THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Professional Examinations Summer 2002

June 05, 2002

FINANCIAL REPORTING **(MARKS 100)**
PE-1 (PAPER-3) **(3 hours)**

Q.1 The balance sheets of Karachi Group as at 31 December 2001 are as follows:

	WAQAR LIMITED	WASIM LIMITED	SHOAIB LIMITED	PAKISTAN LIMITED
	RUPEES IN 000'S			
CAPITAL AND LIABILITIES				
Share Capital	84,000	35,000	30,000	3,400,000
Reserves	321,400	181,375	108,100	2,635,000
	405,400	216,375	138,100	6,035,000
Long-term loans	595,816	128,966	182,439	5,646,384
Current liabilities	1,560,976	617,869	857,410	6,679,771
	2,562,192	963,210	1,177,949	18,361,155
PROPERTY AND ASSETS				
Fixed assets	950,000	250,000	375,000	11,500,000
Long-term investments	210,000	63,000	38,850	-
Current assets	1,402,192	650,210	764,099	6,861,155
	2,562,192	963,210	1,177,949	18,361,155
Notes:				
Investments represents shares in Pakistan Limited. No. of shares are	100,000	30,000	18,500	-

Market value of one share of Pakistan Limited as at 31 December 2001 was Rs. 15 per share

There is a scheme to merge Waqar Limited, Wasim Limited and Shoaib Limited into Pakistan Limited on 31 December 2001.

The due-diligence revealed certain adjustments in relation to the financial statements as at 31 December 2001 which are as follows:

	WAQAR LIMITED	WASIM LIMITED	SHOAIB LIMITED	PAKISTAN LIMITED
		RUPEES IN 000's		
New carrying value of fixed assets (assessed by qualified surveyors)	1,100,000	300,000	300,000	12,000,000
Claims not acknowledged as debts	10,000	5,000	2,500	75,000
Negative goodwill				85,000

Required:

a) Prepare working paper for the merger along with brief justification of the basis used. **(15)**

b) Prepare balance sheet of Pakistan Limited as at 31 December 2001 after merger. **(05)**

Q. 2 a) Your group has recently acquired a new company and the acquisition was accounted for under International Accounting Standard 22 "Business Combinations". After six months, it has been identified that the fair values of certain assets and liabilities are different to those, which have been reported. Your chief executive needs advice for the treatment of the revised fair values. Please write a report advising him on the issue. **(10)**

b) What are the disclosure requirements of the Fourth Schedule of the Companies Ordinance, 1984 for Long-term Loans and Advances? **(05)**

Q.3 The Director Finance of your company is an expatriate and he is confused about the application of International Accounting Standard (IAS) 12 "Income Taxes" in Pakistan. You are required to explain to the Director Finance the status of the IAS along with rationale for the decision. **(05)**

Q.4 You are the Financial Controller of a large manufacturing company, which presently has a manual information system. Management has decided to completely computerize its operations. There are two options. Under Option "A", a reputable software house will be engaged which has promised to develop and implement the system in accordance with management requirements in 12 months. Under option "B", a well-known Enterprise Resource Planning (ERP) package will be purchased, configured and implemented in accordance with requirements, again over a period of 12 months.

Write a half-page report to the Managing Director setting out the pros and cons of both the options also making your recommendations. Assume that the cost of both options is similar. **(08)**

Q.5 Compare and analyse the method of accounting for 'subsidiaries' with the method of accounting for associates. You are required to point out both similarities and differences. **(10)**

Q.6 You are the Financial Advisor of an industrialist who has decided to invest in the confectionery industry. The industrialist has sent to you the financial statements of two confectionery companies, Perfect Confectionery Limited and Ideal Confectionery Limited. He has also informed you that he has a fixed amount of funds allocated for this purpose and will avail an offer to purchase no more than 25% shares in one of the two companies in accordance with your recommendations. The financial statements of the two companies are as follows:

Balance Sheet

	Perfect Confectionery Ltd June 30, 2001 Rs '000'	Ideal Confectionery Ltd June 30, 2001 Rs '000'
CAPITAL AND RESERVES		
Issued, subscribed and paid up capital		
5,000,000 ordinary shares of Rs.10	50,000	90,000
Reserves	180,321	231,197
Accumulated Profit/(Loss)	1,693	1,562
	232,014	**322,759**
Long Term Loans	-	50,000
CURRENT LIABILITIES		
Short term running finances-secured	-	350,000
Creditors accrued and other liabilities	349,784	17,348
	349,784	**367,348**
	581,798	**740,107**
FIXED CAPITAL EXPENDITURE		
Operating fixed assets – tangible	175,208	295,440
CURRENT ASSETS		
Stock in trade	60,413	172,972
Trade Debts	60,655	196,271
Advances – deposits, prepayments and other receivables	7,177	45,640
Cash and bank balances	278,345	29,784
	406,590	444,667
	581,798	**740,107**

