

PAPER 1: ADVANCED ACCOUNTING**MAY 2006**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 are the Balance Sheets of Arun Ltd., Brown Ltd., and Crown Ltd., as at 31.12.2005:

(20 Marks)

Liabilities	Arun Ltd., Rs.	Brown Ltd., Rs.	Crown Ltd., Rs.
Share capital (Shares of Rs.100 each)	6,00,000	4,00,000	2,40,000
Reserves	80,000	40,000	30,000
Profit and loss account	2,00,000	1,20,000	1,00,000
Sundry creditors	80,000	1,00,000	60,000
Arun Ltd.,	--	40,000	32,000
Total	9,60,000	7,00,000	4,62,000
Assets			
Goodwill	80,000	60,000	40,000
Fixed assets	2,80,00	2,00,000	2,40,000
Shares in			
Brown Ltd., (3,000 shares)	3,60,000	--	--
Crown Ltd., (400 shares)	60,000	--	--
Crown Ltd., (1,400 shares)	--	2,08,000	--
Due from : Brown Ltd.,	48,000	--	--
Crown Ltd.,	32,000	--	--
Current assets	1,00,000	2,32,000	1,82,000
Total	9,60,000	7,00,000	4,62,000

(i) All shares were acquired on 1.7.2005

(ii) On 1.1.2005 the Balances to the various accounts were as under:

Particulars	Arun Ltd., Rs.	Brown Ltd., Rs.	Crown Ltd., Rs.
Reserves	40,000	40,000	20,000
Profit and Loss Account	20,000	(Dr.)20,000	12,000

(iii) During 2005, Profits accrued evenly.

(iv) In August, 2005, each company paid interim dividend of 10%. Arun Ltd., and Brown Ltd., have credited their profit and loss account with the dividends received.

(v) During 2005, Crown Ltd., sold an equipment costing Rs.40,000 to Brown Ltd., for Rs.48,000 and Brown Ltd., in turn sold the same to Arun Ltd., for Rs.52,000.

Prepare the consolidated Balance Sheet as at 31.12.2005 of Arun Ltd., and its subsidiaries.

Question 2

The following are the Balance Sheet of Big Ltd., and Small Ltd., as at 31.3.06:

(16 Marks)

(Rs. in lakhs)

	Big Ltd., Rs.	Small Ltd., Rs.		Big Ltd., Rs.	Small Ltd., Rs.
Share capital	40.00	15.00	Sundry assets (inclu. cost of shares)	56.00	20.00
P & L A/c	7.50	--	Goodwill	4.00	5.00
Sundry creditors	12.50	12.50	P & L A/c	--	2.50
	60.00	27.50		60.00	27.50

Additional information :

- The two companies agree to amalgamate and form a new company, Medium Ltd., .
- Big Ltd., holds 10,000 shares in Small Ltd., acquired at cost of Rs.2,50,000 and Small Ltd., holds 5,000 shares in Big Ltd., acquired at a cost of Rs.7,00,000.
- The shares of Big Ltd., are of Rs.100 and are fully paid and the shares of Small Ltd., are of Rs.50 each on which Rs.30 has been paid up.
- It is agreed that the goodwill of Big Ltd., would be valued at Rs.1,50,000 and that of Small Ltd., at Rs.2,50,000.
- The shares which each company holds in the other are to be valued at book value having regard to the goodwill valuation decided as given in (iv)
- The new shares are to be of a nominal value of Rs.50 each credited as Rs.25 paid.

You are required to :

- Prepare the Balance Sheet of Medium Ltd., as at 31st March, 2006 after giving effect to the above transactions; and
- Prepare a statement showing the shareholdings in the new company attributable to the shareholders of the merged companies..

Question 3

The directors of a public limited company are considering the acquisition the entire share capital of an existing company X Ltd., engaged in a line of business suited to them. The directors feel that acquisition of X will not create any further risk to their business interest.

(16 Marks)

The following is the Balance Sheet of X Ltd., as at 31st December, 2005:

Liabilities	Rs.	Assets	Rs.
Share capital: 4,000 equity shares of Rs.100 each fully paid up	4,00,000	Fixed Assets	6,00,000
General reserve	3,00,000	Current Assets:	
Bank overdraft	2,40,000	Stock	2,00,000
Sundry creditors	3,00,000	Sundry debtors	3,40,000
	12,40,000	Cash and Bank balances	1,00,000
			12,40,000

X's financial records for the past five years were as under:

	2005 Rs.	2004 Rs.	2003 Rs.	2002 Rs.	2001 Rs.
Profits	80,000	74,000	70,000	60,000	62,000
Extra ordinary item(s)	3,500	4,000	(6,000)	(8,000)	1,000
	83,500	78,000	64,000	52,000	61,000
Dividends	48,000	40,000	40,000	32,000	32,000
	35,500	38,000	24,000	20,000	29,000

Additional information:

- (i) There were no changes in the issued capital of X during this period.
- (ii) The estimated values of X Ltd.'s assets on 31.12.2005 are:
- | | Replacement Cost | Realizable value |
|--------------|------------------|------------------|
| Fixed assets | 8,00,000 | 5,40,000 |
| Stock | 3,00,000 | 3,20,000 |
- (iii) It is anticipated that 1% of the debtors may prove to be difficult to be realized.
- (iv) The cost of capital to the acquiring company is 10%.
- (v) The current return of an investment of the acquiring company is 10%. Quoted companies with similar businesses and activities as X have a P/E ratio approximating to 8, although these companies tend to be larger than X.

