## P.Q. 2

| | | | Marks |
|---|---|---|---|
| **PERFECT IDEAL GROUP** | | Presentation | 1.0 |
| **Cash flow statement for the year ended December 31, 2009** | | | |
| | | Rs.'000 | |
| **Cash flows from operating activities** | | | |
| Operating profit | | 20,000 | 0.5 |
| Depreciation | | 10,100 | 0.5 |
| Changes in working capital | | | |
| Increase in inventory (W-1) | (4,000) | | 0.5 |
| Increase in receivables (W-1) | (4,500) | | 0.5 |
| Increase in payables (W-1) | 3,750 | | 0.5 |
| | | (4,750) | |
| | | 25,350 | |
| Interest paid | | (1,400) | 0.5 |
| Tax paid (W-2) | | (5,200) | 0.5 |
| Cash flows from operating activities | | 18,750 | |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment (W-3) | | (15,450) | 0.5 |
| Sale of Fine Ltd (W-6) | | 5,700 | 0.5 |
| Cash flows from investing activities | | (9,750) | |
| **Cash flows from financing activities** | | | |
| Repayment of long term loan (W-7) | | (2,500) | 0.5 |
| Dividends paid | | | |
| - Parent Company | (3,000) | | 0.5 |
| - Non-controlling interest (W-4) | (500) | (3,500) | 0.5 |
| Net cash used in financing activities | | (6,000) | |
| Net cash flows for the year | | 3,000 | |
| Cash and cash equivalents at the beginning of the year (W-5) | | (3,000) | 0.5 |
| Cash and cash equivalents at the end of the year (W-5) | | 0 | 0.5 |

Workings:

**(W-1) Working Capital Changes**

| | Net movement per statement of financial position | Movement due to disposal | Net movement per cash flow statement | |
|---|---|---|---|---|
| Inventories | (2,000) | (2,000) | (4,000) | 1.0 |
| Receivables | (2,000) | (2,500) | (4,500) | 1.0 |
| Payables | 2,250 | 1,500 | 3,750 | 1.0 |

**(W-2) Tax liability**

| | | |
|---|---|---|
| Tax liability - opening balance | 5,000 | |
| Charge for the year | 6,500 | |
| Tax reduction due to disposal | (300) | |
| Cash paid (balancing) | (5,200) | 1.0 |
| Tax liability - opening balance | 6,000 | |

**(W-3) Capital expenditure** **Marks**

| | | Marks |
|---|---|---|
| Property, plant and equipment at the beginning of the year | 50,000 | |
| Reduction due to disposal of Fine | (4,000) | |
| Depreciation for the year | (10,100) | |
| Additions for the year | 15,450 | 2.0 |
| Property, plant and equipment at the end of the year | 51,350 | |

**(W-4) Dividends to Non-controlling interest**

| | | |
|---|---|---|
| Non-controlling interest at the beginning of the year | 5,750 | |
| Reduction due to disposal (6,000 x 0.20) | (1,200) | 1.0 |
| Non-controlling interest in the results for the year | 1,000 | 0.5 |
| Dividends paid (balancing) | (500) | 1.0 |
| Non-controlling interest at the end of the year | 5,050 | |

**(W-5) Cash and cash equivalents**

| | Cash | Bank OD | Net balance | |
|---|---|---|---|---|
| At the beginning of the year | 2,000 | 5,000 | (3,000) | 0.5 |
| At the end of the year | 6,000 | 6,000 | 0 | 0.5 |

**(W-6) Net Proceeds from sale of Fine Ltd.**

| | (Rs. '000) | |
|---|---|---|
| Cash received from purchaser | 5,500 | |
| Add bank overdraft of Fine Ltd. | 200 | |
| | 5,700 | 1.0 |

**(W-7) Repayment of long-term loan:**

| | | |
|---|---|---|
| Opening | 12,500 | |
| Less: Reduction due to disposal of subsidiary | (500) | 0.5 |
| Payment (Bal. fig) | (2,500) | 1.0 |
| Closing | 9,500 | |

**P.Q. 3**

**Cactus Limited**
**Income Statement for the year ended December 31, 2009**

| | Rs. '000 | Marks |
|---|---|---|
| Sales (378,200 – 13,000) | 365,200 | 0.5 |
| Cost of sales (W-1) | (208,130) | 0.5 |
| Gross profit | 157,070 | |
| Distribution costs | (32,500) | 0.5 |
| Administrative expenses | (45,000) | 0.5 |
| Profit on disposal of non-current assets | 16,000 | 0.5 |
| Other income (Govt. grant) | 2,500 | 0.5 |
| Financial charges (W-3) | (15,377) | 0.5 |
| Profit before tax | 82,693 | |
| Income tax (15,000 – 2,200) | (12,800) | 0.5 |
| Profit after tax | 69,893 | 1.0 |

