

Test Series: September, 2012

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

Question No. 1 is compulsory.

*Attempt any **five** questions from the remaining **six** questions.*

Working notes should form part of the answer.

Wherever necessary, suitable assumption(s) may be made by the candidates.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) The fair value of plan assets of Fair Ltd. was ₹ 6,00,000 in respect of employee benefit pension plan as on 1st April, 2011. On 30th September, 2011 the plan paid out benefits of ₹ 75,000 and received inward contributions of ₹ 1,65,000. On 31st March, 2012 the fair value of plan assets was ₹ 9,00,000. On 1st April, 2012 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	10.25
Realized gains on plan assets (after tax)	3.00
Fund administrative costs	<u>(3.00)</u>
Expected rate of return	<u>10.25</u>

Calculate the expected and actual returns on plan assets as on 31st March, 2012, as per AS 15.

- (b) Overseas Ltd., is manufacturing goods for local sale and exports. As on 31st March, 2012, it has the following finished stock in the factory warehouse:

- (i) Goods meant for local sales ₹ 200 lakhs (cost ₹ 150 lakhs)
(ii) Goods meant for exports ₹ 100 lakhs (cost ₹ 40 lakhs)

Excise duty is payable at the rate of 12%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence not a cost. Please advise Overseas Ltd. using guidance note, if any issued on this, including valuation of stock.

- (c) From the following information determine the possible value of brand under the potential earning model:

	(₹ in lakhs)
(a) Profit before tax	130.00
(b) Income tax	30.00
(c) Tangible Fixed Asset	200.00
(d) Identifiable Intangible other than brand model	100.00
(e) Expected return on tangible fixed assets	60.00

Appropriate capitalization factor for intangibles is 25%.

- (d) Combine Ltd. is a group engaged in manufacture and sale of industrial and consumer products. One of its division deals with the real estate. The real estate division is continuously engaged in leasing of real estate properties. The accountant showed the rent arising from leasing of real estate as 'other income' in the Statement of Profit and Loss. State, whether the classification of the rent income made by the accountant is correct or not in light of Revised Schedule VI to the Companies Act, 1956? (4 x 5 = 20 Marks)
2. On 31st March, 2012, the abridged Balance Sheets of H Ltd. and S Ltd. stood as follows:

	H Ltd. (₹ in 000's)	S Ltd. (₹ in 000's)
Liabilities:		
Equity share capital (Authorised)	5,000	3,000
Issued and subscribed in equity shares of ₹ 10 each fully paid up	4,000	2,400
General Reserve	928	690
Profit and Loss Account	1,305	810
Bills Payable	124	80
Sundry Creditors	487	427
Provision for taxation	220	180
Other Provisions	65	17
	<u>7,129</u>	<u>4,604</u>
Assets:		
Plant and machinery	2,541	2,450
Furniture and fittings	615	298
Investment in the equity shares of S Ltd.	1,500	—
Stock	983	786
Debtors	700	683

Bills Receivables	120	95
Cash and Bank Balances	410	102
Sundry Advances	<u>260</u>	<u>190</u>
	<u>7,129</u>	<u>4,604</u>

Following additional information is available:

- (a) H Ltd. purchased 90 thousand equity shares in S Ltd. on 1st April, 2011 at which date the following balances stood in the books of S Ltd.

General Reserve ₹ 1,500 thousand; Profit and Loss Account ₹ 633 thousand.

- (b) On 14th July, 2011 S Ltd. declared a dividend of 20% out of pre-acquisition profits and paid corporate dividend tax (including surcharge and cess) at 16.2225%. H Ltd. credited the dividend received to its Profit and Loss Account.
- (c) On 1st November, 2011, S Ltd. issued 3 fully paid equity shares of ₹ 10 each, for every 5 shares held as bonus shares out of pre-acquisition General Reserve.
- (d) On 31st March, 2012, the stock of S Ltd. included goods purchased for ₹ 50 thousand from H Ltd., which had made a profit of 25% on cost.

