THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

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

Q.1 On 1 April 1996 Part Ltd bought 80% of the ordinary share capital of Pieces Ltd and on 1 April 1998 Part Ltd was itself taken over by Holding Ltd who purchased 75% of the ordinary shares in Part Ltd.

The balance sheets of the three companies at 31 October 2000 showed the following positions:

	Holding Ltd		Part Ltd		Pieces Ltd	
Fixed Assets						
Freehold land- cost		178,000		60,000		130,000
Buildings	200,000		240,000		80,000	
Less Accumulated Depreciation	72,000		80,000		32,800	
		128,000		160,000		47,200
Plant and Equipment Cost	205,800		340,000		184,000	
Less Accumulated Dep.	139,800		172,000		96,400	
		66,000		168,000		87,600
Fixed Assets		372,000		388,000		264,800
Investments:						
Shares in Part Ltd. at Cost		270,000				
Shares in Pieces Ltd. at Cost				192,000		
Current Assets:						
Stocks	217,000		151,000		136,800	
Debtors	393,400		249,600		167,000	
Cash at Bank	50,400		0		50,800	
		660,800		400,600		354,600
Current Liabilities						
Creditors	320,000		305,400		198,400	
Short Term Running Finance	0		74,800		0	
Provision for Taxation	114,800		94,400		53,000	
Proposed Dividend	160,000		96,000		20,000	
		594,800		570,600		271,400
Total		708,000		410,000		348,000
Ordinary Shares of Rs 10 each		400,000		240,000		200,000
Revenue Reserves		308,000		170,000		148,000
Total		708,000		410,000		348,000

i. Proposed dividends in Pieces Limited are Rs 20,000
ii. Proposed dividends receivable by Holding Ltd and Part Ltd are included in debtors.
iii. All creditors are payable within one year.
iv. Items purchased by Part Ltd from Pieces Ltd and remaining in stock as at October 31, 2000 amounted to Rs 50,000. The profit element is 20% of selling price for Pieces Ltd.
v. The Depreciation policy of the group is to provide for:
Buildings @2% on cost Plant and Equipment @ 10% of cost with full provision in the year of addition Depreciation has already been charged to 31 October 2000
vi. Included in the plant and equipment of Pieces Ltd is a machine purchased from the manufacturers, Part Ltd on 1 January 1999 for Rs 20,000. Part Ltd recorded a profit of Rs 4,000 on the sale of the machine.
vii. Intra group balances are included in debtors and creditors respectively and are as follows:

		Rs
Holding Ltd	Creditors – Part Ltd	91,200
	- Pieces Ltd	57,800
Part Ltd	Debtors - Holding Ltd	113,800
Pieces Ltd	Debtors -- Holding Ltd	57,800

viii. A cheque drawn by Holding Ltd for Rs 22,600 on 28 October 2000 was received by Part Ltd on 3 November 2000.

ix. At 1 April 1996, reserves in Part limited were Rs 56,000 and in Pieces Limited Rs 40,000. At 1 April 1998,the figures were Rs 80,000 and Rs 120,000 respectively.

Required:
Prepare a group balance sheet for Holding Limited and its subsidiaries as at October 31, 2000 along with all the necessary workings. **(30)**

Q.2 You are the financial consultant to a large listed company, Ayesha Jute Mills Limited. The Chief Executive of the company, who is also a chartered accountant, has been reading about the importance of IAS-39, the new standard on recognition and measurement of financial instruments which is applicable for all financial periods beginning on or after January 1, 2001.

The Chief Executive has provided to you the draft balance sheet drawn up under the previous year's accounting practices when IAS-39 was not applicable as well as certain transactional information. The draft Balance Sheet of Ayesha Jute Mills Ltd. as at June 30, 2002 is set out below:

Ayesha Jute Mills Limited

BALANCE SHEET AS AT JUNE 30, 2002

	Rs
FIXED CAPITAL EXPENDITURE	
Operating Fixed Assets	270,663,959
Assets under Finance Lease	10,007,438
	280,671,397

INVESTMENTS		
8% Govt Bonds	9,000,000	
Listed Term Finance Certificates	15,000,000	
Shares in Listed Companies	55,500,000	
Shares in Unlisted Companies	20,000,000	
Associates	28,000,000	
		127,500,000
CURRENT ASSETS		
Stores and Stocks	270,607,985	
Trade Debtors	206,179,600	
Advances, deposits and prepayments	57,290,444	
Cash and bank balance US $	24,590,000	
Cash and bank balance Pkr	93,292,064	
		651,960,093
		1,060,131,490
SHARE CAPITAL AND RESERVES		
Share capital	215,267,000	
General Reserve	61,100,800	
Unappropriated Profit	1,013,198	
		277,380,998
OBLIGATION UNDER FINANCE LEASE		53,686,355
EMPLOYEES RETIREMENT OBLIGATIONS		114,900,000
CURRENT LIABILITIES		
Short term Running Finance	315,142,639	
Creditors, accrued and other liabilities	287,453,798	
Current portion of obligation under Finance lease	11,567,700	
		614,164,137
		1,060,131,490