**Cactus Limited**
**Statement of Financial Position as of December 31, 2009**

| | | |
|---|---|---|
| *Assets* | | |
| Property (200,000 – 4,000) | 196,000 | 0.5 |
| Plant and equipment (W-4) | 211,070 | 0.5 |
| Capital Work-in-progress [ 72,000 + 3,448 (W-3) ] | 75,448 | 1.0 |
| | 482,518 | |
| Current Assets | | |
| Inventory [ 28,240 + 9,750 (W-1) ] | 37,990 | 1.0 |
| Trade debts ( 55,000 - 13,000) | 42,000 | 1.0 |
| Cash | 25,660 | 0.5 |
| | 105,650 | |
| Total Assets | 588,168 | |
| *Shareholders' equity* | | |
| Issued share capital | 180,000 | |
| Retained earnings (W-5) | 137,443 | 0.5 |
| | 317,443 | |
| Non-current liabilities | | |
| Obligation under finance lease (W-6) | 57,500 | 0.5 |
| Long term loans | 115,000 | 0.5 |
| Deferred income (W-8) | 17,500 | 0.5 |
| Current liabilities | | |
| Trade payable and other accrued liabilities (W-7) | 40,725 | 0.5 |
| Current portion of obligation under finance lease (W-6) (82.5 – 57.5) | 25,000 | 0.5 |
| Provision for taxation | 15,000 | 0.5 |
| | 80,725 | |
| Total equity and liabilities | 588,168 | |

**Workings** **Marks**

1 *Cost of sales*

| | | | |
|---|---|---|---|
| Per question | | 175,450 | |
| less: sale/return goods | (13,000 x 75%) | (9,750) | |
| add: depreciation (W-2) | | 42,430 | |
| | | 208,130 | 1.0 |

2. Depreciation

| | | | |
|---|---|---|---|
| Building | (100,000/ 50 years) | 2,000 | 0.5 |
| HVAC | (20,000/ 10 years) | 2,000 | 0.5 |
| | | 4,000 | |
| Leased plant | (100,000 x 20%) | 20,000 | 0.5 |
| Owned plant | (184,300 x 10%) | 18,430 | 0.5 |
| | | 42,430 | |

3. Finance cost

| | | | |
|---|---|---|---|
| Interest on long term loans | | | |
| - Allied Bank of Pakistan | (80,000 x 0.10) | 8,000 | |
| - National Bank of Pakistan | (35,000 x 0.095) | 3,325 | |
| | | 11,325 | 0.5 |
| Less: Capitalized in the cost of qualifying asset | | | |
| [9.85% (W-9) x 30,000] | | (2,955) | 0.5 |
| [9.85% (W-9) x 20,000 x 3/12] | | (493) | 0.5 |
| | | (3,448) | |
| | | 7,877 | |
| Finance lease (100,000 – 25,000) x 10% | | 7,500 | 0.5 |
| | | 15,377 | |

4. Plant and equipment (cost):

| | | | |
|---|---|---|---|
| - Owned plant (opening) | | 184,300 | |
| - Leased plant | | 100,000 | |
| | | 284,300 | 0.5 |
| Depreciation | | | |
| - Owned plant | 34,800 (accumulated) + 18,430 (current) | (53,230) | 1.0 |
| - Leased plant | | (20,000) | 0.5 |
| | | (73,230) | |
| | | 211,070 | 0.5 |

| | | | Marks |
|---|---|---|---|
| 5. | Retained earnings | | |
| | Balance b/f | 79,550 | |
| | Profit for the year | 69,893 | |
| | Dividends paid | (12,000) | |
| | | 137,443 | 1.0 |
| 6. | Obligation under finance lease | | |
| | Cash price | 100,000 | |
| | less: first instalment paid on 1.1.2009 | (25,000) | |
| | | 75,000 | |
| | Add: interest 10% (31.12.09) | 7,500 | |
| | Total obligation including interest (31.12.09) | 82,500 | 0.5 |
| | 2nd Instalment (1-1-10) | (25,000) | |
| | Due later than one year | 57,500 | 0.5 |
| | Due within one year (82,500 – 57,500) | 25,000 | 0.5 |
| 7. | Trade payable and other accrued liabilities | | |
| | Per question | 29,400 | |
| | Financial charges on loans (W-3) | 11,325 | |
| | | 40,725 | 0.5 |
| 8. | Government grant | | |
| | Deferred income – opening balance (25,000 – 5,000) | 20,000 | |
| | Grant taken to income (25,000 ÷ 10) | 2,500 | 0.5 |
| | Deferred income - closing balance | 17,500 | 0.5 |

