

**PAPER 1: ADVANCED ACCOUNTING
NOVEMBER R2006**

Answer **all** questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidate.

Question 1

The following is the extract from the Balance Sheets of Popular Ltd., :

(16 Marks)

Liabilities	As at 31.3.2004 Rs. in lakhs	As at 31.3.2005 Rs. in lakhs	Assets	As at 31.3.2004 Rs. in lakhs	As at 31.3.2005 Rs. in lakhs
Share capital	500	500	Fixed assets	550	650
General reserve	400	425	10% investment	250	250
Profit and Loss Account	60	90	Stock	260	300
18% term loan	180	165	Debtors	170	110
Sundry creditors	35	45	Cash at Bank	46	45
Provision for tax	11	13	Fictitious assets	10	8
Proposed dividend	100	125			
	1,286	1,363		1,286	1,363

Additional information :

- (i) Replacement values of Fixed Assets were Rs.1,100 lakhs on 31.3.04 and Rs.1,250 lakhs on 31.3.2005 respectively.
- (ii) Rate of depreciation adopted on Fixed Assets was 5% p.a.
- (iii) 50% of the stock is to be valued at 120% of its book value.
- (iv) 50% of investment were trade investments.
- (v) Debtors on 31st March, 2005 included foreign debtors of \$ 35,000 recorded in the books at Rs.35 per U.S.Dollar. The closing exchange rate was \$ 1 = Rs.39.
- (vi) Creditors on 31st March, 2005 included foreign creditors of \$ 60,000 recorded in the books at \$1 = Rs.33. The closing exchange rate was \$1=Rs.39.
- (vii) Profits for the year 2004-05 included Rs.60 lakhs of government subsidy which was not likely to recur.
- (viii) Rs.125 lakhs of Research and Development expenditure was written of to the Profit and Loss Account in the current year. This expenditure was not likely to recur.
- (ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.
- (x) Tax rate during 2004-2005 was 50%, effective future tax rate will be 40%.
- (xi) Normal rate of return expected is 15%.

One of the directors of the company Arvind, fears that the company does not enjoy a goodwill in the prevalent market circumstances.

Critically examine this and establish whether Popular Co., has or has not any goodwill.

If your answers were positive on the existence of goodwill, show the leverage effect it has on the company's result.

Industry average return was 12% on long term funds and 15% on equity funds.

Question 2

The summarized Balance Sheets of X Ltd., and its subsidiary Y Ltd., as at 31.3.2005 were as follows:

(16 Marks)

Liabilities	X Ltd., Rs.	Y Ltd., Rs.	Assets	X Ltd., Rs.	Y Ltd., Rs.
Share capital (Shares of Rs.10 each)	50,00,000	10,00,000	Fixed assets	60,00,000	18,00,000
General reserve	50,00,000	20,00,000	Investment in Y Ltd., (60,000 shares)	6,00,000	--
Profit and loss account	20,00,000	15,00,000	Sundry debtors	35,00,000	5,00,000
Secured loan	20,00,000	2,50,000	Inventories	30,00,000	25,00,000
Current liabilities	30,00,000	2,50,000	Cash and Bank	39,00,000	2,00,000
	1,70,00,000	50,00,000		1,70,00,000	50,00,000

X Ltd., holds 60% of the paid up capital of Y Ltd., and the balance is held by a foreign company.

A memorandum of understanding has been entered into with the foreign company by X Ltd., to the following effect:

- (i) The shares held by the foreign company will be sold to X Ltd., at a price per share to be calculated by capitalizing the yield at 15%. Yield, for this purpose, would mean 50% of the average of pre-tax for the last 3 years, which were Rs.12 lakhs, 18 lakhs and 24 lakhs respectively. (Average tax rate was 40%).
- (ii) The actual cost of shares to the foreign company was Rs. 4,40,000 only. Gains accruing to the foreign company are taxable at 20%. The tax payable will be deducted from the sale proceeds and paid to government by X. 50% of the consideration (after payment of tax) will be remitted to the foreign company by X Ltd., and also any cash for fractional shares allotted.
- (iii) For the balance of consideration, X Ltd., would issue its shares at their intrinsic value.

It was also decided that X Ltd., would absorb Y Ltd., Simultaneously by writing down the Fixed Assets of Y Ltd., by 10%. The Balance Sheet figures included a sum of Rs.1,00,000 due by Y Ltd., to X Ltd., and stock of X Ltd., included stock of Rs.1,50,000 purchased from Y Ltd., who sold them at cost plus 20%.

The entire arrangement was approved and put through by all concerned effective 1.4.2005.

You are required to indicate how the above arrangements will be recorded in the books of X Ltd., and also prepare a Balance Sheet after absorption of Y Ltd. Workings should be form part of your answer.

Question 3
(4×4=16 Marks)

- (a) A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2005, when the exchange rate was Rs.43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transactions was made on 5th April, 2005 when the exchange rate was Rs.47 per US Dollar. However on 31st March, 2005, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31st March, 2005 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

- (b) A private limited company manufacturing fancy terry towels had valued its closing stock of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

Comment on the valuation of the stocks by the company.