Certain other information has been provided which are as follows:

i. The 8% government bonds were purchased directly from the government at the time of issue

ii. Management has stated that the listed Term Finance Certificates (TFCs) are intended to be held till maturity. The TFCs were originally purchased from the market for Rs 30 million, however, half of the TFCs purchased were sold in April 2002.

iii. Financial guarantees outstanding at June 30,2002 amounts to Rs 70 million.

iv. Unutilised forward contracts for the purchase of raw materials in the normal course of business amount to Rs 56 million as at June 30, 2002. These are expected to be settled by delivery.

v. On 31 March 2002, Ayesha Jute entered into a contract for the purchase of equipment for a new dyeing plant for US $ 5 million. The equipment is to be delivered on Sep 30, 2002 and the price is payable on 31 Dec 2002. In order to hedge the commitment to pay US $ 5 million on 31 Dec 2002, the company on March 31 2002 entered into a forward exchange contract to purchase US $ 5 million on 31 Dec 2002 at a predetermined exchange rate of Rs 60 to 1 US $.

Required:
Write a report to the Chief Executive on the following lines:

(a) Briefly compare IAS-39 with existing (old) accounting practices and highlight FOUR major areas where accounting practices have been significantly changed by the introduction of IAS-39? **(06)**

(b) In the light of the balance sheet and other transactional information given above, discuss the potential impact of IAS-39 on the balance sheet components and transactions for Ayesha Jute Mills Limited given above? (financial quantification is not required) **(11)**

Q. 3 You are the Finance Director of a company which specializes in publishing and selling books. Due to fierce competition, the company is facing problems in getting consumers to buy a sufficient volume of its products. The Marketing Department has advised the MD to start an online service whereby customers can order its products online upon payment by credit card. The Marketing people have estimated that, if properly advertised, this can result in a 20-25% increase in sales volume. You are required to write to the MD a report which:

Required:

(a) Lists the major steps to be carried out in setting up such an online service? **(05)**

(b) Discuss briefly the positive and negative factors to be considered in assessing the Marketing Department's plan? **(07)**

Q.4 Kaka Limited intends to acquire a controlling interest by purchasing shares of Dhamaka Limited. A balance sheet of Dhamaka Limited as at June 30, 2002 is set out below:

DHAMAKA LIMITED

BALANCE SHEET AS AT JUNE 30, 2002

	Rs in 000
FIXED CAPITAL EXPENDITURE	321,480
INVESTMENTS	12,000
PRELIMINARY EXPENSES	15,000
CURRENT ASSETS	
Stores and Stocks	160,910
Trade Debtors	165,120
Cash and bank balance	15,100
	341,130
	689,610
SHARE CAPITAL AND RESERVES	
Share capital	170,000
General Reserve	140,630
	310,630
DEFERRED TAXATION	15,640
CURRENT LIABILITIES	
Creditors, accrued and other liabilities	348,340
Provision for Taxation	15,000
	363,340
	689,610

Dhamaka Limited was formed six years ago. Sales and profits for the last three years are as follows:

Years	**Sales Rs 000**	**Profit Rs 000**
2000	350,000	35,670
2001	400,652	42,510
2002	465,540	47,080

The company has also prepared projected profit and loss information for the next five years:

PROJECTED PROFIT AND LOSS

	2003 (Rs. 000)	**2004 (Rs. 000)**	**2005 (Rs. 000)**	**2006 (Rs. 000)**	**2007 (Rs. 000)**
SALES	520,000	580,250	650,000	725,000	790,000
Cost of Sales					
Raw Mat. Consumed	336,000	376,000	416,000	477,000	516,000
Salaries & Wages	48,000	55,000	64,000	74,000	80,000
Depreciation	20,000	22,000	24,000	26,000	28,000
Repair & Maint.	13,000	13,000	14,000	15,000	15,000
Others	15,000	15,250	19,480	14,500	17,000
	432,000	481,250	537,480	606,500	656,000
GROSS PROFIT	**88,000**	**99,000**	**112,520**	**118,500**	**134,000**
Admin and Selling Expenses					
Salaries & Wages	37,000	42,000	48,570	52,500	57,000
Others	5,000	5,000	7,000	7,000	7,000
	42,000	47,000	55,570	59,500	64,000
Other Income	8,000	8,000	8,000	11,000	8,000
PROFIT BEFORE TAXATION	**54,000**	**60,000**	**64,950**	**70,000**	**78,000**