9. Capitalization rate

$$= \frac{(80,000 \times 10\% + 35,000 \times 9.5\%)}{(80,000 + 35,000)}$$

$= 9.85\%$ 0.5

**Marks**

**P Q 4 (a)**

**Ans:**

As per IAS 19 if the net cumulative unrecognised actuarial gains and losses at the end of the previous period, <u>exceed the greater of</u>: 0.5

10% of the PV of the plan obligation and 0.5

10% of the FV of the plan assets, 0.5

the excess <u>must be recognised</u> in profit or loss. 1.0

(ii) However, the whole of the gain or loss need not be recognised immediately, 0.5

it may be spread over the expected average remaining working lives of the employees. 0.5

(iii) <u>Other methods of</u> spreading the gains and losses may be used if:

- The alternative method results in a faster recognition of actuarial gains/losses. 0.5
- The same method is applied to both gains and losses. 0.5
- The same basis is applied consistently from period to period. 0.5



**P.Q. 4 (b)**

| | | Income Statements | | Statement of Financial Position | | Marks |
|---|---|---|---|---|---|---|
| | | Rs. | | Rs. | | |
| 30-Jun-07 | 2006-07 | 533,333 | (W-1) | 533,333 | (W-1) | 1+1 |
| 30-Jun-08 | 2007-08 | 506,667 | (W-3) | 1,040,000 | (W-2) | 1+1 |
| 30-Jun-09 | 2008-09 | 496,000 | (W-5) | 1,536,000 | (W-4) | 1+1 |

**<u>Working:</u>**

**W-1:** 200 x (250 – 25 – 25) x 40 x $^{1}/_{3}$ = Rs.533,333

**W-2:** 200 x (250 – 25 – 18 – 12) x 40 x $^{2}/_{3}$ = Rs.1,040,000

**W-3:** 1,040,000 – 533,333 = Rs.506,667

**W-4:** 200 x (250 – 25 – 18 – 15) x 40 x $^{3}/_{3}$ = Rs.1,536,000

**W-5:** 1,536,000 – 1,040,000 = Rs.496,000

**P.Q 4 (c)** **Marks**

(i) Since coupon and effective rate of interest are the same, carrying amount of the principal at January 1, 2010 is Rs.500, 000.

| **Working:** | **Rs.** | |
|---|---|---|
| Impairment loss (at January 1, 2010): | | |
| Carrying amount of loan at January 1, 2010 | 500,000 | 0.5 |
| Less: Recoverable amount (336,000 x $\frac{1}{1.12}$) | (300,000) | 1.0 |
| Impairment loss | 200,000 | 0.5 |

On January 1, 2010 carrying amount need to be restated to Rs.300, 000 (336,000 x $\frac{1}{1.12}$) 1

and impairment loss of Rs.200, 000 should be recognised in the income statement. 1

(ii) Interest income at December 31, 2010:
(300,000 x 0.12) Rs.36, 000 1

**P.Q 4 (d)**

Carrying value of asset:

| | Rs. | |
|---|---|---|
| Cost | 500,000 | |
| Accumulated depreciation on (100,000 x 2) | (200,000) | |
| Carrying value on December 31. 2009 | 300,000 | 0.5 |
| Tax base | 250,000 | |
| Taxable temporary difference | 50,000 | 0.5 |
| Income tax @ 35% on Rs.50,000 | 17,500 | 0.5 |

Carrying value of the asset on December 31, 2009 was Rs.300, 000. After revaluation its carrying value increased to Rs.400, 000 without altering its tax base because revaluation has no immediate tax impact. This revaluation has resulted in an additional temporary difference of Rs.100,000 (400,000 – 300,000). 1.0

Hence an additional deferred tax liability of Rs.35, 000 (100,000 x 0.35) 0.5

Revaluation gain is credited to revaluation reserve which is a part of other comprehensive income. 0.5

Deferred tax on this gain is debited to revaluation reserve and shown as part of other comprehensive income. 0.5