Prepare a Consolidated Balance Sheet as on 31st March, 2012. (16 Marks)

3. Yes Ltd. and No Ltd., two companies in the field of speciality chemicals, decided to go in for a follow on Public Offer after completion of an amalgamation of their businesses. As per agreed terms initially a new company Ok Ltd. will be incorporated on 1st January, 2012 with an authorized capital of ₹ 2 crore comprised of 20 lakh equity shares of ₹ 10 each. The holding company would acquire the entire shareholding of Yes Ltd. & No Ltd. and in turn would issue its shares to the outside holders of these shares. It is also agreed that the consideration would be a multiple of the average P/E ratio for the period 1st January, 2011 to 31st March, 2011 to the rectified profits of each company, subject to necessary adjustments for complying with the terms of the share issue.

The following information is supplied to you:

	Yes Ltd.	No Ltd.
Ordinary Shares of ₹ 10 each (Nos.)	40 lakhs	20 lakhs
10% Preference shares of ₹ 100 each (Nos.)	2 lakhs	Nil
10% Preference shares of ₹ 10 each (Nos.)	Nil	2 lakhs
5% Debentures of ₹ 10 each (Nos.)	4 lakhs	4 lakhs
Investments Held		
(a) 4 lakh ordinary shares in Yes Ltd.	-	₹ 40 lakhs
(b) 2 lakh ordinary shares in No Ltd.	₹ 20 lakhs	-

Profit before Interest & Tax (PBIT) after considering impact of Inter-company Transactions and Holdings.	₹ 50 lakhs	₹ 25 lakhs
Average P/E ratio January, 2011 to March, 2011	10	8

The following additional information is also furnished to you in respect of adjustments required to the profit figure as given above:

1. The profits of the respective companies would be adjusted for half the value of contingent liabilities as on 31st March, 2011.
2. Debtors of Yes Ltd. include an irrecoverable amount of ₹ 2 lakhs against which ₹ 1 lakh was recovered but kept in Advance account.
3. No Ltd. had omitted to provide for increased FOREX liability of US\$10,000 on loan availed in financial year 2007-08 for purchase of Machinery. The machinery was acquired on 1st January, 2008 and put to use in financial year 2008-09. The additional liability arose due to change in exchange rates and is arrived at in conformity with prevailing provisions of AS 11. The exchange rate is US \$ 1 = INR 50.
4. Yes Ltd. has omitted to invoice a sale that took place on 31st March, 2011 of goods costing ₹ 2,50,000 at a mark up of 15 per cent instead the goods were considered as part of closing inventory.
5. Closing Inventory of ₹ 45 lakhs of No Ltd. as on 31st March, 2011 stands undervalued by 10 per cent.
6. Contingent liabilities of Yes Ltd. and No Ltd. as on 31st March, 2011 stands at ₹ 5 lakhs and ₹ 10 lakhs respectively.

The terms of the share issue are as under:

- (i) Shares in Ok Ltd. will be issued at a premium of ₹ 13 per share for all external shareholders of Yes Ltd. The premium will be ₹ 15 per share for shares in Ok Ltd. issued to all external shareholders of No Ltd.
- (ii) No shares in Ok Ltd. will be issued in lieu of the investments (intercompany holdings) of both companies. Instead the shares so held shall be transferred to Ok Ltd. at the close of the financial year ended 31st March, 2012 at Par Value consideration payable on date of transfer.
- (iii) Ok Ltd. would in addition to the issue of shares to outside shareholders of Yes Ltd. and No Ltd. make a preferential allotment on 31st March, 2012 of 2 lakhs ordinary shares at a premium of ₹ 28 per share to Great Capital Ltd. (GCL). These shares will not be eligible for any dividends declared or paid till that date.
- (iv) Ok Ltd. will go in for a 18 per cent unsecured bank overdraft facility to meet incorporation costs of ₹ 16 lakhs and towards management expenses till 31st March, 2012 estimated at ₹ 14 lakhs. The overdraft is expected to be availed on 1st

February, 2012 and closed on 31st March, 2012 out of the proceeds of the preferential allotment.

