Question Paper

Financial Statement Analysis (CFA560): April 2008

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

Total Marks : 100

<Answer>

1. Which of the following qualitative characteristics is the ability to help users see similarities and differences to evaluate relative financial position and performance of companies?

(a) Verifiability
(b) Consistency
(c) Relevance
(d) Neutrality
(e) Comparability. **(1 mark)**

<Answer>

2. Which of the following is equal to the residual interest that remains in the assets after deducting an entity's liabilities?

(a) Gains
(b) Losses
(c) Equity
(d) Revenues
(e) Expenses. **(1 mark)**

<Answer>

3. Which of the following statements' preparation is primarily governed by the matching principle?

(a) Balance sheet
(b) Income statement
(c) Statement of comprehensive income
(d) Statement of cash flows
(e) Statement of stakeholders equity. **(1 mark)**

<Answer>

4. While translating the financial statements of foreign branches of Indian companies, all revenue items other than opening and closing inventories and depreciation must be translated at

(a) Spot rate
(b) Average rate
(c) Notional rate
(d) Market rate
(e) Book value. **(1 mark)**

<Answer>

5. Expense manipulation can be done by

(a) Vendor financing
(b) Understating liabilities
(c) Trade loading or channel stuffing
(d) Not recognizing rebates or discounts
(e) Overstatement of value of accounts receivables. **(1 mark)**

<Answer>

6. Timing differences are considered temporary because

(a) They are based on different tax rates
(b) They affect book income in different years
(c) They eventually reverse
(d) The costs eventually expire
(e) They result in deferred tax asset/liability. **(1 mark)**

<Answer>

7. As per AS-11, the need for foreign currency translation arises

(a) In respect of the financial statements of foreign branches of the parent enterprise
(b) In respect of the financial statements of the parent enterprise
(c) In respect of only the non-monetary items of the foreign branches of the parent enterprise
(d) In respect of only the monetary items of the foreign branches of the parent enterprise
(e) In respect of only the fixed assets of the foreign branches of the parent enterprise. **(1 mark)**

<Answer>

8. If the yield rate of return of Elina Ltd., is 15.75%, normal rate of return is 9%, paid up value of each equity share is Rs.10 and nominal value of each equity share is Rs.20, the value of an equity share of the company is

(a) Rs.20.00
(b) Rs.17.50
(c) Rs.15.75
(d) Rs.35.00
(e) Rs. 5.71. **(2marks)**

<Answer>

9. The following information is provided by Avon Ltd., for the year ended March 31, 2008:

Particulars	Rs.
Share capital	18,00,000
Creditors	2,25,000
Reserves and surplus	4,50,000
Secured loans	3,75,000

The shareholders' funds were

(a) Rs.16,50,000
(b) Rs.18,75,000
(c) Rs.20,25,000
(d) Rs.18,00,000
(e) Rs.22,50,000. **(2marks)**

<Answer>

10. Elixir Ltd., manufactures Product – M. The company has furnished the following information pertaining to its product per unit:

Particulars	Rs.
Selling price	120
Direct material	50
Direct labour	30
Variable overheads	10

The number of units sold by the company was 4,450. If the direct labour cost is increased by 20%, the number of extra units to be sold to maintain the same quantum of profit would be

(a) 1,010 units
(b) 950 units
(c) 875 units
(d) 1,225 units
(e) 1,113 units. **(2marks)**

<Answer>

11. Which of the following is statutorily required to be shown as a part of the schedules to profit and loss account to convey more information on items appearing in that account?

(a) Information about raw materials consumed
(b) Contingencies
(c) Labor problems
(d) Defalcation by an employee
(e) Pension and other post employment benefit plans. **(1 mark)**

<Answer>

12. Generally Accepted Accounting Principles (GAAP) require the recognition of future income tax assets and liabilities resulting from timing differences. If timing differences were ignored and tax expense was equal to current taxes payable, which accounting principle would be violated?

(a) Consistency
(b) Comparability
(c) Matching
(d) Historical cost
(e) Going concern. **(1 mark)**

<Answer>

13. The primary currency of a foreign entity's economic environment in which the entity operates is known as

(a) Translation currency
(b) Temporal currency
(c) Functional currency
(d) Local currency
(e) Reporting currency. **(1 mark)**

<Answer>

14. Which of the following is an example of a non-cash investing activity?

(a) Loans advanced to others
(b) Purchase of equity securities of other entities
(c) Issuing debenture in exchange of long lived assets
(d) Receipt of interest on short term investments
(e) Sale proceeds of land received by bank draft. **(1 mark)**

<Answer>

15. Ashwin Ltd., has furnished the following data relating to its capital structure:

	March 31, 2007	March 31, 2008
Outstanding shares of stock:		
Common	1,10,000	1,10,000
Convertible preferred	10,000	10,000

During 2007-08, Ashwin Ltd., paid dividends of Rs.3.00 per share on its preferred stock. The preferred shares are convertible into 20,000 shares of common stock and are considered common stock equivalents. Net income for 2007-08 was Rs.8,50,000. Assume that Income tax rate is 30%. The diluted EPS for 2007-08 is

(a) Rs.6.31
(b) Rs.6.54
(c) Rs.7.08
(d) Rs.7.45
(e) Rs.7.00. **(2marks)**

<Answer>

16. Which of the following types of inter-company transactions may take place between the parent and the subsidiary company?

I. Inter-company sales of merchandize.
II. Inter-company debt/equity transactions.
III. Transaction of the fixed assets.

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

<Answer>

17. Which of the following is **not** included in the statement of stakeholders equity?

(a) Preferred shares
(b) Retained earnings
(c) Valuation allowance
(d) Maximum pension liability
(e) Cumulative translation allowance. **(1 mark)**

<Answer>

18. Palodhy Ltd., has provided the following data:

Funds from operations	Rs.1,25,000
Depreciation on fixed assets	Rs. 38,000
Amortization of goodwill	Rs. 31,000
Transfer to general reserve	Rs. 27,000

The amount of net profit transferred to balance sheet by the company during the year was

(a) Rs. 84,000
(b) Rs. 56,000
(c) Rs. 29,000
(d) Rs.1,25,000
(e) Rs. 96,000. **(2marks)**

<Answer>

19. Ramam 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 will be

(a) 0.51
(b) 0.40
(c) 0.14
(d) 0.54
(e) 0.55. **(2marks)**

<Answer>

20. The current sale price of Sohana Ltd., is Rs.120 per unit. Variable costs are expected to increase from Rs.75 to Rs.80 per unit. Fixed costs of Rs.5,00,000 will not change. How many additional sales units are required in order to maintain the current operating income of Rs.2,50,000?