**CASE STUDY** **Marks**

SHARE VALUATION *(figures in thousands)*

(a) **Net Asset based valuation**

| | Rs. | Rs. | Marks |
|---|---|---|---|
| Net assets as per accounts | | 388,630 | |
| Fair value adjustment | | | |
| Land | 136,000 | | |
| Plant and machinery | 22,080 | | |
| Investments | 15,000 | | |
| | | 173,080 | |
| | | 561,710 | 1 |
| Total number of shares | | 21,500 | |

Per share value = 561,710 / 21,500 = Rs. 26.13 1

(b) **Discounted cash flow based valuation**

| | Rs. '000 | 2010 Rs. '000 | 2011 Rs. '000 | 2012 Rs. '000 | 2013 Rs. '000 | 2014 Rs. '000 | Marks |
|---|---|---|---|---|---|---|---|
| Net profit before tax | | 60,600 | 69,400 | 71,540 | 78,450 | 81,500 | |
| add: depreciation | | 26,500 | 31,000 | 32,300 | 32,700 | 29,200 | 1 |
| | | 87,100 | 100,400 | 103,840 | 111,150 | 110,700 | |
| less: capital expenditure | | 15,000 | 16,500 | 18,150 | 19,965 | 21,962 | 1 |
| | | 72,100 | 83,900 | 85,690 | 91,185 | 88,738 | |
| less: taxation (35% of 85% of income) | | (20,250) | (18,029) | (20,647) | (21,283) | (23,339) | 1 |
| | | 51,850 | 65,871 | 65,043 | 69,902 | 65,399 | |
| Working capital adjustment | | 52,791 | (4,267) | (1,909) | 359 | 1,658 | |
| Free cash flows | | 104,641 | 61,604 | 63,134 | 70,261 | 67,057 | |
| PV factors | | 0.8929 | 0.7972 | 0.7118 | 0.6355 | 0.5674 | |
| PV of cash flows | 270,182 | 93,434 | 49,110 | 44,939 | 44,651 | 38,048 | 1 |
| PV of cash flows beyond 2014 | 312,779 | | | | | | |
| Total Present Value | 582,961 | | | | | | |

Value per share = 582,961 / 21,500 = Rs. 27.11

**Working capital adjustment**

| | 2009 Rs. '000 | 2010 Rs. '000 | 2011 Rs. '000 | 2012 Rs. '000 | 2013 Rs. '000 | 2014 Rs. '000 | Marks |
|---|---|---|---|---|---|---|---|
| Inventories | 153,410 | 108,667 | 121,385 | 132,167 | 141,125 | 149,250 | |
| Debtors | 90,370 | 94,889 | 99,633 | 104,615 | 109,846 | 115,338 | |
| Creditors | (251,340) | (263,907) | (277,102) | (290,957) | (305,505) | (320,780) | |
| | (7,560) | (60,351) | (56,084) | (54,175) | (54,534) | (56,192) | 1 |
| Change | | 52,791 | (4,267) | (1,909) | 359 | 1,658 | |

Marks

**Present Value of Cash flows beyond 2014**

| | | |
|---|---|---|
| Cash flow for 2014 | 67,057 | |
| Add: tax 2013 | 23,339 | |
| Less: tax 2014 | (24,246) | |
| | 66,150 | 1 |

Present value 312,779 $\left( \frac{66,150}{0.12} \times 0.5674 \right)$

ii) **Valuation of an unquoted company** **2**

Valuation of unquoted companies should be done considering the following factors:

It may not be sensible to use PE ratio of a listed company for comparison purposes because the market value of a listed company is likely to include a premium to reflect the marketability of shares.

– A small unlisted company is highly vulnerable to loss of key customers, suppliers, employees etc. The costs involved in their possible replacement can be significant.

In the event of a purchase of a unlisted company, following factors can be considered before making a final offer. However, the final offer will largely depend upon the negotiations.

a) General economic and financial conditions in which a company operates
b) The type of industry and the prospects of that industry
c) The size of the entity and its status within the industry
d) Marketability: due to absence of ready market, a higher yield is justified
e) The diversity of shareholding and financial status of principal shareholders
f) The reliability of profit estimates and the past profit record
g) Asset backing and liquidity of the company
h) the nature of the assets, whether highly specialized in nature etc.
i) Gearing: higher the gearing ratio, greater will be the financial risk for the shareholders
j) Dependence of the business on the technical skills of one or more individuals