Question Paper
Financial Statement Analysis (CFA560): July 2008

- **Answer all 70 questions.**
- **Marks are indicated against each question.**

Total Marks : 100

1. The three basic elements in the balance sheet of a company are <Answer>

(a) Assets, liabilities and preference share capital
(b) Assets, liabilities and retained earnings
(c) Assets, liabilities and shareholders' equity
(d) Assets, liabilities and revenues
(e) Assets, liabilities and excess of revenue over expenses. **(1 mark)**

2. "The change in equity of a business enterprise, during a period, from transactions and other events and circumstances from the non owner sources" is known as <Answer>

(a) Comprehensive income
(b) Sundry assets
(c) Sundry liabilities
(d) Investments by owners
(e) Distributions to owners. **(1 mark)**

3. The balance sheet gives information regarding the <Answer>

(a) Results of operations of the firm for a particular period
(b) Financial position of the firm during a particular period
(c) Profit earning capacity of the firm for a particular period
(d) Financial position of the firm on a particular date
(e) Operating efficiency of the firm on a particular date. **(1 mark)**

4. Which of the following is equal to the probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events? <Answer>

(a) Revenues
(b) Gains
(c) Losses
(d) Liabilities
(e) Assets. **(1 mark)**

5. Preparation of income statement is governed by the <Answer>

(a) Accrual principle
(b) Consistency principle
(c) Cost principle
(d) Matching principle
(e) Going concern principle. **(1 mark)**

6. An interest coverage ratio of 6 indicates that <Answer>

(a) Sales are 6 times of interest expense
(b) Profit after tax is 6 times of interest expense
(c) Profit before tax is 6 times of interest expense
(d) Earnings before interest and taxes is 6 times of interest expense
(e) Profit after tax is equal to $1/6^{th}$ of interest expense. **(1 mark)**

7. In common size analysis the items in the income statement are expressed as percentage of <Answer>

(a) Gross profit
(b) Net sales
(c) Total expenses
(d) Selling and distribution expenses
(e) Net profit. **(1 mark)**

8. Gross profit ratio can be calculated from the <Answer>

(a) Income statement
(b) Balance Sheet
(c) Funds flow statement
(d) Cash flow statement
(e) Directors' report. **(1 mark)**

9. The following data was extracted from the books of Write Ltd., for the year 2007-08: <Answer>

Particulars	Rs.
Credit sales	73,000
Average account receivables	11,000

The average collection period is (assume 365 days in a year)

(a) 50 days
(b) 52 days
(c) 55 days
(d) 58 days
(e) 60 days. **(2 marks)**

10. The following data pertains to Harita Ltd., for the period ended March 31, 2008: <Answer>

Particulars	
Cost of goods sold	Rs.12,00,000
Stock turnover ratio	6 times
Closing stock	Rs.2,50,000

The value of opening stock was

(a) Rs.1,50,000
(b) Rs.2,00,000
(c) Rs.4,00,000
(d) Rs.4,70,000
(e) Rs.3,60,000. **(2 marks)**

11. Current ratio is generally used to assess the <Answer>

(a) Effective utilization of capital
(b) Application of debt
(c) Liquidity position
(d) Levels of inventory piled up in different forms
(e) Prompt payment of long-term liabilities. **(1 mark)**

12. Sigma Ltd., has 90,000 equity shares of Rs.10 each fully paid. If it had a profit after tax of Rs.9,00,000 in the current year and paid Rs.3,60,000 by way of equity dividends, the Dividend Pay-out Ratio was <Answer>

(a) 51%
(b) 40%
(c) 14%
(d) 54%
(e) 55%. **(2 marks)**

13. The following figures are collected from the annual report of Akhaya Ltd.: <Answer>

Profit after tax = Rs.5,20,000
Number of outstanding equity shares = 1,00,000
10% Preference share capital = Rs.10,00,000

The earning per equity share for Akhaya Ltd., is

(a) Rs.6.20
(b) Rs.5.20
(c) Rs.4.20
(d) Rs.2.60
(e) Rs.2.10. **(2 marks)**

14. In which of the following situations, price earnings ratio is applied? <Answer>

(a) To determine the financial risk of a business entity
(b) To determine the expected market price of the shares of a company
(c) To assess the earning potential of a company in the near future
(d) To examine the operational efficiency of a company
(e) To check how efficiently the assets are utilized by a firm. **(1 mark)**

15. Which of the following changes can improve break-even point? <Answer>

(a) Increase in fixed cost
(b) Increase in selling price per unit
(c) Increase in variable cost
(d) Increase in sales volume
(e) Increase in production volume. **(1 mark)**

16. The current sales price of Ahana Ltd., is Rs.120 per unit. Variable costs are expected to increase from Rs.80 to Rs.90 per unit. Fixed costs of Rs.2,50,000 will not change. How many sale units additionally are required to maintain an operating income of Rs.1,25,000? <Answer>

(a) 12,500 units
(b) 9,375 units
(c) 8,333 units
(d) 3,125 units
(e) 6,250 units. **(2 marks)**

17. Consider the production cost and sales of ABC Ltd., for the current year <Answer>

Particulars	Rs.
Sales	20,00,000
Variable cost	8,00,000
Fixed cost	4,00,000
No. of units sold	20,000

If the company proposes to increase its sales by 4,000 units in the next year, the increase in expected profit is

(a) Rs. 60,000
(b) Rs.3,20,000
(c) Rs.2,40,000
(d) Rs.2,80,000
(e) Rs.1,60,000. **(2 marks)**

18. Which of the following items could appear in a company's cash flow statement? <Answer>

(a) Proposed dividends
(b) Forfeiture of shares
(c) Bonus issue of shares
(d) Repayment of loan
(e) Conversion of debentures into equity shares. **(1 mark)**

19. Which of the following items is an investing activity in a cash flow statement? <Answer>

(a) Proceeds from borrowings
(b) Repayment of debt
(c) Loans advanced to others
(d) Payments for future contracts
(e) Payments for purchases of inventories. **(1 mark)**

20. Which of the following is a use of funds that decreases cash in cash flow statements? <Answer>

(a) A gross increase in fixed assets
(b) A net decrease in any asset other than cash or fixed assets
(c) Proceeds from sale of equity shares
(d) Funds from operations
(e) A net increase in any liability. **(1 mark)**

21. The following data are available from the books of Alfa Ltd., for the year 2007-08: <Answer>

- Cash inflow from operating activities : Rs.1,29,000.
- Cash used for investing activities : Rs.1,00,000.
- Cash used for financing activities : Rs. 35,000.
- Cash at the beginning of the period : Rs. 95,000.