(a) 16,667
(b) 18,750
(c) 2,500
(d) 2,083
(e) 2,250. **(2marks)**

<Answer>

21. When a company acquires a majority of the common stock of another company and each company would be continuing to exist as per law, it is known as

(a) Acquisition
(b) Consolidation
(c) Merger
(d) Reverse acquisition
(e) Internal reconstruction. **(1 mark)**

<Answer>

22. No disclosure is required in consolidated financial statements in respect of

(a) Remittances-in-transit
(b) Capital reserve
(c) Intra-group transactions
(d) Goodwill
(e) Minority interest. **(1 mark)**

<Answer>

23. Which of the following will **not** result in an increase in net working capital?

(a) Increase in cash
(b) Decrease in creditors
(c) Decrease in bank loan
(d) Decrease in inventory
(e) Decrease in bills payable. **(1 mark)**

<Answer>

24. On July 01, 2007, Sateesh Ltd., acquired 70% equity shares of Sandeep Ltd. The share capital of Sandeep Ltd., consists of 10,000 equity shares of Rs.100 each. The capital profit and revenue profit of Sandeep Ltd., have been calculated as Rs.3,20,000 and Rs.55,000 respectively.

The amount of minority interest shown in Consolidated Balance Sheet as on March 31, 2008 was

(a) Rs.4,57,500
(b) Rs.3,60,000
(c) Rs.3,07,500
(d) Rs.4,05,000
(e) Rs.4,12,500. **(2marks)**

<Answer>

25. Trendy Ltd., holds 75% equity shares of Pace Ltd. During the consolidation of accounts, it is noticed that the sundry creditors of Trendy Ltd., include Rs.20,000 for goods purchased from Pace Ltd., on which the subsidiary company made a profit of 25% on selling price.

If all the goods sold above were still in the stock of Trendy Ltd., as on March 31, 2008, the unrealized profit in the Consolidated Balance Sheet as on March 31, 2008 was

(a) Rs. 2,500
(b) Rs. 4,000
(c) Rs. 5,000
(d) Rs.10,000
(e) Nil. **(2marks)**

<Answer>

26. Which of the following is **not** an important factor leading to the diversity of global accounting standards?

(a) Taxation systems
(b) Legal systems
(c) Inflation rates
(d) Political and economic factors
(e) Compliance costs. **(1 mark)**

<Answer>

27. Which of the following methods is employed for the recognition of revenue whenever costs of goods or services is unknown and there are also ambiguities in collecting the sale proceeds?

(a) Sales basis method
(b) Percentage of completion method
(c) Completed contract method
(d) Installment sales method
(e) Cost recovery method. **(1 mark)**

<Answer>

28. If the earning power of a firm is 0.3, the average of total assets is Rs.20,000 and interest expense is Rs.1,500, then the interest coverage ratio will be

(a) 1.5
(b) 2.0
(c) 3.0
(d) 4.0
(e) 4.5. **(2marks)**

<Answer>

29. Which of the following is a liquidity ratio?

(a) Return on equity
(b) Return on investment
(c) Acid-test ratio
(d) Debt-equity ratio
(e) Debt-asset ratio. **(1 mark)**

<Answer>

30. The following data are extracted from the records of Rahul Ltd.:

Particulars	First year (Rs.)	Second year (Rs.)
Sales	3,00,000	3,50,000
Profit	40,000	55,000

The break-even sales value of the company was

(a) Rs.1,60,000
(b) Rs.1,66,667
(c) Rs.1,87,887
(d) Rs.1,77,750
(e) Rs.1,92,150. **(2marks)**

<Answer>

31. The measurement date for pension plan assets and obligations is the

(a) Last date of the calendar year
(b) Date of the financial statements
(c) Beginning of the accounting period
(d) Date the actuary submits the information
(e) Date of the financial statements or a date not more than three months prior to that date. **(1 mark)**

<Answer>

32. The long term investments are accounted for in the balance sheet at

(a) Cost price less income to date
(b) Cost price or market price, whichever is lower
(c) Cost price
(d) Replacement price
(e) Net realizable value. **(2marks)**

<Answer>

33. The value of each equity share of Ace Ltd., as per yield method is Rs.19.50 and as per fair value method is Rs.22.50. The value of the share according to intrinsic value method is

(a) Rs.21.00
(b) Rs.25.50
(c) Rs.19.50
(d) Rs.42.00
(e) Rs.16.50. **(2marks)**

<Answer>

34. Earning per equity share equals

(a) Sales divided by number of opening equity shares
(b) Net profit after tax and preference dividends divided by weighted average number of equity shares
(c) Net profit after tax and preference dividends divided by number of ending equity shares
(d) Sales divided by weighted average number of equity shares
(e) Net profit after tax and preference dividends divided by number of opening equity shares. **(1 mark)**

<Answer>

35. Information relating to events occurring after the balance sheet date, provision for investment and segregation of income and expenses is most likely to be found in

(a) Auditor's opinion
(b) Segment reporting
(c) Profit and loss account
(d) Schedules to the statements
(e) Management discussion and analysis. **(1 mark)**

<Answer>

36. In the Consolidated Balance Sheet of a holding company, the value of minority interest **does not** consist of a proportionate share of minority shareholders in the

(a) Nominal value of share capital of subsidiary company
(b) Reserves and profits of the subsidiary company at the time of acquisition by the holding company
(c) Income of the subsidiary company after its acquisition by the holding company
(d) Subsidiary company's losses
(e) Reserves of the holding company. **(1 mark)**

<Answer>

37. Ajit Ltd., purchased Sujit Ltd. If the purchase consideration paid by Ajit Ltd., exceeds the value of net assets of Sujit Ltd., the balance is

(a) Debited to goodwill a/c
(b) Debited to capital reserve a/c
(c) Credited to goodwill a/c
(d) Credited to capital reserve a/c
(e) Shown as a loss by debiting the profit and loss a/c. **(1 mark)**

<Answer>

38. Following is the balance sheet of Sangam Ltd., for the year ended March 31, 2008:

Liabilities	Rs.	Assets	Rs.
Share capital (Rs.10)	2,00,000	Sundry assets	3,55,000
General reserve	60,000		
Debentures	55,000		
Creditors	40,000		
Total	3,55,000	Total	3,55,000

Sangam Ltd., is to be taken over by Brij Ltd. The market value of each share of Sangam Ltd., and Brij Ltd., is Rs.20 and Rs.40 respectively. The purchase consideration is in the form of shares to be issued to Brij Ltd., on the basis of market value of shares.