Required :

Estimate the value of the total equity capital of X Ltd., on 31.12.2005 using each of the following bases:

- (a) Balance Sheet value
- (b) Replacement cost
- (c) Realizable value
- (d) Gordon's dividend growth model
- (e) P/E ratio model.

Question 4

- (a) Global Ltd., has initiated a lease for three years in respect of an equipment costing Rs.1,50,000 with expected useful life of 4 years. The asset would revert to Global Limited under the lease agreement. The other information available in respect of lease agreement is : **(8 Marks)**
- i. The un-guaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs.20,000.
 - ii. The implicit rate of interest is 10%.
 - iii. The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of sheet.
- Ascertain in the hands of Global Ltd.
- (i) The annual lease payment.
 - (ii) The unearned finance income
 - (iii) The aggregation of finance income, and also
 - (iv) Show how necessary items will appear in its profit and loss account and balance sheet for the various years.
- (b) Briefly describe the method of valuation of human resources as suggested by Jaggi and Lan. Also point out the special merit and demerit of this method. **(8 Marks)**

Question 5

- (a) Swift Ltd., acquired a patent at a cost of Rs.80,00,000 for a period of 5 years and the product life cycle is also 5 years. The company capitalized the cost and started amortizing the asset at Rs.10,00,000 per annum. After two years it was found that the product life cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs.36,00,000, Rs.46,00,000, Rs.44,00,000, Rs.40,00,000, and Rs.34,00,000. Find out the amortization cost of the patent for each of the years. **(4 Marks)**

- (b) The Chief Accountant of Sports Ltd., gives the following Data regarding its six segments: **(4 Marks)**

Particulars	Rs. in lakhs						Total
	M	N	O	P	Q	R	
Segment Assets	40	80	30	20	20	10	200
Segment results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1,200

The Chief Accountant is of the opinion that segment "M" and "N" alone should be reported. Is the justified in his view? Discuss.

- (c) On 24th January, 2006 Chinnaswamy of Chennai sold goods to Watson of Washington, U.S.A for an invoice price of \$40,000 when the spot market rate was Rs.44.20 per US \$. Payment was to be received after three months on 24th April, 2006. To mitigate the risk of loss from decline in the exchange rate on the date of receipt of payment, Chinnaswamy immediately acquired a forward contract to sell on 24th April, 2006 US \$40,000 @ Rs.43.70. Chinnaswamy closed his books of account on 31st March, 2006 when the spot rate was Rs.43.20 per US \$. On 24th April, 2006, the date of receipt of money by Chinnaswamy, the spot rate was Rs.42.70 per US \$.

Pass Journal entries in the books of Chinnaswamy to record the effect of all the above mentioned events.

(8 Marks)

Question 6

- (a) Narmada Ltd., sold goods for Rs.90 lakhs to Ganga Ltd., during financial year ended 31-3-2006. The Managing Director of Narmada Ltd., own 100% of Ganga Ltd. The sales were made to Ganga Ltd., at normal selling prices followed by Narmada Ltd.,. The Chief Accountant of Narmada Ltd., contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per accounting standard. Is the Chief Accountant correct ? **(4 Marks)**
- (b) Milton Ltd., is a fully tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is Rs.200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate @ 35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account. **(4 Marks)**
- (c) Victory Ltd., purchased goods on credit from Lucky Ltd., for Rs.250 crores for export. The export order was cancelled. Victory Limited decided to sell the same goods in the local market with a price discount. Lucky limited was requested to offer a price discount of 15%. The Chief Accountant of Lucky Ltd., wants to adjust the sale figure to the extent of the discount requested by Victory Ltd., Discuss whether this treatment is justified. **(4 Marks)**
- (d) Accounts of Poornima Ltd., show a net profit of Rs.7,20,000 for the third quarter of 2005 after incorporating the following: **(4 Marks)**
- Bad debts of Rs.40,000 incurred during the year. 50% of the bad debts have been deferred to the next quarter.
 - Extra ordinary loss of Rs.35,000 incurred during the quarter has been fully recognized in this quarter.
 - Additional depreciation of Rs.45,000 resulting from the change in the method of charge of depreciation.

Ascertain the correct quarterly income.