Cash at the end of the year 2007-08 amounted to

(a) Rs. 89,000
(b) Rs.1,01,000
(c) Rs. 31,000
(d) Rs. 98,000
(e) Rs.1,59,000. **(2 marks)**

22. Consider the following production cost and sales of ABC Ltd., for the year 2007-08: <Answer>

Particulars	Rs.
Sales	5,00,000
No. of units sold	5,000
Variable cost Rs.50 per unit	2,50,000
Fixed cost	1,00,000

The break-even sales of the company for the year 2007-08 was

(a) Rs.1,00,000
(b) Rs.2,50,000
(c) Rs.2,00,000
(d) Rs.5,00,000
(e) Rs.3,50,000. **(2 marks)**

23. The minimum set of information items needed to prepare the statement of cash flows for the current year is <Answer>

(a) The current year income statement only
(b) The current year-end balance sheet only
(c) The current year income statement and the current year-end balance sheet
(d) The previous year-end balance sheet and the current year-end balance sheet
(e) The previous year-end balance sheet, the current year-end balance sheet and the current year income statement. **(1 mark)**

24. A company is generally considered to be in a better financial health if it obtains most of its cash needs from <Answer>

(a) Net income
(b) Operating activities
(c) Investing activities
(d) Financing activities
(e) Financial Institutions. **(1 mark)**

25. Following information pertaining to Tara Ltd., was extracted from the accounting records for the year ended March 31, 2008: <Answer>

Particulars	Rs.
Cash received from customers	8,70,000
Royalty received	10,000
Cash paid to suppliers and employees	5,10,000
Taxes paid	1,10,000
Cash dividend paid	30,000

The Net cash flow provided by operations for 2007-08 was

(a) Rs. 2,20,000
(b) Rs. 2,30,000
(c) Rs. 2,50,000
(d) Rs. 2,60,000
(e) Rs. 2,00,000. **(2 marks)**

26. Free cash flows will be arrived by <Answer>

(a) Deducting net capital expenditure from operating cash flow
(b) Adding net capital expenditure to operating cash flow
(c) Deducting operating cash flow from net capital expenditure
(d) Adding after tax proceeds from asset sales to operating cash flow
(e) Deducting net capital expenditure from non-operating cash flow. **(1 mark)**

27. Leeds Ltd., has provided depreciation of Rs.4,00,000 as per accounting records and Rs.7,00,000 as per tax records. Unamortized preliminary expenses, as per tax records is Rs.5,600. There is adequate evidence of future profit sufficiency. Assuming the company adheres to Indian Accounting Standards, the amount of deferred tax asset/liability to be recognized as transaction adjustment, if the tax rate is 40%, is <Answer>

(a) Rs.1,20,000 (deferred tax liability)
(b) Rs.1,17,760 (deferred tax liability)
(c) Rs.1,20,000 (deferred tax asset)
(d) Rs.1,17,760 (deferred tax asset)
(e) Rs.1,12,240 (deferred tax asset). **(2 marks)**

28. PVR Ltd., has incurred a loss of Rs.5,00,000 during the year ended March 31, 2008. The product of the company has become outdated and the company does not expect with reasonable certainty that in future it will earn any taxable profits, rather it expects that there will be loss in future. What should the company do to fully comply with the requirement of AS-22 assuming tax rate is 30%? <Answer>

(a) Create a deferred tax asset for Rs.1,50,000
(b) Create a deferred tax liability for Rs.1,50,000
(c) Not required to create a deferred tax asset or liability
(d) Create a deferred tax asset for Rs.5,00,000
(e) Create a deferred tax liability for Rs.5,00,000. **(2 marks)**

29. SFAS 109, Accounting for Income Taxes, states that a deferred tax asset shall be reduced by a valuation allowance if it is <Answer>

(a) More likely than not to be not realizable
(b) Probable that some portion will not be realized
(c) Reasonably possible that some portion will not be realized
(d) Reasonably certain that some portion will not be realized
(e) Fully realizable. **(1 mark)**

30. Queen Ltd., reported an income of Rs.2,70,000 for the financial year 2007-08. The following data are provided <Answer>

Rent received in advance	Rs.36,000
Income from exempted Government Bonds	Rs.60,000
Depreciation deducted for income tax purpose in excess of depreciation reported for financial accounting purpose	Rs.60,000
Income tax rate	35%

The provision for deferred tax asset/liability is

(a) Rs.6,300 (deferred tax liability)
(b) Rs.6,300 (deferred tax asset)
(c) Rs.8,400 (deferred tax liability)
(d) Rs.4,900 (deferred tax asset)
(e) Rs.9,400 (deferred tax asset). **(2 marks)**

31. In the balance sheet, unearned revenues are to be classified as <Answer>

(a) A current asset
(b) A current liability
(c) An expense
(d) An income
(e) A contingent liability. **(1 mark)**

32. The bonds which are purchased at discount and redeemed at par with no coupon payments at regular intervals are known as <Answer>

(a) Serial bonds
(b) Convertible bonds
(c) Commodity bonds
(d) Zero-Coupon bonds
(e) Callable bonds. **(1 mark)**

33. Zoom Ltd., is engaged in the business of leasing computers under direct finance lease. These computers have no residual value at the end of the lease period of five years and lessee has no bargain purchase option. Zoom Ltd., wants to earn 8% return on investment with a fair value of Rs.3,44,960. Total amount of interest revenue earned by Zoom Ltd., over the life of the lease will be (Assume that the present value on a 5 year lease @ 8% of an annuity of Re.1 is 4.312) <Answer>

(a) Rs.1,39,450
(b) Rs.1,29,360
(c) Rs. 80,000
(d) Rs. 55,040
(e) Rs. 50,000. **(2 marks)**

34. Anu Ltd., entered into a five year operating lease agreement with Avon Enterprises at a monthly rental of Rs.1,000. Anu Ltd., granted first nine months as free of rent, as an inducement for Avon Enterprise to enter into the contract. The lease and rental commenced from June 1, 2007 and March 1, 2008 respectively. The rent expense of Avon Enterprise to be reported in the financial statements for the year ending March 31, 2008 was <Answer>

(a) Rs. 1,000
(b) Rs. 9,000
(c) Rs.10,200
(d) Rs.10,500
(e) Rs.12,000. **(2 marks)**

35. From the following data, calculate the amount of Unearned Finance Income: <Answer>

Lease term	4 years
Agreed lease rental	Rs.5 lakhs per annum
Guaranteed residual value	Rs.1 lakh
Un guaranteed residual value	Rs.2 lakhs
Present value of the Gross Investment in lease	Rs.16 lakhs.