What is the amount of purchase consideration to be paid by Brij Ltd.?

(a) Rs.4,00,000
(b) Rs.4,50,000
(c) Rs.4,05,000
(d) Rs.4,25,000
(e) Rs.4,90,000. **(2marks)**

<Answer>

39. The long-term solvency position is measured by

(a) Profitability ratios
(b) Earnings ratios
(c) Structural ratios
(d) Liquidity ratios
(e) Turnover ratios. **(1 mark)**

<Answer>

40. Operating income can be determined by multiplying the contribution margin ratio with which of the following factors?

(a) Margin of safety
(b) Unit sales price
(c) Break-even units
(d) Variable cost per unit
(e) Change in sales volume. **(1 mark)**

<Answer>

41. Starz Ltd., acquired 60% shares of Twinkle Ltd., on November 01, 2007. The profit and loss account showed a debit balance of Rs.90,000 on April 01, 2007 and showed a credit balance of Rs.1,50,000 on March 31, 2008. The share of Starz Ltd., in the capital profit/loss of Twinkle Ltd., to be considered to find out cost of control, as on March 31, 2008 was

(a) Rs.50,000 (capital loss)
(b) Rs.42,000 (capital loss)
(c) Rs.84,000 (capital profit)
(d) Rs.52,500 (capital profit)
(e) Rs.30,000 (capital profit). **(2marks)**

<Answer>

42. Which of the following statements is **false**?

(a) A debt security represents creditor relationship with an enterprise
(b) Convertible bonds come under the category of debt securities
(c) An equity security represents ownership interest in an enterprise
(d) Companies hold equity securities for utilizing their short-term idle funds
(e) Accounting for equity securities is done based on the voting stock. **(1 mark)**

<Answer>

43. As per AS-23, if an associate has outstanding cumulative preference shares held outside the group, the investor computes its share of profits or losses

(a) Before adjusting for the preference dividends and interest
(b) After adjusting for the preference dividends which are actually paid
(c) After adjusting for the preference dividends, if declared
(d) After adjusting for the preference dividends, whether or not the dividends have been declared
(e) Before adjusting for preference dividends. **(1 mark)**

<Answer>

44. Which of the following is **not** a factor for selecting the functional currency for translating foreign currency transactions?

(a) The expenses incurred by the foreign entity
(b) The source of financing of the foreign entity
(c) The volume of inter-company transactions between the parent and the foreign entity
(d) The currency in which the foreign entities' sales market is denominated
(e) Fluctuations in the exchange rate. **(1 mark)**

<Answer>

45. Duplex Ltd., leased office premises to Simplex Ltd., for a 5-year term beginning April 2, 2007. Under the terms of the operating lease, rent for the first year is Rs.8,000 and rent for years 2 through 5 is Rs.12,500 per annum. However, as an inducement to enter the lease, Duplex Ltd., granted Simplex Ltd., the first six months of the lease rent-free. In its March 31, 2008 income statement, what amount should Duplex Ltd., report as rental income?

(a) Rs. 12,000
(b) Rs. 11,600
(c) Rs. 10,800
(d) Rs. 8,000
(e) Rs. 10,000. **(2marks)**

<Answer>

46. Mohana Ltd., had the following activities during 2007-08:

- Acquired 300 debentures in Crux Ltd., for Rs.34,000.
- Sold an investment in Avanti Ltd., for Rs.48,000, when the carrying value was Rs.45,000.
- Acquired Rs.68,000 four-year certificate of deposit from a bank. (During the year, interest of Rs.5,100 was paid to Mohana Ltd.)
- Collected dividends of Rs.2,600 on stock investments.

In Mohana Ltd.'s 2007-08 statement of cash flows, net cash used in investing activities should be

(a) Rs.43,300
(b) Rs.45,900
(c) Rs.48,400
(d) Rs.54,000
(e) Rs.51,000. **(2marks)**

<Answer>

47. Vamshi Textiles Ltd., of Mumbai sold goods to McMilan Garments of London for £75,000 on October 31, 2007. The dues were realized from McMilan Garments on April 30, 2008. Vamshi Textiles Ltd., closes its books of accounts on March 31 every year. The exchange rates have been provided below:

October 31, 2007 - Rs.48.70 per £
March 31, 2008 - Rs.49.50 per £
April 30, 2008 - Rs.49.05 per £

Gain/loss on settlement is

(a) Rs.26,250 (Loss)
(b) Rs.26,250 (Gain)
(c) Rs.33,750 (Loss)
(d) Rs.33,750 (Gain)
(e) Rs.60,000 (Loss). **(2marks)**

<Answer>

48. On April 1, 2007 Harish Ltd., adopted a defined benefit pension plan. The plan's service cost of Rs.2,25,000 was fully funded at the end of the year 2007-08. Prior service cost was funded by a contribution of Rs.90,000 in the year 2007-08. Amortization of prior service cost was Rs.36,000 for the year 2007-08. On March 31, 2008 the prepaid pension cost to be reported in the balance sheet is

(a) Rs.1,35,000
(b) Rs.1,26,000
(c) Rs. 90,000
(d) Rs. 54,000
(e) Rs. 36,000. **(2marks)**

<Answer>

49. Following information pertaining to Alex Ltd., was extracted from the accounting records for the year ended March 31, 2008:

Particulars	Rs.
Cash received from sales	9,28,000
Royalties received	12,500
Cash paid to suppliers and employees	5,45,000
Taxes paid	1,30,000
Dividends paid	42,000
Dividends received	35,000

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

(a) Rs.2,58,500
(b) Rs.2,23,500
(c) Rs.3,00,500
(d) Rs.2,88,000
(e) Rs.2,53,000. **(2marks)**

