

**PAPER 1: ADVANCED ACCOUNTING
NOVEMBER 1998**

Answer all questions.
Working notes should form part of the answer.
Make suitable assumptions wherever necessary.

Question 1

X and Y who are software engineers, commenced practice on 1.4.97 with an initial capital of Rs.5 lakhs. On the same date they borrowed Rs.5 lakhs repayable in flexible instalments. With the amount borrowed they purchased office furniture and personal computers on 1.4.97 for Rs.5 lakhs. They also took on lease, office accommodation by paying Rs.60,000 being rental advances for three months.

Details of other information furnished by X and Y are as follows:

- (a) An amount of Rs.1 lakh being the fees receivable as on 31.3.98 represented one month's billing on an average.
- (b) One month rent was outstanding as on 31.3.98. [Rent is payable apart from the advance]
- (c) Office expenses [excluding rent, interest and depreciation] constituted 30% of total billings.
- (d) Entire tax on income for the year was paid in advance and the tax rate was 30%
- (e) Depreciation on furniture and computers is to be allowed at 15%
- (f) Partners have drawn Rs.10,000 each per month
- (g) Debt service coverage ratio is 3 times
- (h) Interest coverage ratios is 7 times
- (i) Acid test ratio as on 31.3.98 is 3 times
- (j) Partners invested firm's excess cash in 5 year 8% government bonds
- (k) You are required to prepare:
 - A. The financial statements of the firm for the year ended 31.3.98.
 - B. The cash account summary to quantify the amount invested in government bonds.

For your exercise treat the provision for tax and Advance Tax Paid separately as current liability and Current Asset. **(20 Marks)**

Question 2

E Ltd., manufactures and sells food products. The following draft financial statements were prepared by the chief accountant for the year ended 31.3.98 and placed before you for advice:

Profit and Loss Statement for the year ended 31.3.98	(Figures in Rs. Lakhs)
Sales and other income	3,500
Cost of goods sold including operation expenses and depreciation	2,740
Operating profit	760
Profit on sale of property	200
Interest chargers	300
Profit before tax	660
Tax evasion	330
Profit after tax	330
Proposed dividend	300
Profit retained	30
Add opening balance of profit	360
Profit carried to Balance Sheet	390

Balance Sheet as on 31.3.98

(Figures in Rs. Lakhs)

Liabilities		Assets	
Share capital	3,000	Fixed Assets	5,000
General reserve	540	Less: Deprn.	1,000
P & L a/c balance	390		4,000
Secured loans	2,000	Current assets:	
Current liabilities and provisions		Stock	800
Creditors	240	Debtors	1,000
Provision for tax	350	Royalty receivable	100
Proposed dividend	300	Advance tax	200
	870	Cash balance	550
		Miscellaneous exp. to the extent not written off.	150
	6,800		6,800

You are provided with further information as follows:

- On 1.4.97 E Ltd., had sold some of its fixed assets for Rs.100 lakhs [written down value Rs.250 lakhs]. These assets were revalued earlier. As on 1.4.97 the revaluation reserve corresponding to these assets stood at Rs.200 lakhs. The profit on sale of property as shown in the profit and loss statement represented the transfer of this amount. Loss on sale of the asset was included in the cost of goods sold etc.,
- During the year E Ltd., undertook restructuring exercise of its operations at a cost of Rs.150 lakhs. This amount stood included in "miscellaneous expenditure to the extent not written off".
- Included in sales and other income is a sum of Rs.100 lakhs representing royalty receivable for supply of know-how to a company in South – East Asia. As per agreement the amount is to be received in US Dollars. However exchange permission was denied to the company in South – East Asia for remitting the same.
- E Ltd., purchased fixed assets costing Rs.1,825 lakhs on 1.4.97 and the same was fully financed by foreign currency loan [i.e. US Dollars] repayable in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = Rs.36.50]. as on 31.3.98 the first installment was paid when 1 US Dollar fetched Rs.41.50. The entire loss on exchange was included in cost of goods sold etc., E Ltd., normally provides depreciation on fixed assets at 20% on WDV basis.
- Dividend at 10% on paid up equity capital is to be maintained as in prior years.