(a) Rs.23 lakhs
(b) Rs.21 lakhs
(c) Rs.20 lakhs
(d) Rs.16 lakhs
(e) Rs. 7 lakhs. **(2 marks)**

36. At the end of the first year of operation, Frenzy Company reported Rs.90,000 as its taxable income and Rs.76,000 as its pre-tax financial income. The difference between these two is for a single temporary difference. The company believes that only 75% of the deductible temporary difference is more likely than not to be realized because of uncertainty of the economic environment. If the current tax rate is 30% and no charge has been enacted for future years then at the year end balance sheet how much will be reported as deferred tax asset? <Answer>

(a) Rs.14,000
(b) Rs.12,000
(c) Rs.10,500
(d) Rs. 4,200
(e) Rs. 3,150. **(2 marks)**

37. Emerald Ltd., showed the accounting income Rs.8,00,000 for the year ended on March 31, 2008. In computation of accounting income, the following data were considered: <Answer>

Gain on Revaluation of Asset (Cr. to Profit & Loss account)	Rs.3,50,000
Depreciation deducted for accounting purpose in excess of depreciation deducted for income tax purpose	Rs. 50,000
Income Tax Rate	35%

The provision of income tax and deferred tax asset/liability is

(a) Rs.2,80,000; Rs. 17,500 (DTA)
(b) Rs.2,80,000; Rs.1,40,000 (DTA)
(c) Rs.2,97,500; Rs. 17,500 (DTA)
(d) Rs.1,75,000; Rs. 17,500 (DTA)
(e) Rs.1,75,000; Rs.1,05,000 (DTL). **(2 marks)**

38. Aryan Ltd., has an employee benefit plan for compensated absences that give the employees 10 paid vacation days and 10 paid sick days. Employees can elect to receive payment in lieu of vacation days and not in lieu of sick days. On December 31, 2007, the unadjusted balance of liability for compensated absences was Rs.21,000. As on December 31, 2007, Aryan Ltd., estimates that there were 150 days of vacation days and 75 sick days available. If the employees earn an average of Rs.100 per day, assuming that the vacation days and sick days can be carried forward indefinitely, the amount of liability for compensated absences required to be reported in the Balance sheet is <Answer>

(a) Rs.36,000
(b) Rs.24,000
(c) Rs.22,500
(d) Rs.21,000
(e) Rs.15,000. **(2 marks)**

39. On January 1, 2007, Guss Company signed a 7-year lease for equipment having a 10-year economic life. The present value of the monthly lease payments equaled 80% of the equipment's fair value. The lease agreement provides for neither a transfer of title to Guss Company nor a bargain purchase option. In its 2007 income statement, Guss Company should report <Answer>

(a) Rent expense equal to the 2007 lease payments
(b) Rent expense equal to the 2007 lease payments less interest expense
(c) Lease amortization equal to the one-tenth of the equipment's fair value
(d) Lease amortization equal to one-seventh of 80% of the equipment's fair value
(e) Lease amortization equal to one- fifth of equipment's fair value. **(2 marks)**

40. On April 1, 2008 Srivastava Company leased three cars from Sujatha Automobiles for five years for an equal annual rent of Rs.1,00,000 per car to be paid on April 1, each year. Srivastava guaranteed Rs.40,000 as a residual value to Sujatha Automobiles at the end of the lease period. The lease fulfills all criteria as capital lease and the implicit interest rate in the lease is considered as 9%. Present values of 9% for different periods are <Answer>

For an annuity due with 5 payments	4.240
For an ordinary annuity with five payments	3.890
Present value of Re.1 for 5^{th} period	0.650

If the first annual payment is made on April 1, 2008, Srivastava's recorded capital lease liability immediately after the first required payment is

(a) Rs.4,50,000
(b) Rs.4,15,000
(c) Rs.4,05,000
(d) Rs.3,75,000
(e) Rs.3,50,000. **(2 marks)**

41. Vishnu Ltd., entered into a nine-year capital lease for a farmhouse on April 1, 2007. The lease payments of Rs.1,04,000 were agreed to be paid annually beginning with April 1, 2008. The lease payments include real estate taxes amounting to Rs.4,000. If the incremental borrowing rate is 9%, the amount to be reported as capitalized lease liability is <Answer>

(a) Rs.5,99,500
(b) Rs.6,23,480
(c) Rs.6,47,460
(d) Rs.7,27,480
(e) Rs.9,45,000. **(2 marks)**

42. Rasi Ltd., reported a pre-tax financial income of Rs.2,50,000, a taxable temporary difference of Rs.28,000 and Rs.8,000 as deductible temporary difference for the financial year ended March 31, 2008. If the company has no operating loss or tax bracket, then taxable income of the company was <Answer>

(a) Rs.2,30,000
(b) Rs.2,78,000
(c) Rs.2,58,000
(d) Rs.2,86,000
(e) Rs.2,70,000. **(2 marks)**

43. Amith Ltd., has furnished the following data as on March 31, 2008: <Answer>

Particulars	Rs.
Sundry debtors	10,00,000
Bad debts	4,00,000

The company enjoyed 30% tax bracket from April 1, 2008.

