Paper 1: Financial Reporting

Self evaluation practice paper

Q1 is compulsory. Out of remaining six questions, answer **any five** questions.

Support your answer with working notes along with suitable assumptions, wherever necessary.

1. (a) Energy Ltd. sold certain goods to Power Ltd. on 15.03.2013 for ` 15,00,000 by virtue of an agreement entered into between them. On the same day, Power Ltd. entered into another agreement with Energy Ltd. to resell the same goods at ` 13,50,000 (including holding cost) on 16.06.2013. You are required to identify the nature of transaction between two parties.

Also prepare an abstract of balance sheet in the books of Energy Ltd. for the financial year ending 31.03.2013 as per the requirements of Revised Schedule VI. **(5)**

(b) P Ltd. had purchased certain investments in 2011 for ` 20,00,000. However, these investments are no longer considered for holding purpose and hence been written down to ` 14,00,000. With reference to the relevant AS, explain how P Ltd. will recognize the permanent decline in the value of investments. If the company wishes to re – classify these investments as current investments, what treatment should be given for reclassification? **(5)**

(c) Metro Constructions Ltd. was awarded a contract of construction of a bridge for ` 10 Lakhs on 1st April, 2007. The position of the contract on 31st March, 2012 and 31st March, 2013 was as under :

		` in Lakhs
	As on 31.03.2012	**As on 31.03.2013**
Cost incurred up to date	5.50	9.00
Estimated further cost of completion	2.50	Nil

Total contract cost originally estimated was ` 8.00 Lakhs. While closing the books of accounts on 31.03.2013, the chief accountant calculated prior period expense as under :

		` in Lakhs
Total cost of construction as on 31.03.2013		9.00
Less :		
Cost incurred as on 31.03.2012	5.50	
Estimated additional cost during 2012-13	2.50	8.00
Excess cost treated as prior period expense		1.00

Calculate the amount of provision for foreseeable loss, which must be made and the proportion of total contract value to be recognized as turnover in the financial statements for the year ending 31st March, 2013.

Also comment on the treatment given by the chief accountant. **(6)**

(d) X Ltd. borrowed ` 250 Lakhs on 01.04.2012 for construction of boiler plant @ 14 % p.a. The plant is expected to be completed in 5 years. The weighted average cost of capital is 18 % p.a. Company's accountant capitalized interest amounting to ` 45 Lakhs for the accounting period ending on 31.03.2013. Due to surplus funds out of the total borrowings, ` 13 Lakhs was earned and credited to Profit and loss A/c. Comment on the above treatment of accountant with reference to relevant accounting standard. **(4)**

2. The following is the balance sheet of GST Ltd. as on 31st March, 2012 :

` in Lakhs

Liabilities	`	**Assets**	`
6,00,000 equity shares of ` 100 each	600	Land and building	200
2 Lakhs,12% Preference shares of		Plant and machinery	300
` 100 each	200	Furniture and fixtures	50
15% debentures	200	Inventory	150
Debenture interest	26	Sundry debtors	70
Loan from ICICI Bank	74	Cash and bank balance	130
Trade creditors	300	Preliminary Expenses	10
		Issue of debentures	5
		Profit and loss account	485
	1,400		**1,400**

GST Ltd. did not perform well and has suffered stringent losses during the last few years. However, the board of directors of the company have analyzed that the company can perform well and the financial and operational position can be recovered by proper financial restructuring and as per board's decision the following scheme of reconstruction has been devised:

(i) Ordinary shares are to be reduced to `25/ share, fully paid up.

(ii) Preference shares to be reduced with coupon rate of 10% and with equal number of shares of `50/ share, `50 paid up.

(iii) Debenture holders have agreed to forego interest accrued to them. Besides this, they have agreed to accept new debentures carrying 10% interest.

(iv) Creditors have agreed to forego 45% of their existing receivables and the balance outstanding to be converted into ordinary shares of `30/ share.

(v) The company issues 5,00,000 ordinary shares at `30/ share to pay off the secured bank loan. The entire issued capital is required to be paid on application. The existing shareholders have agreed to subscribe to new shares issued by the company.

(vi) During the course of re – construction, the company estimates that 10% of book debts amount will not be recovered.

(vii) While land and building is to be revalued at `250 Lakhs, plant and machinery is to be written down to `104 Lakhs.