You are required to redraft the financial statements of E Ltd., for the year ended 31.3.98 in accordance with relevant provisions of accounting standards. Journals entries (wherever applicable) in respect of the information given are to be shown. Schedules previous year's figures and cash flow statement are not required. **(20 Marks)**

Question 3

The following are the changes in the account balances taken from the Balance Sheets of PQ Ltd., as at the beginning and end of the year: **(15 Marks)**

	Changes in Rupees in debit or [credit]
Equity share capital 30,000 shares of Rs.10 each issued and fully paid	0
Capital reserve	[49,200]
8% Debentures	[50,000]
Debenture discount	1,000
Freehold property at Cost / Revaluation	43,000
Plant and Machinery at cost	60,000
Depreciation on plant and machinery	[14,400]

Debtors	50,000
Stock and work-in-progress	38,500
Creditors	[11,800]
Net profit for the year	[76,500]
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	[3,300]
Trade investments at cost	47,000
Bank	[64,300]
	0

You are informed that:

- Capital reserve as at the end of the year represented realized profits on sale of one freehold property together with surplus arising on the revaluation of balance of freehold properties.
 - During the year plant costing Rs.18,000 against which depreciation provision of Rs.13,500 was lying, was sold for Rs.7,000.
 - During the middle of the year Rs.50,000 debentures were issued for cash at a discount of Rs.1,000.
 - The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.
- You are required to prepare a statement which will explain, why Bank borrowing has increased by Rs.64,300 during the year end. Ignore taxation.

Question 4

Capital structure of Lot Ltd., as at 31.3.98 was as under:

(15 Marks)

(Rs. In lakhs)	
Equity share capital	10
10% preference share capital	5
15% debentures	8
Reserves	4

Lot Ltd., earns a profit of Rs.5 lakhs annually on an average before deduction of interest on debentures and income-tax which works out to 40%.

Normal return on equity shares of companies similarly placed is 12% provided:

- Profit after tax covers fixed interest and fixed dividends at least 3 times.
- Capital gearing ratio is .75
- Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Lot Ltd., has been regularly paying equity dividend of 10%. Compute the value per equity share of the company.

Question 5

Given below is the Balance Sheet of H Ltd., as on 31.3.97:

(15 Marks)

(Figures in Rs.lakhs)			
Equity share capital (in equity shares of Rs.10 each)	4.00	Block assets less depreciation to date	6.00
10% preference share capital	3.00	Stock and debtors	5.30
General reserve	1.00	Cash and Bank	0.70
Profit and loss account	1.00		
Creditors	3.00		
	12.00		12.00

M Ltd., another existing company holds 25% of equity share capital of H Ltd., purchased at Rs.10 per share. It was agreed that M Ltd., should take over the entire undertaking of H Ltd., on 30.9.97 on which date the position of current assets (except cash and Bank balances) and creditors was as follows:

Stock and debtors	4 lakhs
Creditors	2 lakhs

Profits earned for half year ended 30.9.97 by H Ltd., was Rs.70,500 after charging depreciation of Rs.32,500 on block assets. H Ltd., declared 10% dividend for 1996-19978 on 30.8.97 and the same was paid within a week.

Goodwill of H Ltd., was valued at Rs.80,000 and block assets were valued at 10% over their book value as on 31.3.97 for purposes of take over. Preference shareholders of H Ltd., will be allotted 10% preference shares of Rs.10 each by M Ltd., Equity shareholders of H Ltd., will receive requisite number of equity shares of Rs. 10 from M Ltd., valued at Rs.10 per share.

- (a) Compute the purchase consideration.
- (b) Explain, how the capital reserve or goodwill, if any, will appear in the Balance Sheet of M Ltd., after absorption.

Question 6

- (a) Briefly explain the qualitative characteristics of Financial Statements. **(8 Marks)**
- (b) The content of corporate social report is essentially based on social objectives” Discuss. **(7 Marks)**