If the tax laws are revised to eliminate deductions for accrued bad debts with existing allowances to be taken into income ratably over 4 years, the non-current tax liability will be

(a) Rs.1,20,000
(b) Rs.3,00,000
(c) Rs.2,80,000
(d) Rs. 30,000
(e) Rs. 90,000. **(2 marks)**

44. The liabilities payable over a longer period of time, generally after one year, are known as <Answer>

(a) Current liabilities
(b) Provisions
(c) Long-term liabilities
(d) Contingent liabilities
(e) Reserves. **(1 mark)**

45. In a lease agreement unearned rent by the lessor would be amortized to rental revenue over the lease term on a <Answer>

(a) Straight line basis
(b) Written down value basis
(c) Declining balance basis
(d) Units of production basis
(e) Sum of the years' digits basis. **(1 mark)**

46. Which of the following entity or entities is/are considered as related parties in a lease agreement? <Answer>

I. A parent company and its subsidiaries.
II. An owner company and its joint ventures and partnerships.
III. An investor and its investees.

(a) Only (I) above
(b) Only (II) above
(c) Only (III) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

47. The lessor should show the leased property in the balance sheet under the head <Answer>

(a) Reserves and surplus
(b) Secured loans
(c) Current assets
(d) Miscellaneous expenditure
(e) Investment in leased property. **(1 mark)**

48. The parties involved in 'Leveraged lease' are <Answer>

(a) Lessor, lessee, and a long-term creditor
(b) Lessor and lessee only
(c) Lessor and a long-term creditor
(d) Lessor, lessee, and a short-term creditor
(e) Lessor and short-term creditor. **(1 mark)**

49. In which of the following lease agreements, there is no recognition of the leased asset in the balance sheet? <Answer>

(a) Capital lease
(b) Operating lease
(c) Sales-type lease
(d) Direct financing lease
(e) Leveraged leases. **(1 mark)**

50. The actuarial estimation of future pension benefits payable to employees on retirement based on expected future salary and service of the employee is known as <Answer>

(a) Projected benefit obligations
(b) Accumulated benefit obligations
(c) Vested benefit obligations
(d) Non-vested benefit obligations
(e) Additional benefit obligations. **(1 mark)**

51. In a pension plan, the difference between the fair value of plan assets at the end of the period and the fair value of plan assets at the beginning of the period adjusted for contributions and payments during the period is <Answer>

(a) Service cost
(b) Interest cost
(c) Actual return on plan assets
(d) Actuarial gains or losses
(e) Prior service cost. **(1 mark)**

52. The net post retirement expense does **not** include <Answer>

(a) Current service cost
(b) Interest cost
(c) Actual return on plan assets
(d) Actuarial gains and losses, which should be recognized immediately
(e) Past service cost which should also be recognized immediately. **(1 mark)**

53. Under pension accounting, the liability to be shown in the balance sheet of the employer company is the difference between <Answer>

(a) The value of the assets and the value of pension liability
(b) The value of the liability and the value of pension liability
(c) The value of the pension and the value of pension fund
(d) The value of the pension and the value of pension liability
(e) The value of the asset and the value of pension fund. **(1 mark)**

54. Rosy Ltd., has provided the following data for the year ended March 31, 2008: <Answer>

Particulars	Rs.
Fair value of plan asset	82,80,000
Accumulated Benefit Obligation	1,03,20,000
Projected Benefit Obligation	1,36,80,000

The amount of pension liability shown in Balance sheet as on March 31, 2008 was

(a) Rs.1,36,80,000
(b) Rs. 54,00,000
(c) Rs. 33,60,000
(d) Rs. 22,80,000
(e) Rs. 20,40,000. **(2 marks)**

55. Equity method is prescribed for accounting for investments where the investor holds significant influence over investee actions. What is the percentage of the voting rights that specifies the significant influence? <Answer>

(a) 50%
(b) 30%
(c) More than 50%
(d) 20%
(e) 25%. **(1 mark)**

56. An investment classified as available-for-sale security is to be reflected in the financial statement at (its) <Answer>

(a) Fair value
(b) The par or the stated value of the securities
(c) Accumulated income minus accumulated dividends since acquisition
(d) The cost to acquire the investment
(e) Face value. **(1 mark)**

57. Under AS-13, if long-term investments of a company are reclassified to current investments, it would be recognized in the financial statements at <Answer>

(a) Lower of cost and carrying amount at the date of transfer
(b) Higher of cost and carrying amount at the date of transfer
(c) Lower of cost and fair value at date of transfer
(d) Lower of cost and replacement value at the date of transfer
(e) Higher of cost and replacement value at the date of transfer. **(1 mark)**

58. On December 01, 2007 Hema Ltd., acquired 60% shares in Suma Ltd. The net profit earned by Suma Ltd., for the year 2007-08 was Rs.60,000. The profit was earned evenly throughout the year. The amount treated as capital profit in consolidated balance sheet prepared by Hema Ltd., was <Answer>

(a) Rs.36,000
(b) Rs.60,000
(c) Rs.40,000
(d) Rs.24,000
(e) Rs.16,000. **(2 marks)**

59. For the preparation of consolidated balance sheet, the profits earned by a subsidiary company before holding company acquires control over it are known as <Answer>

(a) Revenue profits
(b) Capital profits
(c) Super profits
(d) Normal profits
(e) Minority interest. **(1 mark)**

60. On March 31, 2008, A Ltd., acquired B Ltd. As on that date B Ltd.,'s balance sheet was as follows: <Answer >

Liabilities	Rs.	Assets	Rs.
Equity share capital	3,00,000	Net fixed assets	13,00,000
Reserves and Surplus	9,50,000	Current assets	5,70,000
Current liabilities	7,20,000	Preliminary Expenses	1,00,000
Total	19,70,000	Total	19,70,000

If all the assets and liabilities of B Ltd., were taken over at their book values, the purchase consideration payable by A Ltd., was

(a) Rs.12,24,000
(b) Rs.11,50,000
(c) Rs.15,22,000
(d) Rs.14,30,000
(e) Rs.10,28,000. **(2 marks)**

61. H Ltd., acquired 75% shares of S Ltd., on August 1, 2007. The equity share capital of S Ltd., is Rs.1,00,000. The Land and buildings of S Ltd., were appreciated by Rs.2,00,000. The minority interest shown in the consolidated balance sheet as on March 31, 2008 was <Answer >

