

May 2007 Advanced Accounting

Question 1:

16 Marks

The following informations extracted from the Books of "X" Limited group (as at 31st December, 2006):

Liabilities	X Ltd	Y Ltd	Z Ltd	Assets	X Ltd	Y Ltd	Z Ltd
Share capital (Fully paid equity shares of Rs.10 each)	8,00,000	6,00,000	4,00,000	Fixed Assets Less Depreciation	4,20,000	3,76,000	5,22,000
Profit and Loss Account	2,10,000	1,90,000	1,28,000	Investments at cost	6,30,000	4,00,000	--
Dividend received				Current Assets	1,20,000	60,000	40,000
From Y Ltd in 2005	60,000						
From Y Ltd in 2006	60,000						
From Z Ltd in 2006		36,000					
Current liabilities	40,000	10,000	34,000				
	11,70,000	8,36,000	5,62,000		11,70,000	8,36,000	5,62,000

All the companies pay dividends of 12 percent of paid up Share capital in March following the end of the accounting year. The receiving companies account for the dividends in their books when they are received.

"X" Limited acquired 50,000 equity shares of Y Ltd. on 31st December, 2004.

"Y" Limited acquired 30,000 equity shares of Z Ltd. on 31st December, 2005.

The detailed information of Profit and Loss Accounts is as follows:

	X Ltd	Y Ltd	Z Ltd
	Rs.	Rs.	Rs.
Balance of Profit and Loss Account on 31 st December, 2004 after dividends of 12% in respect of Calendar year 2004, but excluding Dividends received	86,000	78,000	60,000
Net profit earned in 2005	1,20,000	84,000	56,000
	2,06,000	1,62,000	1,16,000
Less – Dividends of 12% (Received in 2006)	96,000	72,000	48,000
	1,10,000	90,000	68,000
Net profit earned in 2006 (Before taking into account proposed Dividends of 12% in respect of Calendar year 2006)	1,00,000	1,00,000	60,000
	2,10,000	1,90,000	1,28,000

Taking into account the transactions from 2004 to 2006 and ignoring taxation, you are required to prepare:

- (i) The consolidated Balance Sheet of X Limited group as at 31st December, 2006.
- (ii) The consolidated Profit and Loss Account for the year ending 31st December, 2006.
- (iii) Cost of control.
- (iv) Minority shareholders interest.

Question 2 :

16 Marks

The following are the Balance Sheets (as at 31.3.2006) of A Ltd., and B Ltd.,

Liabilities	A Ltd	B Ltd	Assets	A Ltd	B Ltd
Share capital: Equity shares of Rs.10 each	36,00,000	18,00,000	Fixed Assets:	50,00,000	30,00,000
10% Preference shares of Rs.100 each	12,00,000	-	Investments	5,00,000	5,00,000
12% Preference Shares of Rs.100 each	-	6,00,000	Current Assets		
Reserve and Surplus:			Stock	18,00,000	12,00,000
Statutory Reserve	1,00,000	1,00,000	Debtors	15,00,000	12,00,000
General Reserve	25,00,000	17,00,000	Bills receivable	50,000	10,000

Secured Loan:			Cash at Bank	1,50,000	90,000
15% Debentures	5,00,000	-			
12% Debentures	-	5,00,000			
Current Liabilities :					
Sundry Creditors	10,80,000	12,80,000			
Bills payable	20,000	20,000			
	90,00,000	60,00,000		90,00,000	60,00,000

Contingent liabilities for bills receivable discounted Rs.20,000.

(A) The following additional information is provided to you:

	A Ltd (Rs.)	B Ltd (Rs.)
Profit before Interest and Tax	14,75,000	7,80,000
Rate of Income Tax	40%	40%
Preference Dividend	1,20,000	72,000
Equity Dividend	3,60,000	2,70,000

(B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.

(C) A Ltd. proposes to absorb B Ltd. at the end of business on 31.3.2006. The agreed terms for absorption are:

- i. 12% Preference shareholders of B Ltd will receive 10% Preference shares of A Ltd. sufficient to increase their present income by 20%.
- ii. The Equity shareholders of B Ltd. will receive equity shares of A Ltd on the following terms:
 - a. The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of A Ltd. based on the results of 2005-06 of both the Companies.
 - b. The market price of Equity shares of A Ltd. is Rs.40 per share.
 - c. The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.
 - d. In addition to Equity shares, 10% Preference shares of A Ltd. will be issued to the equity shareholders of B Ltd to make up for the loss in income arising from the exchange of shares based on the dividends for the year 2005-2006.
- iii. 12% Debenture holders of B Ltd. are to be paid at 8% premium by 15% debentures of A Ltd. issued at a discount of 10%.
- iv. Rs.16,000 is to be paid by A Ltd. to B Ltd. for liquidation expenses. Sundry creditors of B Ltd. include Rs.20,000 due to A Ltd. Bills receivable discounted by A Ltd were all accepted by B Ltd.
- v. Fixed assets of both the companies are to be revalued at 20% above book value. Stock-in-trade is taken over at 10% less than their book value.
- vi. Statutory reserve has to be maintained for two more years.
- vii. For the next two years, no increase in the rate of equity dividend is anticipated.
- viii. Liquidation expense is to be considered as part of purchase consideration.

