

ATL provides such services at cost plus 20%. **(06)**

(ii) As at 31 December 2013, ATL owned 100,000 shares (Rs. 10 each) of Zee Limited valued at Rs. 4.3 million. On 28 January 2014, Zee Limited declared a 20% interim dividend for the half year ended 31 December 2013. **(02)**

(iii) On 19 December 2013, ATL sold 20 desktop computers costing Rs. 1.2 million at a markup of 25%. These computers carry twelve months warranty. Defective computers are repaired or replaced by ATL free of cost. Past experience shows that 10% computers need repairs and average cost of repair is Rs. 10,000 per computer. **(03)**

(iv) On 15 December 2013, a heavy duty printer was sold on credit for Rs. 5 million. Under the agreement, the buyer may return the printer within 30 days of the sale. **(03)**

Required:
With reference to the International Financial Reporting Standards explain how and when the revenue should be recorded in each of the above case. ***(Accounting entries not required)***

Q.7 The following information pertains to a listed company, Fu-tech (Pakistan) Limited.

(i) Shareholders' equity as at 1 January 2013:

Share capital (Rs. 10 each)	Rs. 116 million
Retained earnings	Rs. 58 million

(ii) Profit after tax for the year ended 31 December 2013 amounted to Rs. 47 million. (2012: Rs. 38 million)

(iii) In May 2013 the management discovered that inventories costing Rs. 18 million have been misappropriated. The entire loss has been recorded in 2013. However, it is estimated that inventories costing Rs. 13 million and Rs. 5 million were misappropriated in the years 2012 and 2013 respectively.

(iv) Depreciation expense for the year ended 31 December 2013 included incremental depreciation amounting to Rs. 6.5 million on account of revaluation surplus.

(v) Right shares were issued on 15 September 2013 at Rs. 12 per share in the ratio of 1 right share for every 4 shares held by the shareholders of the company.

(vi) Dividend information is as under:

	2013	**2012**	**2011**
Cash dividend – Interim	*18%	-	10%
Cash dividend – Final	14%	15%	-
Bonus shares – Final	-	-	16%

****interim dividend was announced before the issue of right shares.***

(vii) Applicable tax rate for the company is 34%.

Required:
Prepare a statement of changes in equity for the year ended 31 December 2013 in accordance with the requirements of the Companies Ordinance, 1984. ***(Show comparative figures)*** **(13)**

(THE END)