(a) Rs.2,00,000
(b) Rs.1,50,000
(c) Rs.1,00,000
(d) Rs. 75,000
(e) Rs. 50,000. **(2 marks)**

62. Wealth Ltd., acquired 55% shares of Gold Ltd., on February 01, 2007. Wealth Ltd., sells goods at cost plus 20%. During the year 2007-08, it supplied goods worth Rs.90,000 to Gold Ltd., out of which, 60% were unsold and still in stock of Gold Ltd., as on March 31, 2008. The unrealized profit on stock to be adjusted while preparing Consolidated Balance Sheet as on March 31, 2008 was <Answer >

(a) Rs. 5,000
(b) Rs. 5,940
(c) Rs. 9,000
(d) Rs.10,800
(e) Rs. 6,000. **(2 marks)**

63. Consolidated financial statements are typically prepared when one company has a controlling financial interest in another unless <Answer >

(a) The subsidiary is a finance company
(b) The fiscal year ends of the two companies are more than three months apart
(c) Such control is likely to be temporary
(d) The two companies are in unrelated industries, such as manufacturing and real estate
(e) The subsidiary is an insurance company. **(1 mark)**

64. The share capital of Sanjana Ltd., is Rs.10,00,000, consisting of 1,000, 15% Preference shares of Rs.100 each fully paid and 9,000 equity shares of Rs.100 each, Rs.90 paid-up. The profit of the company for the year 2007-08 was Rs.1,12,200. The normal rate of return is 8%. The value of each equity share of the company was <Answer >

(a) Rs.171
(b) Rs.125
(c) Rs.150
(d) Rs.135
(e) Rs.263. **(2 marks)**

65. On March 31, 2008, Major Ltd., acquired 80% equity shares of Minor Ltd. Consider the following data: <Answer>

- Major Ltd., has share in capital profits of Minor Ltd., to the tune of Rs. 2,94,000.
- The post acquisition profits of Minor Ltd., were Rs. 69,750.
- The unrealized profit on account of inter company sales was Rs.15,000.
- The profit and loss account of Major Ltd., showed a credit balance of Rs. 6,00,000 as on April 01, 2007 and the it made a profit of Rs. 2,40,000 during the year 2007-08.

In the Consolidated Balance Sheet as on March 31, 2008, the profit and loss account of Major Ltd., was shown at

(a) Rs. 8,83,800
(b) Rs. 8,80,800
(c) Rs. 5,23,800
(d) Rs. 9,07,800
(e) Rs. 5,35,800. **(1 mark)**

66. When Purchase Consideration is greater than Net Asset Value, it is to be adjusted to <Answer>

(a) Capital reserve
(b) Goodwill
(c) Profit and loss account
(d) Preliminary expenses
(e) Promoters' funds. **(1 mark)**

67. The adjustment entry passed to eliminate the inter-company owings is to <Answer>

(a) Debit Amalgamation Adjustment a/c, Credit Statutory reserve account
(b) Debit Sundry Creditors a/c, Credit Sundry Debtors a/c
(c) Debit Sundry Creditors a/c, Credit Statutory reserve a/c
(d) Debit Amalgamation Adjustment a/c, Credit Sundry Debtors a/c
(e) Debit Sundry Debtors a/c, Credit Sundry Creditors a/c. **(1 mark)**

68. The exchange rate established by the terms of an agreement for exchange of two currencies at a specified future date is called <Answer>

(a) Exchange rate
(b) Forward rate
(c) Average rate
(d) Settlement rate
(e) Closing rate. **(1 mark)**

69. Artic Ltd., bought a machine for $30,000 on April 1, 2006 on installment. The amount is repayable in two equal installments at the end of each year (March, 31) together with interest at the rate of 10% p.a. The machine was installed on June 1, 2006. The exchange rates are cited below: <Answer>

April 1, 2006	-	Rs.35 per $
March 31, 2007	-	Rs.38 per $
March 31, 2008	-	Rs.36 per $

The loss or gain on foreign exchange transaction is

(a) Rs.99,000
(b) Rs.90,000
(c) Rs.28,500
(d) Rs.70,500
(e) Rs.39,000. **(2 marks)**

70. According to AS-11, in translating the financial statements of non-integral foreign operations for incorporation in the financial statements, the reporting enterprise should transfer the resulting exchange differences to <Answer>

(a) Foreign currency translation reserve
(b) Profit and loss account
(c) Suspense account
(d) Branch account
(e) Exchange account. **(1 mark)**

END OF QUESTION PAPER

Suggested Answers
Financial Statement Analysis (CFA560): July 2008

	Answer	**Reason**	
1.	C	The balance sheet is modeled after the basic accounting equation of Assets = Liabilities + Shareholders' Equity. Thus, alternative (c) is the correct answer.	< TOP
2.	A	According to SFAC 6, para 70, Comprehensive income is "the change in equity of a business enterprise during a period from transactions and other events and circumstances from the non owner sources". It includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners.	< TOP
3.	D	Balance sheet is prepared on a particular date to know the financial position of the concern. Hence, option (d) is correct answer.	< TOP
4.	E	As per SFAC 6, the probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events is equal to assets.	< TOP
5.	D	Preparation of income statement is governed by matching principle which states that the performance can be measured only if revenues and related costs are accounted for during the same time period.	< TOP
6.	D	Interest coverage ratio measures the firm's ability to handle financial burdens. This ratio tells how many times the firm can cover or meet the interest payment associated with debt. Interest coverage ratio = EBIT / Interest expense. Hence interest coverage ratio of 6 indicates EBIT is 6 times of interest expense.	< TOP
7.	B	In common size analysis the items in the income statement are expressed as percentage of net sales.	< TOP
8.	A	Gross profit ratio can be calculated from the income statement.	< TOP

9. C — Average daily sales = Credit sales/365 = Rs.73,000/365 = Rs.200
Average collection period = Average account receivables / Average daily sales
= Rs.11,000 / Rs.200 = 55 days. < TOP

10. A — < TOP

Stock turnover ratio = Cost of goods sold/Average inventory = 6 times
or Rs.12,00,000/Average inventory = 6 times
Or average inventory = Rs.12,00,000/6 = Rs.2,00,000
= (Opening inventory + Closing inventory)/2 = Rs.2,00,000
= (Opening inventory + Rs.2,50,000)/2 = Rs.2,00,000
Opening inventory = Rs.4,00,000 – Rs.2,50,000 = Rs.1,50,000.