Additional Information:

a. Since the company is operating in a stable market, it is fairly confident about the accuracy of its projections. However, management considers it prudent to assume a zero percent growth rate for annual cash flows beyond the year 2007.
b. Dhamaka Limited has a policy of paying interim dividends during the year. Dividends of Rs 22 million were paid in the year ended June 30,2002. The company expects 10% growth per annum in the amount of dividend paid.
c. Tax rate are assumed to be 30%. In future years, taxable income is expected to be 90% of accounting income due to various timing differences. Taxes are paid in the year subsequent to the accounting year to which they relate.
d. The company operates a funded pension scheme for its management. Annual contributions to the scheme are paid to the fund and are also incorporated in the five years projections. In addition, unfunded employee retirement obligation exists for non management employees. In the absence of an actuarial valuation, these had not been provided. The actuary recently appointed has valued the obligation at Rs 32 million as at June 30,2002.
e. Fixed capital expenditure is expected to be stable at Rs 20 million per annum in future.

f. The company consider its investment in working capital to be excessive as at June 30,2002. In future, it plans to maintain stock in trade at the end of each year equivalent to three months sales value for that year. Debtors and creditors are expected to increase at the rate of ten percent per annum.

g. The fair value of certain assets is higher than the book value as follows:

	Book value Rs 000	Fair value Rs 000
Land	30,000	90,000
Plant and machinery	254,360	286,940
Investments	12,000	18,000

h. The discount rate to be used is 15%. At this discount rate, the discount factors are:

Year 1	0.8695
Year 2	0.7561
Year 3	0.6575
Year 4	0.5717
Year 5	0.4971

Required:
As financial consultant to Kaka Limited, you are required to do the following:

(a) Compute the share value of Dhamaka Limited using the following methods.
   (i) Net assets valuation
   (ii) Discounted cash flow valuation **(23)**

(b) Briefly compare the two methods of valuation given above and recommend an appropriate purchase strategy to Kaka in the light of the share valuation computed above. **(04)**

Q.5 The draft balance sheet at 31 March 2002 of Window Limited and its 80% subsidiary Glass Ltd, acquired on 30 September 2001, are as follows:

	Window Limited Rs 000	Glass Limited Rs 000
Fixed assets		
Intangible assets		
Patents	-	400
Goodwill	-	550
Tangible assets	6,276	1,104
Investments: Shares in Glass Ltd	180	-
	6,456	2,054
Current assets		
Stocks	1,854	806
Debtors	1,950	846
Suspense account	256	-
Cash	1,672	264
	5,732	1,916
Creditors: amounts falling due within one year	(3,428)	(1,040)
Net current assets	2,304	876
Total assets less current liabilities	8,760	2,930
Capital and reserves		
Called up share capital		
Ordinary Rs 10 shares	4,000	1,400
Revaluation reserve	950	-
Profit and loss account	3,810	1,530
	8,760	2,930

The following points are relevant.

(i) At acquisition the balance sheet of Glass Ltd showed net assets with a book value of Rs 2,530,000. Included in this total are freehold land with a book value of Rs.500,000 (market value Rs 1,200,000), patents with a book value of Rs 400,000(market value Rs 450,000) and good will (arising on the acquisition of an unincorporated business some years ago) with a book value of Rs 600,000. The fair values of all other assets and liabilities are approximately equal to their book values.

(ii) The directors of Window Limited intend to restructure and reorganize Glass Ltd and wish to provide for future losses and restructuring costs which are forecasted at Rs 116,000.

(iii) An investment in plant and machinery will be required to bring the remaining production line of Glass Ltd up to date. This will amount to Rs 580,000 in the next 12 months.

(vi) The consideration comprised cash of Rs 180,000 and 80,000 shares of Window Limited issued at a nominal value of Rs 10 and fair value of Rs 26 each. The shares have not yet been reflected in the books of Window Limited.

(v) Professional fees to bankers and solicitors in respect of the acquisition amounted to Rs 150,000. In addition the directors of Window Limited estimate that the value of their time spent on working the acquisition amounted to Rs 106,000.

(vi) Glass Ltd sells part of its output to Window Limited. Included in the stock of Window Limited are goods valued at Rs 300,000 purchased from Glass Ltd at cost plus 25%.

(vii) Group policy is to amortise goodwill, on time apportioned basis over ten years (rounded to the nearest Rs 000).

Required:

(a) Calculate the value of goodwill arising on the acquisition of Glass Ltd. **(08)**

(b) Show the Share Capital and Reserves on the Consolidated Balance Sheet of Window Limited as at March 31 2002. (You are not required to compute or show minority interest). **(06)**

(THE END)