You are required to:

- (i) Find out the Purchase Consideration.
- (ii) Give journal entries in the books of A Ltd.
- (iii) Give the Balance Sheet as at 31.3.2006 after redemption.

Question 3 :**16 Marks**

The following is the Balance Sheet (as at 31st December, 2006) of Sun Ltd.:

Liabilities	Rs.	Assets	Rs.
Share Capital		Fixed Assets:	
80,000 Equity Shares of Rs.10 each fully paid up	8,00,000	Goodwill	1,00,000
50,000 Equity Shares of Rs.10 each, Rs.8 paid up	4,00,000	Plant & Machinery	8,00,000
36,000 Equity Shares of Rs.5 each fully paid	1,80,000	Land & Building	10,00,000
30,000 Equity shares of Rs.5 each, Rs.4 paid up	1,20,000	Furniture & Fixtures	1,00,000
3,000, 10% Preference Shares of Rs.100 each fully paid up	3,00,000	Vehicles	2,00,000
Reserve and Surplus:		Investments	3,00,000
General reserve	1,40,000	Current Assets:	
Profit and Loss Account	2,10,000	Stock	2,10,000
Secured Loan : 12% Debenture	2,00,000	Debtors	1,95,000
Unsecured Loan : 15% Debenture	1,50,000	Prepaid Expenses	40,000
Deposits	1,00,000	Advances	45,000
Current Liabilities :		Cash & Bank balance	2,00,000
Bank loan	50,000	Preliminary expenses	10,000
Creditors	1,50,000		
Outstanding expenses	20,000		
Provision for tax	2,00,000		
Proposed Dividend:			
Equity	1,50,000		
Preference	30,000		
	32,00,000		32,00,000

Additional information :

- (1) In 2004 a new machinery costing Rs.50,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same).
- (2) Stock is overvalued by Rs.10,000 in 2005. Debtors are to be reduced by Rs.5,000 in 2006, some old furniture (Book value Rs.10,000) was disposed of for Rs.6,000.
- (3) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of Fixed Assets except machinery is not to be considered for valuation of goodwill.
- (4) Of the investment 20 per cent is trading and the balance is non-trading. All trade investments are to be valued at 20 per cent below cost. Trade investment were purchased on 1st January, 2006. 50 percent of the non-trade investments were acquired on 1st January, 2005 and the rest on 1st January, 2004. A uniform rate of dividend of 10 per cent is earned on all investments.
- (5) Expected increase in expenditure without commensurate increase in selling price is Rs.20,000.
- (6) Research and Development expenses anticipated in future Rs.30,000 per annum.
- (7) In a similar business a normal return on capital employed is 10%.
- (8) Profit after tax are as follows.
In 2004- Rs.2,10,000, in 2005- Rs. 1,90,000 and in 2006 – Rs. 2,00,000.
- (9) Current income tax rate is 50%, expected income tax rate will be 40%.

From the above, ascertain the ex-dividend and cum-dividend intrinsic value for different categories of Equity shares. For this purpose goodwill may be taken as 3 years purchase of superprofits. Depreciation is charged on machinery @ 10% on reducing system.

Question 4 (a) :

8 Marks

A buyer buys a stock option of New Light Company Limited on 30th August, 2006 with a strike price of Rs.150 per unit to be expire on September, 30, 2006. The premium is Rs.10 per unit and the market lot is of 100. the margin to be paid is Rs.60 per unit.

Show, how the transactions will appear in the books of the seller, when:

- (i) The option is settled by delivery of the Asset, and
- (ii) The option is settled in cash and the Index price is Rs.160 per unit.

Question 4 (b) :

8 Marks

When the general price index, was 100, Expert Ltd. purchased Fixed Assts of Rs.2 crore and it had also permanent working capital of Rs.80 lakhs. The entire amount required for purchase of the fixed assets and permanent working capital was raised by way of 12% redeemable preference share capital. Expert Ltd. wants to maintain its physical capital.

On 31st March, 2006, the company had reserves of Rs.3.50 crores. The general price index on that day was 200. The written down value of Fixed Assets was Rs.20 lakhs and they were sold for Rs.3.00 crores. The proceeds were utilized for redemption of the Preference Shares.

On the same day (31st March, 2006), the company purchased a new factory for Rs.20 crores. The ratio of permanent working capital to cost of Assets is to be maintained at 0.4:1.

The company raised the additional funds required for the purpose by issue of Equity Shares.

- (1) Calculate the amount of Equity capital raised, and
- (2) Show the Balance Sheet as at 1.4.2006.

Question 5 (a):

4 Marks

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company Accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss Account as a prior period item.

Is the Company's proposed accounting treatment correct? Discuss.

Question 5(b) :

4 Marks

Mr."X" as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, "X" will receive an additional Rs.2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr.X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal ? Discuss.

Question 5(c) :

4 Marks

A Company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company. It was noticed that the production lines output was not of the desired quality. However company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.

Question 6 :

4×5 =20 Marks

- (a) Capital adequacy requirements of merchant bankers.
- (b) Interest rate swaps.
- (c) Major issues in environmental accounting.

- (d) Impairment of asset and its application to inventory.
- (e) Treatment of borrowing costs.
- (f) Accounting for investment by a holding company in subsidiaries.