11. C — Liquidity implies a firm's ability to pay its debts in the short run. This ability can be measured by the use of current ratio. < TOP

12. B — < TOP

$$\text{Dividend pay-out ratio} = \frac{\text{Dividends}}{\text{Profit after tax}} \times 100$$

$$\text{Dividend pay-out ratio} = \frac{\text{Rs.}3{,}60{,}000}{\text{Rs.}9{,}00{,}000} \times 100 = 40\%$$

13. C — < TOP

Partiulars	Rs.
Profit after tax	5,20,000
Less: Preference dividend (Rs.10,00,000 x 10%)	1,00,000
Prfoit available to equity shareholders	4,20,000
Earning per share (Rs.4,20,000 /1,00,000)	4.20

14. B — Price-earnings ratio is used to determine the expected market price per share of the company. One may project the EPS of a company for the next few years and thereafter by assuming the continuity of the same P/E multiple, the future market price per share may be calculated. < TOP

15. B — < TOP

$$\text{Break even point} = \frac{\text{Fixed cost}}{\text{Sale price per unit} - \text{Variable cost per unit}}$$

From the above relation, increase in sale price can improve break-even point. Break-even point will not be improved with the increase in variable cost, fixed cost, sales volume and production volume. Hence, (b) is correct answer.

	Answer	Reason	
16.	D	Projected sales units = $\frac{\text{Fixed cost} + \text{Target operating income}}{\text{Contribution margin per unit}}$	< TOP

Projected sales units = $\frac{\text{Rs.}2,50,000 + \text{Rs.}1,25,000}{\text{Rs.}120 - \text{Rs.}90}$ = 12,500 units

Current sales units = $\frac{\text{Rs.}2,50,000 + \text{Rs.}1,25,000}{\text{Rs.}120 - \text{Rs.}80}$ = 9,375 Units.

Increase in units: 12,500 – 9,375 = 3,125 units.

17. C Contribution per unit= Sales price per unit – variable cost per unit < TOP

Sales price per unit = Rs.20,00,000/20,000=Rs.100

Contribution per unit= Rs.100-Rs.40= Rs.60

Increase in profit = Rs.60 ×4,000 = 2,40,000.

18. D Repayment of loan will lead to an outflow of cash which will appear in the company's cash flow statement. Hence, (d) is correct answer. < TOP

19. C Loans advanced to others is an investing activity in a cash flow statement. < TOP

20. A A gross increase in fixed assets is a use of funds that decreases cash in cash flow statements. < TOP

The other options are sources of funds which increase cash.

- A net decrease in any asset other than cash or fixed assets
- Proceeds from sale of equity or preference shares.
- Funds from operations
- A net increase in any liability.

21. A < TOP

Particulars	Rs.	Rs.
Cash at the beginning of the period		95,000
Add : Cash inflow from operating activities		1,29,000
Total cash inflows		2,24,000
Less: Cash used for investment activities	1,00,000	
Less: Cash used for financing activities	35,000	1,35,000
Cash at the end of the period		89,000

22. C < TOP

Break-even sales(units)	=	Fixed cost /contribution per unit
Contribution per unit	=	Sales price per unit – variable cost per unit
Sales price	=	5,00,000/5,000=100
Contribution	=	100 – 50 = Rs.50
	=	1,00,000/50 = 2,000 units

Break-even sales = break-even units x sales price per unit = 2,000 × Rs.100 = Rs.2,00,000.

23. E The minimum set of information items needed to prepare the statement of cash flows for the current year is < TOP

- The previous year-end balance sheet.
- The current year-end balance sheet.
- The current year income statement.

Hence option (e) is correct.

24. B Companies that are financed with operating cash flows are said to be internally financed. They have less need of debt and equity financing and do not need to sell assets to meet cash needs. Hence the right answer is option (b) where the company obtains most of its cash needs from operating activities. Option (a) is incorrect, net income of a company reflects the net of income less expenses accrued. It does not reflect the excess cash needed for the daily requirements. Cash needs from investing activities, from financing activities and financial institutions all indicate use of external sources and not internal financing. < TOP

25. D Payment of dividends is a financing activity. All other transactions listed are cash flows from operating activities. Accordingly, the net cash flows from operating is Rs.2,60,000 (Rs.8,70,000 + Rs.10,000 – Rs.5,10,000 – Rs.1,10,000). < TOP

26. A The basic definition used by many analysts to compute free cash flow is cash from operations less the amount of net capital expenditure required to maintain the firm's productive capacity. < TOP

Answer		Reason

27. B Deferred tax should be recognised for all the timing differences. In the instant case the timing difference between taxable income and accounting income is- [< TOP]

Particulars	Rs.
Excess depreciation as per tax records (Rs.7,00,000 – Rs.4,00,000)	3,00,000
Less Expenses provided in taxable income	(5,600)
Timing Difference	2,94,400

As tax expense is more than the current tax due to timing difference of Rs. 2,94,400, Therefore deferred tax liability = 40% of Rs.2,94,400 = Rs.1,17,760.

28. C As the company has incurred a loss of Rs. 5 lakhs which is also the loss as per income-tax Act, the company should have created the deferred tax assets for Rs. 1,50,000 (30% of 5 lakhs). Deferred tax should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised. In this case the company does not expect sufficient future taxable income, therefore the company is correct in not creating deferred tax assets as per AS-22. [< TOP]

29. A A deferred tax asset shall be reduced by a valuation allowance if the weight of the available evidence, both positive and negative indicates that it is more likely than not (that is, the possibility is greater than 50%) that some portion will not be realized. The allowance should suffice to reduce the deferred tax asset to the amount that is more likely than not to be realized. [< TOP]

Option (b), (e) are incorrect because FASB specifically rejected the term probable and likely as used in SFAS 5. Option (c) and (d) are incorrect because FASB believes that the appropriate criterion is the one that produces results that are closest to the expected outcome. A reasonable possibility does not meet the criteria.

