FINANCIAL ACCOUNTING
MOCK EXAMINATION – Spring 2014
MODULE - C

Total Marks: 100
Time Allowed: 03:00 hrs.
Date: February 19, 2014

Important:

Extra 15 minutes are allowed to read the question paper only. Students are allowed to consult from original IFRS in the exam room.

Question 01

The extract of statement of financial position of Mujahid Limited for the year ended June 30, 2013 and 2012 as comparative is as under: -

	2013	2012
	Rupees in thousand	
Property, plant and equipment	135,000	150,000
Advance income	--	2,000
Accrued expenses	1,500	--
Prepaid expenses	--	3,500
Development cost	4,000	5,000
Loan	9,100	--

The following notes are also relevant for the computation of current and deferred tax:

1. The property, plant and equipment is being depreciated under tax laws at 15% per annum while under IAS 16 it is being depreciated at 10% per annum under reducing balance basis. The tax base of property, plant and equipment was Rs. 109 million on June 30, 2012.
2. The profit before tax is Rs. 450 million for the year ended June 30, 2013.
3. The profit includes Rs. 2 million of expenses which were disallowed by the tax authorities and Rs. 4.6 million of income which was exempt from tax.
4. Un-used tax losses brought forward at the start of year 2013 are Rs. 250 million.
5. The advance income has been taxed in the year of receipt.
6. The expenses under tax laws are allowed when paid.
7. The development cost of Rs. 6 million has been incurred in 2012 and was being amortized over six years; however, the whole amount was claimed as an expense under tax laws in 2012.
8. The tax rate has been 35% in the current year and 40% in the previous year.

Required:

(a) Calculate current tax payable (if any) **(05)**

(b) Calculate deferred tax expense for the year and liability/(asset) as at June 30, 2013 and prepare a reconciliation to be presented in the notes to the financial statement for the year ended June 30, 2013 **(10)**

Question 02

Kamal Limited prepares financial statements to 31 March each year. During the year ended 31 March 2013, Kamal Limited entered into the following transactions:

1. On 1 January 2013, Kamal Limited supplied goods on credit to a customer. The goods had a list price of Rs. 450,000. Due to the size of the order, the customer received a volume discount of Rs. 50,000 and the invoice to the customer showed an amount payable of Rs. 400,000. The terms of sale allowed the customer a prompt payment discount of Rs. 20,000 provided payment was made before 31 January 2013. On 30 January 2013, the customer paid Rs. 380,000 in full and final settlement of the amount payable. **(03)**
2. On 31 March 2013, Kamal Limited supplied two machines to a customer. Both machines were accepted by the customer on 31 March 2013. Machine 1 was a machine that was routinely supplied by Kamal Limited to many customers and the installation process was very simple. Machine 1 was installed on 2 April 2013 by employees of the customer. Machine 2 was more specialised and the installation process more complicated, requiring significant assistance from Kamal Limited. Machine 2 was installed between 2 and 5 April 2013. Details of costs and sales prices are as follows:

	Machine 1	Machine 2	
	Rs. '000	Rs. '000	
Sales price	320	300	
Cost of production	160	150	
Cost of installation (to Kamal Limited)	Nil	10	**(04)**

3. On 30 September 2012, Kamal Limited sold a property to a bank for Rs. 2 million. The carrying amount of the property at the date of sale was Rs. 1·5 million and its market value was Rs. 3·5 million. Property prices are expected to rise at an annual rate of 5% for the foreseeable future. Kamal Limited continued to occupy this property but paid no rent to the new owners. Kamal Limited has the option to repurchase the property on 30 September 2017 for Rs. 3·221 million. Kamal Limited's credit rating is such that financial institutions would require an annual interest rate of 10% on loan finance to Kamal Limited. **(04)**
4. On 30 September 2012, Kamal Limited delivered a machine to a customer that had been manufactured to that customer's requirements. The machine cost Kamal Limited Rs. 600,000 to manufacture and the agreed selling price was Rs. 1,007,557. Kamal Limited agreed to accept payment on 30 September 2015. Kamal Limited would expect an annual rate of return of 8% on loan investments. The present value of Re. 1 receivable in three years' time at an annual discount rate of 8% is approximately 0.794. **(04)**

Required:

Explain how the four transactions would be reported in the financial statements of Kappa for the year ended 31 March 2013 and (for transaction (ii) ONLY) the year ended 31 March 2014. **(15)**

Question 03

The partners of Orange & company and Banana & company decided to merge their partnerships and to form a new partnership under the name Mango & company. The partners were sharing profit and loss before merger as under

Orange & company	Ratios
A	2
B	3

Banana & company

C	1
D	3

The firms are formally to be merged on July 01, 2012 just after the year end of Banana & company on June 30, 2012. The year-end of Orange & company is however on December 31, 2011. The balance sheets of both the firm at their respective year end are as under.