Profit & Loss Account

	Perfect Confectionery Ltd	Ideal Confectionery Ltd
Sales	646,763	735,482
Cost of sales	517,411	573,676
Gross Profit	129,352	162,806
Selling and Distribution Expenses	27,415	36,740
Administration & General Expenses	20,770	28,430
Operating Profit (Loss)	81,167	96,636
Less: Financial charges	12,194	25,000
Add: Other Income	12,376	20,482
Profit before taxation	81,349	92,118
Taxation	20,337	23.029
Profit after taxation	61,012	69,089
Accumulated (Loss) B.F.	1,809	1,847
Available for appropriations	62,821	70,936
Appropriations:		
General Reserve	36,000	41,000
Dividends Paid	25,128	28,374
Accumulated Profit C.F.	1,693	1,562

Additional Information about

Perfect Confectionery Limited

i. This is a public unquoted company, which was formed 5 years ago.
ii. The creditors, accrued and other liabilities are high because these include the liability for raw materials procured under a 7 years supplier credit.
iii. Financial charges comprise entirely of financial charges of a long term loan which was paid off during the year.
vi. The company has regularly been paying dividends of 40% every year. In addition, two years ago, a 25% bonus issue was made.

Ideal Confectionery Limited

i. This is a public unquoted company, which was formed six years ago.
ii. The manufacturing facility is a little larger than that of Perfect Confectionery Limited.
iii. The short-term finance facility of Rs 350 million has been obtained for 10 years at a concessional markup rate of 10%.
iv. Other income includes the disposal of one of the machines at a handsome profit of Rs 16 million.
v. The company has regularly been paying 40% dividends every year. It has never made a bonus issue.

Required: Write a report to the industrialist analyzing the financial statements of two companies and setting out your recommendations. The industrialist has requested that the report should be brief and should only include the relevant data. **(17)**

Q.7 Interwood Furnishings manufactures and retails low-price furniture and household equipment. Business has declined over recent years the company has failed to introduce new product ranges.

Trading losses have gradually increased and the results of the last two years have been disastrous. There have been far-reaching changes in the management of the company and the recently appointed board of directors know that drastic action is required if liquidation is to be avoided. Consequently a scheme of reconstruction has been drawn up and it is hoped that this will be acceptable to all parties.

You are provided with the following information:

(1) Summarised audited balance sheet at 31 December 2001:

	Rs.000	Rs.000	Rs.000
FIXED ASSETS (net book value)			
Offices and showroom			560
Factory and warehouse			444
Plant and machinery			580
Motor vehicles			310
			1894
CURRENT ASSETS			
Stock		500	
Debtors		360	
		860	
CURRENT LIABILITIES			
Creditors	620		
Overdraft	1040		
Arrears of interest	80	1740	(880)
			1014
LONG TERM LIABILITIES			
10% unsecured loan stock 2016			(800)
			214
Ordinary share capital (Rs 10 shares)			600
8 % preference share capital (Rs 10 shares)			200
Profit and loss account			(586)
			214

(2) The bank overdraft is secured by a floating charge. No other liabilities are secured

(3) Preference dividends are 2 years in arrears.

(4) On a liquidation, realizable values of assets would be:

	Rs'000
Offices and showrooms	700
Factory and warehouse	460
Plant and machinery	250
Motor vehicles	240
Stock	300
Debtors	256

Liquidation costs would amount to Rs 180,000.

(5) On a going concern basis, provided a suitable reconstruction scheme is accepted and approved and provided adequate finance is obtained, the following asset values would be appropriate:

	Rs '000
Offices and showrooms	760
Factory and warehouse	520
Plant and machinery	414
Motor vehicles	290
Stock	450
Debtors	330

(6) The reconstruction proposals are as follows:

(a) 60,000 Rs 10 ordinary shares are to be redesignated as 6,000 ordinary shares of Rs 10 each.

(b) The preference shares and arrears of dividends are to be cancelled. In return former preference shareholders would receive 4,000 ordinary shares of Rs 10 each.

(c) The bank overdraft would be converted to a fluctuating-rate loan repayable in 2002 and secured by a fixed charge on the property assets. Overdraft facilities of Rs 200,000 would be provided secured by a floating charge.

(d) Unsecured loan stock would be converted to 14% secured loan stock repayable in 2016. Security would be by means of a floating charge.

Loan stock holders would also receive Rs 60,000 cash and the balance in Rs 10 ordinary shares issued at par in satisfaction of their arrears of interest.

(e) The company would make a right issue of 10 for 1 at par. The proceeds of the right issue would be applied in paying off creditors, reconstruction costs and in providing working capital.

(f) The directors have produced figures which indicate that profit before interest but after all other expenses should amount in 2004 to Rs 1,000,000, 2002 would be expected to break-even and 2003 to show a small profit.

(g) Reconstruction scheme costs would amount to Rs 100,000.

Required: (i) State what considerations the loan stock holders should take into account in deciding whether to accept the reconstruction scheme; **(08)**

(ii) Show the journal entries required, and resulting balance sheet, assuming the scheme is implemented in full; **(17)**

(THE END)