30. C Deferred tax asset/liability [< TOP]

Particulars	Rs.
Rent received in advance = Rs.36,000 × 35%	12,600 (DTA)
Income from exempted Government bonds (permanent diff)	
Excess depreciation for income tax purpose Rs.60,000 x 35%	21,000 (DTL)
Total	8,400 (DTL)

31. B Unearned revenue is a liability till it is earned. Once it is earned, it becomes income. (b) is the correct answer. [< TOP]

32. D The bonds which are purchased at discount and redeemed at par with no coupon payments at regular intervals is known as Zero-Coupon bonds. [< TOP]

33. D The annual lease payment is Rs.80,000 (Rs.3,44,960 /4.312). Zoom Ltd., will receive 5 × Rs.80,000 = Rs.4,00,000 over the five years. Thus the interest revenue will be the excess of lease payment over the present value of the asset i.e. Rs.(4,00,000 – 3,44,960) = Rs.55,040. [< TOP]

34. C According to SFAS-13, rent expense of operating leases is to be amortized on a straight-line basis if no other better-suited method is available. In the given case, Avon Enterprise should pay monthly rental for 5 years i.e. (60-9) = 51 months. The total rental amount of Rs.51,000 i.e. 51 x Rs.1,000 will be amortized over 5 years. Thus Rs.51,000/5 = Rs.10,200 to be shown as rent expense in Avon Enterprise's financial statement for the year ending March 31, 2008. [< TOP]

35. E Gross Investment in the lease = Agreed lease rental + Guaranteed residual value + Un guaranteed residual value = Rs.20 lakhs + Rs.1 lakhs + Rs.2 lakhs = Rs.23 lakhs [< TOP]
Present value of the Gross investment in lease = Rs.16 lakhs
Unearned Finance lease = Rs.23 lakhs – Rs.16 lakhs = Rs.7 lakhs.

36. E The amount of temporary difference is the difference of the taxable income and the financial income and it is (Rs.90,000 – 76,000) = Rs.14,000. As there is a possibility of only 75% to be realized, the amount to be realized is 75% of Rs.14,000 = Rs.10,500. Thus the deferred tax asset is 30% of Rs.10,500 i.e. Rs.3,150. [< TOP]

Answer	Reason

37. D < TOP

	Rs.
Accounting income	8,00,000
Add: Depreciation deducted for accounting purpose in excess of depreciation deducted for income tax purpose	50,000
Less: Gain on Revaluation of Asset	3,50,000
Taxable income	5,00,000

Current tax = 35% of Rs.5,00,000 = Rs.1,75,000

Deferred tax/liability

Depreciation deducted for accounting purpose in excess of depreciation deducted for income tax purpose	DTA	Rs.50,000 × 35%	17,500
Gain on Revaluation of Asset	Permanent difference		
NET			17,500 (DTA)

38. E SFAS 43 states that accrual of a liability for future vacation pay is required if all the conditions below are met. < TOP

i. Obligations arises from employee services already performed.

ii. Obligations arises from rights that vest or accumulate.

iii. Payment is probable

iv. Amount can be reasonably estimated.

The criteria are met for the vacation pay (150 x Rs.100= Rs.15,000). So Aryan Ltd., is required to report Rs.15,000. The same criteria apply to accrual of a liability for future sick pay. Except that if sick pay benefits accumulate but do not vest, accrual is permitted but not required because its payment is contingent upon future employee sickness. So no liability is required for these sick pay benefits. The unadjusted balance of liability account does not affect the computation of the required liability.

39. A The lessee has entered into an operating lease because none of the criteria of a capital lease are met. The lease does not transfer ownership of the equipment to the lessee by the end of the lease term nor does it contain a bargain purchase option. The lease term is less than 75% of the estimated economic life of the equipment and the present value of the minimum lease payments at the beginning of the lease term is less than 90% of the fair value of the equipment. The lessee records neither an asset nor an obligation for an operating lease; instead, the lessee records its lease payments as rent expense. < TOP

40. E Before the payment was made on 1st April 2008, the initial lease liability will be the present value of the five years lease rental together with the present value of the residual value i.e. Rs.(1,00,000 × 4.240 + 40,000 × 0.6500) = Rs.4,50,000. The payment made on 1st April 2008, should be excluded from this value and the capitalized liability will be Rs.(4,50,000 – 1,00,000) = Rs.3,50,000. < TOP

41. A Real estate taxes are not an expense or liability until incurred. Therefore, they are excluded from the minimum lease payments and are not reflected in the capital lease liability. < TOP

The amount of capitalized lease liability = (Rs.1,04,000 – Rs.4,000) x 5.995 = Rs.5,99,500.

42. A < TOP

Particulars	Rs.	Rs.
Pre-tax financial income		2,50,000
Taxable temporary differences	28,000	
Less: Deductible temporary differences	8,000	20,000
Taxable income		2,30,000

43. E The deferred tax benefit shown in balance sheet of Amit Ltd., as on April 1, 2008 is Rs.1,20,000 (Rs.4,00,000 × 0.30) < TOP

Less: current tax liability is ¼ of Rs.1,20,000 is Rs.30,000

The amount of non-current tax liability is Rs.1,20,000 – Rs.30,000 = Rs.90,000.