	Balance Sheet	
	Orange & company As at December 31, 2011 Rupees	**Banana & company As at June 30, 2012 Rupees**
Property, plant and equipment		
Land	1,000,000	1,200,000
Building	800,000	760,000
Plant and machinery	1,540,000	986,000
Vehicles	460,000	464,000
Intangible assets		
Goodwill	700,000	500,000
Patents	-	700,000
Non-Current Assets		
Investments	780,000	900,000
Current Assets		
Stocks	320,000	250,000
Trade Debtor	760,000	825,000
Other receivables	120,000	25,000
Cash and Bank	1,520,000	890,000
	8,000,000	**7,500,000**
Current Liabilities		
Trade creditors	650,000	435,000
Other payables	150,000	165,000
Partners' Capital Accounts		
A/C	4,000,000	3,900,000
B/D	3,200,000	3,000,000
	8,000,000	**7,500,000**

The following changes took place in the balance sheet of Orange & company as at June 30, 2012.

01. The carrying amounts of the property, plant and equipment changed as under

Build	Rs. 700,000
Plant and machinery	Rs. 1,300,000
Vehicles	Rs. 300,000

02. Stock in trade increased to Rs. 450,000
03. Trade debtors increased to Rs. 1,020,000
04. Other receivables and cash and bank increased to Rs. 175,000 and Rs. 2,025,000 respectively
05. The trade creditors and other liabilities increased to Rs. 700,000 and Rs. 200,000 respectively
06. Profit for the six months ending June 30, 2012 was Rs. 350,000

The partners merged the two firms at July 01, 2012 on the following term and conditions

01. All the partners in new firm shall share the profit and losses equally
02. The capital of the new firm will be Rs. 16,000,000 which will be contributed by all the partners in new firm in their new profit sharing ratios. Any adjustments in capital accounts will be made in cash in the new firm.
03. The property plant and equipment of both the firms are takeover at following values

	Orange & company Rupees	**Banana & company Rupees**
Land	1,800,000	2,000,000
Building	800,000	700,000
Plant and machinery	1,400,000	1,200,000
Vehicles	500,000	-

04. The vehicles of Banana & company are not taken over by new company. Banana & company sold these vehicles for Rs. 550,000
05. The Goodwill of the both the firm is valued at Rs. 1,000,000 and Rs. 800,000 respectively for Orange & company and Banana & company.
06. Orange & company have two patents currently appearing in the books of the firm at nil value. The fair market of patent 01 is Rs. 300,000 and patent 02 is Rs. 500,000. The patent 01 is not taken over by new firm. Mr. A agreed to take this at its fair value. The fair value of patent of Banana & company is 800,000.
07. All other assets except cash and bank are taken over at their respective book values.
08. The trade creditors and other payables of the both the firms are repaid by the respective firms.
09. The remaining cash and bank balances (after making all the adjustments) of both the firms are taken over by new firms

Required

a. Prepare realization accounts
b. Prepare partners' capital accounts
c. Prepare Statement of Financial Position as at July 01, 2012. **(20)**

Question 04

The following trial balance relates to Sarhad Sugar Limited at 30 September 2013:

	Rs.'000	**Rs.'000**
Leasehold property – at valuation 1 October 2012 (note (i))	50,000	
Plant and equipment – at cost (note (i))	76,600	
Plant and equipment – accumulated depreciation at 1 October 2012		24,600