Required:

1) Evaluate the impact of financial re – construction. **(6)**

2) Prepare the new balance sheet as on 31st March, 2012 following Revised Schedule VI, assuming that the scheme of re – construction is implemented in letter and spirit. **(10)**

3. Big Ltd. purchased 8,000 equity shares of `100 each from Small Ltd. on 1st April, 2010. On that day, share capital of Small Ltd. was `10,00,000 and remained unchanged up to 31.03.2013.

Further transactions by Big Ltd :

On 01.04.2011 : Sale of 500 shares out of original investments

On 01.04.2012 : Purchase of 1,000 equity shares of Small Ltd.

Small Ltd. paid 15% dividend each year in the month of September. Profit and loss account balances in Small Ltd. and the investments of Big Ltd in Small Ltd. on different dates were as under:

As on	**P & L a/c balance of Small Ltd.**	**Investments of Big Ltd. in Small Ltd.**
1st April, 2010	`5,00,000	`12,80,000
31st March, 2011	`6,20,000	`12,80,000
31st March, 2012	`7,20,000	`11,90,000
31st March, 2013	`8,00,000	`14,00,000

The amounts shown as investments represent cost price as reduced by sale and increased by further purchase without making any adjustments for profit and loss on sale or dividend.

You are required to:

A. Prepare "Investment in Shares in Small Ltd. Account" for the year 2010-11, 2011-12 and 2012-13 in the books of Big Ltd. **(6)**

B. Prepare relevant statements to show the balances as on 31st March 2011, 2012 and 2013 for consolidated accounts in respect of: **(10)**
   1) Goodwill or Cost of Control
   2) Revenue Profit
   3) Capital Profit.

(Show detailed workings wherever necessary)

4. (a) Balance sheet of Goodwill Ltd. as on 31.03.2012 is given below:

Liabilities	`	**Assets**	`
Share Capital:		Fixed Assets	28,50,000
5,000 equity shares of `100 each, `100 paid-up	5,00,000	Investments: In subsidiaries	6,40,000
10,000 equity shares of `50 each, fully paid up	5,00,000	Non-trade investments	2,00,000
16,000 equity shares of `40 each, fully paid up	6,40,000	Current Assets: Stock	5,00,000
Share suspense	2,00,000	Debtors	10,00,000
Reserves & Surplus:		Cash in hand	2,40,200
		Prepaid expenses	42,500
General reserve	15,51,200	Cash at bank	2,50,000
P & L a/c	8,40,000		
15% Debentures	6,00,000	Miscellaneous expenses: Preliminary expenses written off	1,08,500
Current Liabilities and provisions:			
Sundry creditors	2,00,000		
Tax provision	8,00,000		
	58,31,200		**58,31,200**

Further information:

(i) Return on capital employed in similar business is 15%.

(ii) Profit before tax (before deducting interest on 60% of debentures convertible on 1st April, 2013) for past five years were as under:

2007-08	`5,00,000
2008-09	`7,50,000
2009-10	`4,30,000
2010-11	` 9,75,000
2011-12	`12,32,000

(iii) Non-trade investments earned @ 10% on an average.

(iv) Rate of tax during 2011-12 was 30%, effective future tax rate will be 50%.

(v) Expected future expenses are as follows:

Expenditure on annual research	`2,90,000
Foreign currency loss (annualized)	`35,000

Required:

1) Value the goodwill on the basis of 4years purchase of weighted super profits. **(6)**

2) Find out intrinsic value of different categories of equity shares. **(6)**

(b) It is apparent from the books of G Ltd. that the trade payables are normally paid in 12 months. You are required to advise the company upon classification of these trade payables based on the reporting framework as provided in Revised Schedule VI of Companies Act, 1956. **(4)**

5. (a) Beloved Ltd issued `10,00,000, 6% convertible debentures(face value `100 per debenture) at par on 01.04.2010. The debentures are redeemable at premium of 10% on 31.03.2013 or at the debenture holders' discretion, they may be converted into ordinary shares. The prevailing market rate for debentures issued without conversion option is 10%.

P.V. factors:

End of year	**10%**
1	0.91
2	0.83
3	0.75

You are required to find out the equity and liability components. Also compute the debenture liability at the end of each year. **(8)**

(b) Manjoo Ltd. granted 500 options to each of its 4,000 employees in 2007 at an exercise price of ` 50. The market price of options was also ` 50.