44. C The liabilities payable over a longer period of time, generally after one year, are known as long-term liabilities. < TOP

45. A In a lease agreement unearned rent by the lessor would be amortized to rental revenue over the lease term on a Straight line basis. < TOP

Answer		Reason	
46.	E	The following entities are considered as related parties in a lease agreement: • A parent company and its subsidiaries. • An owner company and its joint ventures and partnerships. • An investor and its investees. Hence, (e) is correct answer.	< TOP
47.	E	The lessor should show the leased property on the balance sheet under the head "Investment in leased property".	< TOP
48.	A	The parties involved in 'Leveraged lease' are Lessor, lessee, and a long-term creditor.	< TOP
49.	B	In the case of an operating lease there is no recognition of the leased asset in the balance sheet since the substance of the lease is only that of a rental.	< TOP
50.	A	The actuarial estimation of future pension benefits payable to employees on retirement based on expected future salary and service of the employee is known as projected benefit obligations.	< TOP
51.	C	Actual return on plan assets refers to the difference between the fair value of plan assets at the end of the period and the fair value of plan assets at the beginning of the period adjusted for contributions and payments during the period.	< TOP
52.	C	The net post retirement expense includes • Current service cost • Interest cost • Expected return on plan assets • Actuarial gains and losses, which should be recognized immediately • Past service cost which should also be recognized immediately. Hence, it includes expected return on plan asset, but does not includes actual return on plan assets.	< TOP
53.	A	Under pension accounting, the liability to be shown on the balance sheet of the employer company is the difference between the value of the assets and the value of pension liability.	< TOP
54.	E	As per US GAAP, a minimum pension liability is to be reported for the excess of ABO over the fair value of plan assets Rs.20,40,000 (Rs. 1,03,20,000 – Rs. 82,80,000).	< TOP
55.	D	In case the equity method is adopted, 20% of the voting rights or the ownership gives the investor the scope to exercise significant influence on the operating and the financial policies of the investee.	< TOP
56.	A	As per SFAS-115, available-for-sale securities are investments in debt securities that are not classified as held to maturity or trading securities. They are measured at fair value in the financial statement.	< TOP
57.	A	As per the para 23 of the Accounting Standard AS-13, if long-term investments are reclassified as current investments, then the transfers are made at the lower of cost and carrying amount at the date of transfer.	< TOP
58.	D	Profit for the year 2007- 08 = Rs.60,000 Profit for 8 months (from April 01, 2007 to December 01, 2007) = $60,000 \times \frac{8}{12} = \text{Rs.}40,000$ Share of capital profit of Hema Ltd. = Rs.40,000 × 60% = Rs.24,000.	< TOP
59.	B	The profits earned by a subsidiary company before the holding company acquires control over it is known as capital profit. Any profit before acquisition date is the capital profit. Other profits mentioned in (a), (c), (d) and (e) are not relevant. Hence, (b) is correct answer.	< TOP
60.	B	If all assets and liabilities of B Ltd., were taken up by A Ltd., at book value, the purchase consideration would be	< TOP

Particulars	Rs.
Net Fixed Assets	13,00,000
Current assets	5,70,000
Less : Liabilities taken over	18,70,000
Current liabilities	7,20,000
Purchase Consideration	11,50,000

Answer		Reason

61. D Minority interest = 100 – 75 = 25% < TOP

Profit on appreciation of land and buildings = Rs.2,00,000.

Share of minority in profit on appreciation = 25% of Rs.2,00,000

$\frac{25}{100} \times \text{Rs.}2,00,000$ = Rs. 50,000

Share of minority in Equity share capital (25% of Rs.1,00,000) = Rs. 25,000

Total minority interest = Rs. 75,000.

62. C Value of unsold goods in stock = Rs.90,000 × 60% = Rs.54,000 < TOP

Profit included in the unsold stock = Rs.54,000 × 20 / 120 = Rs. 9,000

Unrealised profit to be adjusted in consolidated balance sheet= Rs.9,000.

63. C Per ARB 51, a subsidiary should not be consolidated when control is likely to be temporary. SFAS 94, requires consolidation of all majority-owned subsidiary regardless of the industry or business of the subsidiary. ARB 51 states that a difference in fiscal periods of a parent and a subsidiary does not of itself justify the exclusion of the subsidiary from consolidation < TOP

64. D < TOP

Particulars	Rs.
Profit	1,12,200
Less: Preference dividend (1,00,000 x 15%)	15,000
Profits available to equity shareholders	97,200

Rate of return (97,200/8,10,000) × 100 = 12%

Yield value of equity share = (Expected rate of return / Normal rate of return) × Paid-up value of share = (12/8) × 90 = Rs.135.

65. B Degree of control in Minor Ltd: 80% < TOP

Profit & Loss account on 1-4-2007	Rs.6,00,000
Profit for the year 2007-08	Rs.2,40,000
Share of Revenue Profit in Minor Ltd. 80% of 69,750	Rs. 55,800
	Rs.8,95,800
Less: Unrealised Profit	Rs. 15,000
	Rs.8,80,800

Share in capital profit will be considered for the calculation of the cost of control and not added to the profit and loss account of Major Ltd.

66. B If the purchase consideration in more than net asset value, it is to be debited to goodwill, hence the correct answer is (b). < TOP

67. B At the time of amalgamation, inter company owings should be eliminated. If the purchasing company owes an amount to the vendor company or vice versa, the amount is included in the debtors of one company and creditors of the other company. The following adjustment entry is passed to eliminate the inter company owings. < TOP

Sundry Creditors account Dr.

To Sundry Debtors account

68. B The exchange rate established by the terms of an agreement for exchange of two currencies at a specified future date is called the forward rate as per the definitions given by the AS –11. hence the option (b) is the correct answer. < TOP

69. D < TOP

Year	Principal outstanding (in \$)	Interest (in \$)	Exchange variations
2006-07	30,000	3,000	Rs.99,000
2007-08	15,000	1,500	(Rs.28,500)

Calculation of gain or loss on Exchange variation

Principal outstanding x change in exchange rate over immediately preceding exchange rate:

Year	Exchange calculation	Gain or loss (Rs.)
2006-07	\$30,000 × (Rs.38 – Rs.35)	Loss of Rs.90,000
2007-08	\$15,000 × (Rs.36 – Rs.38)	Gain of Rs.30,000

Interest x change in exchange rate over the rate at which asset is booked:

Year	Exchange calculation	Gain or loss (Rs.)
2006-07	\$3,000 × (Rs.38 – Rs.35)	Loss of Rs.9,000
2007-08	\$1,500 × (Rs.36 – Rs.35)	Loss of Rs.1,500

The exchange variation gain is = Rs.99,000 – Rs.28,500 = Rs.70,500.

	Answer	Reason	
70.	A	According to AS-11, in translating the financial statements of a non-integral foreign operation for incorporation in the financial statements, the reporting enterprise should transfer the resulting exchange differences to Foreign currency translation reserve.	< TOP

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