Capitalised development expenditure – at 1 October 2012 (note (ii))	20,000	
Development expenditure – accumulated amortisation at 1 October 2012		6,000
Closing inventory at 30 September 2013	20,000	
Trade receivables	43,100	
Bank		1,300
Trade payables and provisions (note (iii))		23,800
Revenue (note (i))		300,000
Cost of sales	204,000	
Distribution costs	14,500	
Administrative expenses (note (iii))	22,200	
Interest on bank borrowings	1,000	
Equity dividend paid	6,000	
Research and development costs (note (ii))	8,600	
Share capital		70,000
Retained earnings at 1 October 2012		24,500
Deferred tax (note (v))		5,800
Leasehold property revaluation reserve		10,000
	466,000	466,000

The following notes are relevant:

(i) Non-current assets – tangible:

The leasehold property had a remaining life of 20 years at 1 October 2012. The company's policy is to revalue its property at each year end and at 30 September 2013 it was valued at Rs.43 million. Ignore deferred tax on the revaluation.

On 1 October 2012 an item of plant was disposed of for Rs.2·5 million cash. The proceeds have been treated as sales revenue by Sarhad Sugar Limited. The plant is still included in the above

trial balance figures at its cost of Rs.8 million and accumulated depreciation of Rs.4 million (to the date of disposal).

All plant is depreciated at 20% per annum using the reducing balance method.

Depreciation and amortisation of all non-current assets is charged to cost of sales.

(ii) Non-current assets – intangible:

In addition to the capitalised development expenditure (of Rs.20 million), further research and development costs were incurred on a new project which commenced on 1 October 2012. The research stage of the new project lasted until 31 December 2012 and incurred Rs.1·4 million of costs. From that date the project incurred development costs of Rs. 800,000 per month. On 1 April 2013 the directors became confident that the project would be successful and yield a profit well in excess of its costs. The project is still in development at 30 September 2013.

Capitalised development expenditure is amortised at 20% per annum using the straight-line method. All expensed research and development is charged to cost of sales.

(iii) Sarhad Sugar Limited is being sued by a customer for Rs.2 million for breach of contract over a cancelled order. Sarhad Sugar Limited has obtained legal opinion that there is a 20% chance that Sarhad Sugar Limited will lose the case. Accordingly Sarhad Sugar Limited has provided Rs. 400,000 (Rs.2 million x 20%) included in administrative expenses in respect of the claim. The unrecoverable legal costs of defending the action are estimated at Rs. 100,000. These have not been provided for as the legal action will not go to court until next year.

(iv) The directors have estimated the provision for income tax for the year ended 30 September 2013 at Rs.11·4 million. The required deferred tax provision at 30 September 2013 is Rs.6 million.

Required:

(a) Prepare the statement of comprehensive income for the year ended 30 September 2013. **(10)**

(b) Prepare the statement of financial position as at 30 September 2013. **(10)**

Note: notes to the financial statements are not required.

Question 05

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, 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 might be payable on certain conditions.

(b) A company has an item of equipment which cost Rs. 400,000 in 1997 and was expected to last for ten years. At the beginning of the 2013 financial year the book value was Rs. 280,000. 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 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.

(d) An item has been produced at a manufacturing cost of Rs. 1,800 against a customer's order at an agreed price of Rs. 2,300. The item was in inventory at the year-end awaiting delivery instructions. In January 2014 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, which is expected to make it marketable with other customers at a price of about Rs. 1,900.

(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 these costs are 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. ***(15)***

Question 06

During 2013 Henry has the following research and development projects in progress.

Project A was completed at the end of 2012. Development expenditure brought forward at the beginning of 2013 was Rs. 412,500 on this project. Savings in production costs arising from this project are first expected to arise in 2013. In 2013 savings are expected to be Rs. 100,000, followed by savings of Rs. 300,000 in 2014 and Rs. 200,000 in 2014.

Project B commenced on 1 April 2013. Costs incurred during the year were Rs. 56,000. In addition to these costs a machine was purchased on 1 April 2013 for Rs. 30,000 for use on the project. This machine has a useful life of five years. At the end of 2013 there were still some uncertainties surrounding the completion of the project.

Project C had been started in 2012. In 2012 the costs relating to this project of Rs. 36,700 had been written off, as at the end of 2012 there were still some uncertainties surrounding the completion of the project. Those uncertainties have now been resolved and a further Rs. 45,000 costs incurred during the year.

Required

Show how the above would appear in the financial statements of Henry as of 31 December 2013. **(15)**