50. In accounting for business combinations, which of the following intangibles should **not** be recognized as an asset apart from goodwill? <Answer>

(a) Trademarks
(b) Lease agreements
(c) Employee quality
(d) Patents
(e) Copyrights. **(1 mark)**

51. Pavani Ltd., reported a net income of Rs.90,000 for the financial year 2007-08. The following data are provided: <Answer>

Rent received in advance	Rs.12,000
Income from exempted Government Bonds	Rs.20,000
Depreciation deducted for income tax purpose, in excess of depreciation reported for financial accounting purpose	Rs.20,000
Income tax rate	35%

The provision for deferred tax asset/liability was

(a) Rs.2,100 (deferred tax liability)
(b) Rs.2,100 (deferred tax asset)
(c) Rs.2,800 (deferred tax liability)
(d) Rs.4,900 (deferred tax asset)
(e) Rs.9,400 (deferred tax asset). **(2marks)**

52. On March 31, 2008, Gomati Enterprises entered into a seven years capital lease agreement for an office building. Annual lease payments of Rs.1,05,000, including wealth tax of Rs.5,000 are to be made on March 31, of each year beginning with March 31, 2008. Gomati Enterprises is not aware of the lessor's implicit interest rate but the incremental borrowing rate is 8% for Gomati Enterprises. Assuming that the present value for Re.1 for 7 years at 8% is 5.6, the amount Gomati Enterprises should report as capitalized lease liability as on March 31, 2008 was <Answer>

(a) Rs.11,33,333
(b) Rs. 6,53,500
(c) Rs. 5,60,000
(d) Rs. 5,23,333
(e) Rs. 4,68,000. **(2marks)**

53. On March 1, 2007, George Ltd., purchased 75% of Angel Ltd.'s Rs.10 par common stock for Rs.16,50,000 in a business combination initiated after September 30, 2005. On this date, the carrying amount of Angel Ltd.'s net assets was Rs.20,00,000. The fair values of the assets acquired and liabilities assumed were the same as their carrying amounts on Angel Ltd.'s balance sheet, except for plant assets, the fair value of which was Rs.3,00,000 in excess of the carrying amount. For the year ended March 31, 2007, Angel Ltd., had net income of Rs.4,20,000 and paid cash dividends totaling Rs.1,80,000. The capital reserve recognized at the date of the business combination is <Answer>

(a) Nil
(b) Rs. 75,000
(c) Rs. 95,000
(d) Rs.1,75,000
(e) Rs.2,12,000. **(2marks)**

54. On October 1, 2007, Lalita Ltd., received Rs.2,58,220 for 12% Bonds of face value Rs.2,50,000. The issue price yield is 10%. The interest expense for the six months period ended March 31, 2008 was <Answer>

(a) Rs.12,500
(b) Rs.12,911
(c) Rs.13,750
(d) Rs.15,000
(e) Rs.15,412. **(2marks)**

<Answer>

55. Stock options to obtain 30,000 shares of common stock at an exercise price of Rs.20 were outstanding during a period when the average market price of the common stock was Rs.25. When computing diluted earnings per share, the weighted average number of common shares outstanding will increase by

(a) 6,000 shares
(b) 12,000 shares
(c) 20,000 shares
(d) 24,000 shares
(e) 30,000 shares. **(1 mark)**

<Answer>

56. On March 31, 2008, Garg Ltd., had outstanding 9%, 25,000 bonds with a value of Rs.100 each maturing on March 31, 2013. Interest is payable semiannually every March 31 and September 30. On March 31, 2008 after amortization was recorded for the period, the unamortized bond premium and bond issue costs were Rs.15,000 and Rs.25,000 respectively. On the date, Garg Ltd., acquired all its outstanding bonds on the open market at Rs.98 and retired them. At March 31, 2008, what amount should Garg Ltd., recognize as gain on retirement of bonds?

(a) Rs. 10,000
(b) Rs. 40,000
(c) Rs. 60,000
(d) Rs. 90,000
(e) Rs.1,00,000. **(2marks)**

<Answer>

57. Jyotsna Ltd., leased a new machine to Devaki Ltd., on April 1, 2007. The lease is an operating lease and expires on April 1, 2012. The annual rental is Rs.27,00,000. Additionally on April 1, 2007 Devaki Ltd., paid Rs.15,00,000 to Jyotsna Ltd., as a lease bonus and Rs.7,50,000 as a security deposit to be refunded upon expiration of the lease. In Jyotsna Ltd.,'s 2007-08 income statement prepared on March 31, 2008, the amount of rental revenue was

(a) Rs.42,00,000
(b) Rs.37,50,000
(c) Rs.30,00,000
(d) Rs.34,50,000
(e) Rs.49,50,000. **(2marks)**

<Answer>

58. The method of preparing the consolidated financial statements of a parent and majority-owned subsidiary that involves the restatement of the net assets of the subsidiary to fair value at the date of acquisition for only the majority interest, is called

(a) Economic Unit Concept
(b) Proportionate Consolidation Concept
(c) Parent Company Concept
(d) Proportionate Unit Concept
(e) Economic Parent Concept. **(1 mark)**

<Answer>

59.SFAS 52, Foreign Currency Translation, requires the current rate of exchange to be used for remeasuring certain balance sheet items and the historical rate of exchange for other balance sheet items. An item that should be remeasured using the historical exchange rate is

(a) Taxes payable
(b) Accounts and notes payable
(c) Bank balances
(d) Cost of goods sold
(e) Accounts and notes receivable. **(1 mark)**

<Answer>

60. Under AS-21, in cases where there are differences between the reporting dates of the subsidiary and the holding company, the time lag should **not** exceed

(a) Six months
(b) One year
(c) One month
(d) Six years
(e) Three months. **(1 mark)**

<Answer>

61. The process of reducing a recognized liability, systematically by recognizing revenues or reducing a recognized asset systematically by recognizing expenses or costs is known as

(a) Assumption
(b) Attribution
(c) Curtailment
(d) Settlement
(e) Amortization. **(1 mark)**

<Answer>

62. Which of the following disclosures to be made in case of defined benefit plans is **false**?

(a) A description of each plan
(b) A description of groups of employees covered
(c) A reconciliation of movements or changes during the previous period being reported
(d) The amount of actual return on plan assets
(e) A description of the principal actuarial assumptions. **(1 mark)**