Fair value per option	: ` 15
Face value per share	: ` 10
Contractual life of options	: 6 years
Vesting period	: 3 years
Exercise period	: 3 years
Expected life	: 5 years

The expected annual forfeitures are estimated at 3%. However actual forfeitures in 2007 were 5%. Manjoo Ltd. expects that the actual forfeitures for rest of the 5 years would average only 3%. The company revised its estimated forfeiture @10% p.a. during the year 2008. Of the total employees, 2500 employees completed the 3 years vesting period. The position of remaining employees was as under:

Year end	No. of employees exercising their rights
2011	1000
2012	300

The rights of remaining employees expired unexercised at the end of 2012.

You are required to compute: **(8)**

(i) Expense to be recognized each year.

(ii) Amount to be recorded in Share Capital and Securities Premium account upon issue of shares.

6. (a) From the following information calculate:

(i) Gross Value Added and Net Value Added.

(ii) Value added by manufacturing and trading activities.

(iii) Value added per employee and average earnings per employee.

(iv) Profit before tax.

Books of Future Ltd.

Application of Value Added
for the year ended 31st March, 2013

	` '000	**` '000**	**%**
To pay employees		14,760	87.70
To pay providers of capital:			
Interest on 10% debentures	1,309		
Dividends	125	1,434	8.52
To pay government:			
Corporate tax	376		
Deferred tax	54	430	2.56
To provide for maintenance and expansion:			
Depreciation	342		
Fixed assets replacement reserve	- 311		
Retained profits	175	206	1.22

You are informed that 40 employees worked in Future Ltd. during the year 2012-13. **(8)**

(b) A mutual fund company provides following information regarding its scheme:

Scheme name	: ABC
Scheme size	: `50 crores
Face value of units	: `10
Investments	: In shares
Market value of shares	: `75 crores

Compute NAV per unit of mutual fund. Also comment on your answer. **(4)**

(c) AVTAAR Ltd's books of accounts furnishes following information:

(i) Equity share capital : 2,00,000 shares of `10 each.

(ii) Profits, dividends and retained earnings:

Year	Profit before tax (`)	Dividend (`)	Retained earnings(`)
2010	9,00,000	2,15,000	2,35,000
2011	12,00,000	2,50,000	3,50,000
2012	8,00,000	2,96,000	1,03,500

(iii) The normal earnings of similar company in the industry in which AVTAAR Ltd. belongs is 12%. The normal rate of return expected by shareholders is 10%. Tax rate is 50% which is uniform since last three years.

Value the shares of company under earnings capitalization method. **(4)**

7. Attempt **any four** of the following: **4 x 4 = (16)**

(a) B Ltd. has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of `50 crores in capital assets, received subsidy from the government in September, 2012. Company credits the subsidy in P & L account and thereby reduces the losses for the year ended 31st March, 2013.

Justify the treatment given by company in view of relevant AS.

(b) During the year 2012-13, a company develops a software product and incurs some expenses in line of development and production which are as follows:

	`
R & D cost	49,200
Testing costs	15,000
Production masters for training materials	10,000
Cost of duplication of software training materials	28,000
Packing and labeling costs	17,500

Compute:

(i) Expense to be charged to P & L account.

(ii) Expense to be capitalized.

(c) Beta Ltd's financial statements shows following position as on 31st March, 2013:

PBT	`430 Lakhs
15% debentures (`100 each)	2 Lakhs
Shareholders funds	`1800 Lakhs
Return to providers of funds	`240 Lakhs
Co's net investments	`590 Lakhs
Required rate of return	10%
Tax rate	40%

Calculate Economic Value Added.

(d) J Ltd. wants to calculate the provision in respect of defined benefit scheme of gratuity for its employees for the interim period ending on 30th September, 2012. Suggest on what basis the company shall calculate the provision.

(e) Compute the 'Net Assets' value of each category of equity shares of XML Ltd. from the following information:

Abstract of balance sheet for the year ended 31st March, 2013

	Note No.	`
Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital	1	7,40,000
(b) Reserves and Surplus		2,50,000
		9,90,000

Notes to accounts:	`	`
1) Share capital:		
5,000 equity shares of `10 each, `10 paid	5,00,000	
8,000 equity shares of `5 each, `3 paid	2,40,000	7,40,000