- (c) A company with a turn over of Rs.125 crores and an annual advertising budget of Rs.2 crore had taken up the marketing of a new product. It was estimated that the company would have a turn over of Rs.25 cores from the new products. The company had debited to its profit and loss account the total

expenditure of Rs. 2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

- (d) A company deals in petroleum products . the sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalization of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

Question 4

- (a) P Limited is considering the acquisition of R Limited. The financial data at the time of acquisition being: **(10 Marks)**

	P Limited	R Limited
Net profit after tax (Rs. in lakhs)	60	12
Number of shares (lakhs)	12	5
Earning per share (Rs.)	5	2.40
Market price per share (Rs.)	150	48
Price earning ratio	30	20

It is expected that the net profit after tax of the two companies would continue to be Rs.72 lakhs even after the amalgamation.

- (b) A company has a capital base of Rs.1 crore and has earned profits to the tune of Rs.11 lakhs. The Return On Investment (ROI) of the particular industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by Rs.2.5 lakhs over and above the target profit. **(6 Marks)**
- (c) The following information is available of a concern; calculate E.V.A.: **(4 Marks)**

Debt capital 12%	Rs.2,000 crores
Equity capital	Rs.500 crores
Reserve and surplus	Rs.7,500 crores
Capital employed	Rs.10,000 crores
Risk – free rate	9%
Beta factor	1.05
Market rate of return	19%
Equity (market)risk premium	10%
Operating profit after tax	Rs.2,100 crores
Tax rate	30%

Question 5

- (a) Mohur Ltd., has equity capital of Rs.40,00,000 consisting of fully paid equity shares of Rs.10 each. The net profit for the year 2004-05 was Rs.60,00,000. It has also issued 36,000 , 10% convertible debentures of Rs.50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings. **(8Marks)**

- (b) Find out the average capital employed of ND Ltd., from its Balance Sheet as at 31st March, 2006: **(8 Marks)**

Liabilities	(Rs. in lakhs)	Assets	(Rs. in lakhs)
Share capital :		Fixed assts :	
Equity shares of Rs.10 each	50.00	Land and Buildings	25.00
9% Pref. Shares fully paid up	10.00	Plant and Machinery	80.25
Reserve and Surplus:		Furniture and fixture	5.50
General reserve	12.00	Vehicle	5.00
Profit and loss	20.00	Investments	10.00
Secured loans:		Current Assets:	
16% debentures	5.00	Stock	6.75

16% term loan	18.00	Sundry debtors	4.90
Cash credit	13.30	Cash and Bank	10.40
Current liabilities and provisions:		Preliminary expenses	0.50
Sundry creditors	2.70		
Provision for taxation	6.40		
Proposed dividend on :			
Equity shares	10.00		
Preference shares	0.90		
	<u>148.30</u>		<u>148.30</u>

Non-trade investments were 20% of the total investments.

Balances as on 1.4.2005 to the following accounts were:

Profit and loss account Rs.8.70 lakhs, General reserve Rs.6.50 lakhs.

Question 6

The Balance Sheet of Golden and Silver Limited as on 31.3.2006 are given below:

(16 Marks)

Liabilities	Golden Ltd., Rs.	Silver Ltd., Rs.	Assets	Golden Ltd., Rs.	Silver Ltd., Rs.
Equity share capital	2,40,000	2,40,000	Fixed assets	88,000	1,68,000
General reserve	40,000	32,000	Investment	1,80,000	10,000
P/ L A/c	24,000	39,000	Sundry debtors	12,000	30,000
Bills payable	4,000	10,000	Bills receivable	8,000	32,000
Sundry creditors	8,000	15,000	Stock in trade	20,000	80,000
			Cash at Bank	8,000	16,000
	<u>3,16,000</u>	<u>3,36,000</u>		<u>3,16,000</u>	<u>3,36,000</u>

Note: Contingent liability of Golden Ltd. : Bills discounted not yet matured at Rs.5,000.

Additional information:

- On 1.10.2003, Golden Ltd., acquired 16,000 shares of Rs.10 each at the rate of Rs.11 per share.
- Balances to General reserve and Profit and Loss Account of Silver Ltd., stood on 1.4.2003 to Rs.60,000 and Rs.32,000 respectively.
- Dividends have been paid @ 10% for each of the years 2003-04 and 2004-05. Dividends for the year 2003-04 was paid out of the pre-acquisition profits. No dividend has been proposed for the year 2005-06 as yet and no provision need to be made in consolidated Balance Sheet. Golden Ltd., has credited all dividends received to profit and loss account.
- On 1.3.2006, bonus shares were issued by Silver Ltd., at the rate of one fully paid share for every five held and effect has been given to that in the above accounts. The bonus was declared from general reserves from out of profits earned prior to 1.4.2003.
- On 1.10.2003, Fixed assets was revalued at Rs.2,16,000, but no adjustment had been made in the books.
- Depreciation had been charged @ 10% p.a. on the book value as on 1.4.2003 (on straight line method), there being no addition or sale since then.
- Out of the Current profits Rs.4,000 have been transferred to General reserve every year.
- Bills receivable of Golden Ltd., include Rs.4,000 bills accepted by Silver Ltd., Bills discounted by Golden Ltd., but not yet matured include Rs.3,000 accepted by Silver Ltd.,
- Sundry Creditors of Golden Ltd., include Rs.4,000 due to Silver Ltd., Sundry debtors of Silver Ltd., include Rs.8,000 due from Golden Ltd.,

- (x) It is found that Golden Ltd., has remitted a cheque of Rs.4,000, which has not yet been received by Silver Ltd.,

Prepare consolidated Balance Sheet as at 31.3.2006 of Golden Ltd., and its Subsidiary.