<Answer>

63. Mohit Ltd., operates a showroom in a leased property, which will expire on December 31, 2013. In January 2008, Mohit Ltd. decorated the showroom and made leasehold improvements of Rs.60,000. The Company has estimated that the economic life of the improvement will be 8 years. Currently the company is following straight-line depreciation method. The amount to be reported regarding improvement of leasehold property in balance sheet for the year ended March 31, 2008 was

(a) Rs.57,500
(b) Rs.54,000
(c) Rs.51,200
(d) Rs.45,000
(e) Rs. 9,000. **(2marks)**

<Answer>

64. Kailash Ltd., began operations on January 1, 2004 and reported pre-tax income of Rs.6,00,000 and taxable income of Rs.6,50,000 for its first year. Kailash Ltd., had a temporary difference relating to accrued product warranty costs that it expected to pay in the following manner:

Year 2005	Rs.60,000
Year 2006	Rs.80,000
Year 2007	Rs.40,000

The enacted tax rates are 35% for years 2004 and 2005, and 40% for 2006 and 2007. The deferred tax account at the end of year 2004 was

(a) Rs.65,000 as deferred tax asset
(b) Rs.65,000 as deferred tax liability
(c) Rs.69,000 as deferred tax asset
(d) Rs.69,000 as deferred tax liability
(e) Rs.42,000 as deferred tax asset. **(2marks)**

<Answer>

65. Accounting Standard (AS-11) defines an integral foreign operation as

(a) The activities of the reporting entity which are an integral part of a foreign entity
(b) The activities of the foreign entity that specializes in integration
(c) An operation of the reporting enterprise that is an integral part of foreign entity
(d) A foreign operation, the activities of which are an integral part of those of the reporting enterprise
(e) A joint venture of reporting entity and its foreign subsidiary. **(1 mark)**

<Answer>

66. Which of the following is **not** a cause of permanent difference and has a deferred tax consequence?

(a) Interest received from investments in bonds issued by State and Municipal Governments
(b) Investment expenses incurred to obtain tax-exempt income
(c) Expenses due to violations of the law
(d) Contingent losses as accruals of litigation expenses
(e) Penalty in respect of infringement of law. **(2marks)**

<Answer>

67. Which of the following occurs because of the present values of future pension benefits increase due to time value of money?

(a) Amortization of prior service cost
(b) Service cost
(c) Interest cost
(d) Accumulated benefit obligation
(e) Projected benefit obligation. **(1 mark)**

<Answer>

68. Keval Ltd., has furnished the following information for the year ended March 31, 2008:

Particulars	Rs.
Fair value of plan assets	27,60,000
Accumulated Benefit Obligation	34,40,000
Projected Benefit Obligation	45,60,000

The amount of pension liability that should be shown on March 31, 2008 balance sheet was

(a) Rs.45,60,000
(b) Rs.18,00,000
(c) Rs.11,20,000
(d) Rs. 7,60,000
(e) Rs. 6,80,000. **(2marks)**

<Answer>

69. When entity disposes of a wholly or partially owned subsidiary or of an investee by transferring it unilaterally to the entity's shareholders, it is called

(a) Spin-off
(b) Divestiture
(c) Equity carve out
(d) Sell-off
(e) Leveraged buy out. **(1 mark)**

<Answer>

70. An investment classified as available-for-sale security is to be reflected in the financial statement at the

(a) Face value of the securities
(b) Fair value of the securities
(c) Stated value of the securities
(d) Cost adjusted for the fair value or mark-to-market method
(e) Cost to acquire the asset. **(1 mark)**

END OF QUESTION PAPER

Suggested Answers
Financial Statement Analysis (CFA560): April 2008

	Answer	Reason	
1.	E	Comparability is the ability to help users see similarities and differences among events and conditions. It enhances the ability of investors and creditors to compare information across companies to make their resource allocation decisions. The financial statement users must be able to compare the statements of an entity through time in order to identify trends in financial position and compare the financial statements of different entities in order to evaluate their relative financial position and performance. Hence, the answer is (e).	< TOP >
2.	C	Equity is equal to the residual interest that remains in the assets after deducting an entity's liabilities. Hence, the answer is (c).	< TOP >
3.	B	The preparation of the income statement is governed by the matching principle which states that the performance can be measured only if revenues and related costs are accounted for during the same time period. Balance sheet is prepared on the basis of dual aspect concept, i.e., liabilities and assets both need to be balanced. All the other (c) Statement of comprehensive income, (d) Statement of cash flows and (e) Statement of stakeholders equity are not prepared on the basis of matching principle.	< TOP >
4.	B	While translating the financial statements of foreign branches of Indian companies, all revenue items other than opening and closing inventories and depreciation must be translated at average rate.	< TOP >
5.	B	Expense manipulation can be done by understating liabilities. All the other help in revenue manipulation: (a) Vendor financing, (c) Trade loading or channel stuffing, (d) Not recognizing rebates or discounts and (e) Overstatement of value of accounts receivables.	< TOP >
6.	C	The transactions reverse so that the subsequent period's income will be affected in an opposite way from the original transaction. If the timing difference originally caused book income to be higher than taxable income, the reversal will cause book income to be lower than taxable income.	< TOP >
7.	A	As per para 17 of AS-11, the need for foreign currency translation arises in respect of the financial statements of foreign branches of the parent enterprise. It also applies in respect of translation of foreign currency transactions of an enterprise into its reporting currency. Hence, (a) is the correct answer. All other options in (b), (c), (d) and (e) pertain to items in the financial statements and hence are incorrect.	< TOP >
8.	B	Value of equity share	< TOP >

$$= \left[\frac{\text{Yield rate of return}}{\text{Normal rate of return}}\right] \times \text{Paid} - \text{up value of equity share}$$

$= (15.75/9) \times \text{Rs.}10 = \text{Rs.}17.50.$

9. E < TOP >

Particulars	Rs.
Equity share capital	18,00,000
Reserves and surplus	4,50,000
Share holders fund	22,50,000

10. E < TOP >

Contribution per unit = Rs.120 – Rs.90 = Rs.30

Present contribution = 4,450 × Rs.30 = Rs.1,33,500

Increase in labor cost = Rs.30 × 20% = Rs.6.

New contribution per unit = Rs.120 – Rs.90 – Rs.6 = Rs.24

Number of units to be sold = Rs.1,33,500 ÷ Rs.24 = 5,562.5 or 5,563

Extra units to be sold = 5,563 – 4,450 = 1,113 units.

11.	A	The schedules to profit and loss account are prepared to convey more information on the items appearing in the profit and loss account. Some of this information may be statutory in nature like for example, information about raw material consumed, depreciation charge, provision for tax, etc. All the other form part of an exhaustive list of various explanatory notes that form an integral part of the financial statements. Hence, the answer is (a).	< TOP >
12.	C	The failure to recognize timing differences results in a mismatching of tax expense with related revenues and expenses. Hence, matching principle would be violated.	< TOP >

	Answer	Reason	
13.	C	The currency of the primary economic environment in which the entity operates normally that is the currency of the environment in which an entity primarily generates and expends cash is called functional currency.	< TOP >
14.	C	Loans advanced to others and Purchase of equity securities of other entities imply payment is made in cash, hence both (a) and (b) are cash investing activities. Where as when debentures are issued in exchange of long lived assets, no cash flow takes place hence is a non cash investing activity. Receipt of interest on short term investments (d) and Sale proceeds of land received by bank draft (e), both imply cash in flow. Hence (c) is the correct answer.	< TOP >
15.	B	The effect of the convertible preferred stock is to increase the numerator by Rs.30,000 (Rs.3.00 dividend per share × 10,000shares) for the amount of the preferred dividends that would not be paid (assuming conversion) and increase the denominator by 20,000 shares. This security is dilutive because it decreases the EPS from Rs.7.45 to Rs.6.54.	< TOP >

Diluted Earnings per share = $\frac{\text{Rs.}8,50,000 - 30,000 + 30,000}{1,10,000 + 20,000}$ = Rs.6.54

16.	E	The types of inter-company transactions may take place between the parent and the subsidiary company are (I) Inter-company sales of merchandize, (II) Inter-company debt/equity transactions and (III) Transaction of the fixed assets. Hence, (e) the combination of all the statements is the correct answer.	< TOP >
17.	D	Maximum pension liability is not included in the statement of stakeholders equity, but minimum pension liability is included. All the other (a) Preferred shares, (b) Retained earnings, (c) Valuation allowance and (e) Cumulative translation allowance are included in the statement of stakeholders equity. Hence, the answer is (d).	< TOP >
18.	C		< TOP >

Particulars	Rs.	Rs.
Funds from operations		1,25,000
Less: Depreciation	38,000	
Amortization of goodwill	31,000	
Transfer to general reserve	27,000	96,000
Net profit earned during the year		29,000

19. B < TOP >

Dividend pay-out ratio = DPS/EPS
Dividend per share = Rs. 3,60,000/90,000 = Rs.4
Earning per share = Rs.9,00,000/90,000 = Rs.10
Dividend pay-out ratio = Rs. 4/Rs. 10 = 0.40

20. D < TOP >

Projected unit sales = (Fixed costs + Target operating income) ÷ Unit contribution margin.
Projected unit sales = (Rs.5,00,000 + Rs.2,50,000) ÷ Rs.40 = 18,750 units.
Current sales units = (Rs.5,00,000 + Rs.2,50,000) ÷ Rs.45 = 16,667 units.
Increase in units: 18,750 – 16,667 = 2,083 units.

21.	A	When a company acquires a majority of the common stock of another company and each company would be continuing to exist as per law, it is known as acquisition. Hence, the answer is (a).	< TOP >
22.	C	No disclosure is required in consolidated financial statements in respect of Intra-group transactions. The other items, Remittances-in-transit, capital reserve/Goodwill and minority interest are disclosed in consolidated financial statements.	< TOP >
23.	D	Decrease in inventory will not result in an increase in net working capital.	< TOP >
24.	E		< TOP >

Particulars	Rs.
Nominal value of 3,000 shares @ Rs.100 per share	3,00,000
Share of capital Profit (3,20,000) × 30%	96,000
Share of Revenue Profit	
(55,000)] × 30%	16,500
Minority interest	4,12,500

25. C < TOP >

Stock remained unsold = Rs.20,000
Unrealised profit = Rs.20,000 $\times 25\%$ = Rs.5,000
Unrealised profit to be eliminated in full.

	Answer	**Reason**	
26.	E	Difference in taxation, difference in legal systems, inflation rates, political and economic factors have contributed the development of diverse global accounting practices. Compliance costs are a primary argument for harmonization of global account standards.	< TOP >
27.	E	The cost recovery method is employed whenever costs of goods or services is unknown and there are also ambiguities in collecting the sale proceeds. Hence, the correct answer is (e).	< TOP >
28.	D	Interest coverage ratio = EBIT/Interest expenses Earnings before interest and taxes (EBIT) = Average of fixed assets × Earning power ratio = Rs.20,000 × 0.3 = Rs.6,000 Interest coverage ratio = Rs.6,000/Rs.1500 = 4.	< TOP >
29.	C	Debt – equity ratio and debt – Assets ratio are leverage ratios for a company. Return on equity and return on investment represents the profitability ratios of a business entity. Acid test ratio indicates the liquidity status of a company.	< TOP >
30.	B	Contribution to sales ratio = Change of profit ÷ Change of sales = Rs.15,000 ÷ Rs.50,000 = 0.30 or 30% Break-even point: Sales × contribution to sales ratio = Fixed cost + Profit Rs.3,00,000 × 30% = Fixed cost + Rs.40,000 Fixed cost = Rs.90,000 – Rs.40,000 = Rs.50,000 Break-even sales in rupees = Rs.50,000 ÷ 0.30 = Rs.1,66,667.	< TOP >
31.	D	The measurement of pension plan assets and obligations required by USGAAP is as of the date of the financial statements or, if used consistently from year-to-year, a date not more than three months prior to the date of financial statements, Data for measuring the plan assets and obligations may be prepared by the actuary prior to these dates and projected forward to account for subsequent events. Hence, the measurement date for pension plan assets and obligations is the date the actuary submits the information.	< TOP >
32.	C	The long term investments are accounted for in the balance sheet at cost price.	< TOP >
33.	B	Value as per fair value method is (value as per intrinsic value method + value as per yield method)/2 Value as per intrinsic value method is (2 × Rs.22.5) – Rs.19.5 = Rs.25.5	< TOP >
34.	B	Return on equity is measured by dividing *net profit after tax and dividends* by weighted average number of equity shares.	< TOP >
35.	E	The Management Discussion and Analysis (MD&A) in the annual report comprises of a lengthy discussion and analysis on the financial health of the other investee company and also it include detailed explanation of Deferred tax assets, Sundry debtors, Cash and cash equivalents, Loans and Advances, Current liabilities, Provisions, Detailed discussion on net profit, Segregation of income and expenses, Disclosure of debt, Depreciation and amortization, Provision for investment, Stock option plans, Reconciliation of Indian and US GAAP financial statements, Related party transaction, and Events occurring after the balance sheet date. Hence, the answer is (e).	< TOP >
36.	E	In the Consolidated Balance Sheet of a Holding Company, the value of minority interest consists of the proportionate share of minority shareholders in the 1. Nominal value of share capital of subsidiary company 2. Reserves and profits of the subsidiary company at the time of acquisition by the holding company 3. Income of the subsidiary company after its acquisition by the holding company 4. Subsidiary company's losses or decreases in the value of assets of subsidiary company The value of minority interest does not consist of the proportionate share of minority shareholders in the reserves of the holding company. Hence, (e) is the correct answer.	< TOP >
37.	A	If the purchase consideration paid is more than the net assets, the excess price paid is treated as goodwill. So the excess price should be debited to goodwill a/c.	< TOP >
38.	A	Each share of Brij Ltd. has a market value of Rs.40, while that of Sangam Ltd. is Rs.20. This implies that for every two shares of Sangam Ltd., Brij Ltd. will issue one share. The amount of purchase consideration is 20,000/2 = 10,000 shares issued at Rs.40 = Rs.4,00,000.	< TOP >

	Answer	Reason	
39.	C	Profitability Ratio measures the efficiency of the firm's activities and its ability to generate profits. Structural ratios measure the long term solvency of a firm. Liquidity ratios measure the short term solvency of a firm. Turnover ratios give the speed of conversion of current assets into cash. From earning ratio we can get information on earnings of the firm and their affect on price of common stock. Hence, (c) is correct answer.	< TOP >
40.	A	Operating income = Margin of safety × Contribution margin ratio.	< TOP >
41.	E	Profit made during the year 2007-2008 = Rs.1,50,000 + Rs.90,000 = Rs.2,40,000 Profit made for the period April 01, 2007 to November 01, 2007 = Rs.2,40,000 × 7/12 = Rs.1,40,000 The credit balance in profit and loss account as on November 01, 2007 is = Rs.1,40,000 – Rs.90,000 = Rs.50,000 Hence capital profit = Rs.50,000 Share of Starz Ltd. in the capital profit = Rs.50,000 x 60% = Rs.30,000.	< TOP >
42.	D	The motivations for the company to held equity securities are to exert influence over the management of another company and to receive dividend and stock price appreciation income.	< TOP >
43.	D	As per para 17 of AS-23, if an associate has outstanding cumulative preference shares held outside the group, the investor computes its share of profits or losses after adjusting for the preference dividends whether or not the dividend has been declared.	< TOP >
44.	E	Fluctuations in the exchange rates is not a factor for selecting the currency for translation. Generally the following factors are considered: The impact of the foreign entity's cash flows on the parent's cash flows and their immediate availability for remittance to the parent. The responsiveness of the foreign entities sales prices to exchange rate changes and to international competitions. The currency in which the foreign entities sales market is denominated. The expenses incurred by the foreign entity. The source of financing of the foreign entity. The volume of inter-company transactions between the parent and the foreign entity.	< TOP >
45.	C	Accrual accounting recognizes revenue in the period(s) it is earned, rather than only when the related cash is received. Thus, the total amount of rental revenue to be received should be allocated ratably over the lease term.	< TOP >

Particulars	Rs.
Rental receipts during first year of lease (Rs.8,000 × 6/12)	4,000
Rental receipts during years 2 through 5 (Rs.12,500 × 4)	50,000
Rental receipts over lease term	54,000
Divide by: Years in lease term	5
Annual rental revenue recognized	10,800

46. D Investing activities include all cash flows involving assets, other than operating assets. The investing activities are: < TOP >

	Rs.
Purchase of debentures	(34,000)
Sale of investment	48,000
Acquisition of CD	(68,000)
Net cash used	(54,000)

The gain on sale of investments in Avanti Ltd. (Rs.48,000 – Rs.45,000 = Rs.3,000), the interest earned (Rs.5,100), and dividends earned (Rs.2,600) are all operating items. Note that the sale of investments is reported in the investing section at the cash inflow amount (Rs.48,000), not at the carrying value of the investment (Rs.45,000). If the CD had been for three months instead of four years, it would be part of "Cash and Cash equivalents" and would not be shown under investing activities.

47. C < TOP >

Date	Amount in £	Exchange rate	Amount in Rs.	
31.03.2008	75,000	Rs.49.50	37,12,500	(A)
31.04.2008	75,000	Rs.49.05	36,78,750	(B)
Loss on settlement	75,000	Re.00.45	33,750	(A) – (B)

	Answer	Reason	
48.	D	Accrued pension cost = Service cost + Amortization of prior service cost = Rs.2,25,000 + Rs.36,000 = Rs.2,61,000 Funding payments = Rs.2,25,000 + Rs.90,000 = Rs3,15,000 The amount of prepaid pension cost is Rs.54,000 (Rs.3,15,000 – Rs.2,61,000)	< TOP >
49.	C	Payment of dividends is a financing activity. All other transactions listed are cash flows from operating activities. Accordingly, the net cash flows from operations is Rs.3,00,500 (Rs.9,28,000 + Rs.12,500 – Rs.5,45,000 – Rs.1,30,000 + Rs.35,000).	< TOP >
50.	C	SFAS 141 requires other intangibles to be recognized as assets apart from goodwill if they arise from contractual obligations or legal rights, regardless of whether those rights are transferable or separable from the acquired entity or from other rights and obligations. If an intangible asset does not arise from contractual or other legal rights, it shall be recognized as an asset apart from goodwill only if it is separable. Trademarks, patents, lease agreements and copy rights all arise from contractual or legal rights. Employee quality does not and is not separable.	< TOP >
51.	C	Deferred tax asset/liability	< TOP >

Rent received in advance = Rs.12,000 × 35%	4,200 (DTA)
Income from exempted Government bonds (permanent diff)	-
Excess depreciation for income tax purpose Rs.20,000 x 35%	7,000 (DTL)
Total	**2,800 (DTL)**

52.	C	The annual wealth tax is an executory cost and it will not be capitalized until it is incurred. Capital leases liability should be recorded at the present value of the minimum lease payments. Thus in the Balance Sheet of 2007-08 of Gomati Enterprises, the capitalized amount will be Rs. (1,05,000 – 5,000) × 5.6 = Rs.5,60,000.	< TOP >
53.	B	A business combination initiated after September 30, 2005 is accounted for as a purchase. The excess of the cost of the acquired entity over the fair value of the acquired net assets is goodwill. As indicated below, the fair value of 75% of the net assets of the acquired entity is Rs.17,25,000. Capital reserve is there fore Rs.75,000.	< TOP >

Particulars	Rs.
Cost	16,50,000
Fair value of acquired net assets:	
Carrying amount: Rs.20,00,000 × 75%	(15,00,000)
Undervalued plant: Rs.3,00,000 × 75%	(2,25,000)
Capital reserve	75,000

54.	B	The amortization of the bond premium can be done using either the interest method or the Straight-line method (if the results are not materially different). The application of the straight-line method, requires the data as to the time the bonds will be outstanding. Since in our problem, this data is not given, the interest method is used. Under the interest method the interest expense is computed as under Book value of the bonds × Yield rate × Time period = Interest expense Rs.2,58,220 × 10% × 6/12 = Rs.12,911.	< TOP >
55.	A	The number of shares for diluted EPS is calculated as below $\frac{\text{(Average market price – Exercise price)} \times \text{Number of shares under option}}{\text{Average market price}}$ = 25 – 20 / 25 × 30,000 = 6,000 shares	< TOP >
56.	B	A gain or loss on redemption of bonds is the difference between the cash paid (Rs.25,00,000 × 98% = Rs.24,50,000) and the net book value of the bonds. To compute the net book value, premium or discount and bond issue costs must be considered. Book value is Rs.24,90,000 (Rs.25,00,000 face value, less Rs.25,000 bond issue costs, plus Rs.15,000 premium). Therefore the gain on redemption is Rs.40,000 (Rs.24,90,000 book value less Rs.24,50,000 cash paid).	< TOP >
57.	C	As per US GAAP, in an operating lease, the lessor should recognize rental revenue on a straight line basis. This means that the lease bonus Rs.15,00,000 should recorded as unearned revenue on January 1, 2007 and recognized as rental revenue over the five year lease term. Thus, Rental revenue = 27,00,000 + (15,00,000 ÷ 5) = Rs.30,00,000 The security deposit should not be treated as rental revenue. It is has to be refunded after the expiration of the lease and thus treated as long term liability.	< TOP >

	Answer	Reason	
58.	C	Parent Company Concept: This refers to the method of preparing the consolidated financial statements of a parent and majority owned subsidiary that involves the restatement of the net assets of the subsidiary to fair value at the date of acquisition for only the majority interest.	< TOP >
59.	D	Financial statements are remeasured using the temporal rate method. In general, this method adjusts monetary items at the current rate and non monetary items at the historical rate. Cost of goods sold is a non monetary item that should be remeasured using the historical rate.	< TOP >
60.	A	As per para 18 of AS-21, the financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly those financial statements are drawn up to two different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between reporting dates should not be more than six months.	< TOP >
61.	E	The process of reducing a recognized liability, systematically by recognizing revenues or reducing a recognized asset systematically by recognizing expenses or costs is known as amortization. Hence, the answer is (e)	< TOP >
62.	C	A disclosure with respect to reconciliation of movements or changes during the reporting period and not previous period being reported is required to be made in case of defined benefit plan. All the others are the disclosures to be made in case of defined benefit plan.	< TOP >
63.	A	Leasehold improvements are to be capitalized and amortized over the period of remaining lease term or the expected economic life of the improvement, whichever shorter. In the given case, as the remaining lease term (from January 2008 to December 2013) is 6 years and it is less than the expected economic life (8 Years), Rs.60,000 is to be amortized over 6 years at a rate of Rs.10,000 i.e. 60,000/6 per year. Thus the amount to be amortized is Rs.10,000 × 3/12 = Rs.2,500 and the amount to be reported net of amortization in balance sheet is Rs.(60,000 – 2,500) = Rs.57,500.	< TOP >
64.	C	The computation is as follows: (Rs.60,000 × 35%) + (Rs.80,000 × 40%) + (Rs.40,000 × 40%) = Rs.21,000 + Rs.32,000 + Rs.16,000 = Rs.69,000. Since Kailash Ltd., has not yet realized the tax benefits from the warranty deductions, they have a deferred tax asset.	< TOP >
65.	D	As per Para 7 of AS-11, of the new standard defines integral foreign operation as Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.	< TOP >
66.	D	Contingent losses as accruals of litigation expenses are a temporary difference. All the others are (a) Interest received from investments in bonds issued by state and municipal governments, (b) Investment expenses incurred to obtain tax-exempt income, (c) Expenses due to violations of the law and (e) Penalty in respect of infringement of law are examples of permanent differences. Hence, the answer is (d).	< TOP >
67.	C	Interest cost occurs because of the present values of future pension benefits due to time value of money. Hence, the answer is (c).	< TOP >
68.	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.6,80,000 (Rs.34,40,000 – Rs.27,60,000). This amount plus the prepaid pension cost or less accrued pension cost will be the additional liability to be recorded.	< TOP >
69.	A	When a company disposes of a wholly or partially owned subsidiary or of an investee by transferring it unilaterally to the entity's shareholders is known as spin-off. Hence, the answer is (a).	< TOP >
70.	D	Available-for-sale securities are investments in debt securities that are not classified as held-to-maturity or trading securities and in equity securities with readily determinable fair values that are not classified as trading securities. They are measured at cost that is adjusted for the fair value or the mark-to-market method. Hence, the answer is (d).	< TOP >

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