(v) It is agreed that interim dividends will be paid on 31.03.2012 for the period January, 2012 to March, 2012 by Ok Ltd. at 2 per cent; Yes Ltd. at 3 per cent and No Ltd. at 2.5 per cent. Ignore dividend distribution tax.

(vi) The prevailing Income tax rate is 25 per cent.

You are required to compute the number of shares to be issued to the shareholders of each of the companies and prepare the projected Profit and Loss Account for the period from 1st January, 2012 to 31.03.2012 of Ok Ltd. and its Balance Sheet as on 31st March, 2012. (16 Marks)

4. Balance Sheet of Appraisal Ltd. as at 31st March, 2012 is given below:

Liabilities	₹	Assets	₹
Share Capital:		Fixed assets:	
12,000 Equity shares of ₹ 100 each fully paid up	12,00,000	Building	3,00,000
Reserve and Surplus:		Machinery	4,40,000
Profit and Loss A/c	1,00,000	Current assets, loans and advances:	
Current liabilities and provision:		Stock	6,00,000
Bank overdraft	20,000	Sundry debtors	3,20,000
Creditors	1,20,000	Bank	1,20,000
Provision for taxation	2,20,000		
Proposed dividend	<u>1,20,000</u>		
	<u>17,80,000</u>		<u>17,80,000</u>

The net profits of the company, after deducting usual working expenses but before providing for taxation, were as under:

Year	₹
2009-10	4,00,000
2010-11	4,80,000
2011-12	4,40,000

On 31st March, 2012, Building was revalued at ₹ 4,00,000 and Machinery at ₹ 5,00,000. Sundry debtors, on the same date, included ₹ 20,000 as irrecoverable. Having regard to nature of the business, a 10% return, on net tangible capital invested, is considered reasonable.

You are required to value the company's share ex-dividend. Valuation of goodwill may be based on three year's purchase of annual super profits. Depreciation on Building- 2% and Machineries -10%. The income-tax rate is to be assumed at 50%. All workings should form part of your answer. (16 Marks)

5. (a) The following are the balances in the accounts statements of Plus Ltd. for the year, 2011

	₹ in lakhs		₹ in lakhs
Turnover	1,150	Printing and Stationery	11
Loss on Sale of Machinery	37.5	Auditor's Remuneration	14
Depreciation on Plant and Machinery	100	Retained Profits (Opening Balance)	497
Dividend to Ordinary Shareholders	73	Retained Profits for the year	144
Debtors	100	Rent, Rates and Taxes	82.5
Creditors	63.5	Other Expenses	42.5
Total Stock of all materials, W.I.P. and finished goods		Ordinary Share Capital issued	750
Opening Stock	80	Interest on Borrowings	20
Closing Stock	100	Income Tax for the year	138
Raw Materials purchased	312.5	Wages and Salaries	163.5
PF Contribution	14	Employees State Insurance	17.5

Prepare a value added statement for the company for 2011.

- (b) Consolidated balance sheet of Whole Ltd. group and its associate One Ltd., as on 31.03.2012 before adjustment for equity method are given below:

(₹ in '000s)

Liabilities	Whole Ltd.	One Ltd.	Assets	Whole Ltd.	One Ltd.
Share Capital (₹ 10)	600	100	Goodwill	10	
P & L A/c	300	-	Sundry Assets	1,175	130
Minority Interest	75	-	Investment in One Ltd.	15	-
Sundry Liabilities	<u>225</u>	<u>150</u>	P & L A/c	<u>-</u>	<u>120</u>
	<u>1,200</u>	<u>250</u>		<u>1,200</u>	<u>250</u>

Whole Ltd. acquired 30% of ordinary shares of One Ltd., on 01.04.2010 for ₹ 15,000. The balance of One Ltd., profit and loss account on that date was ₹ 40,000 (Debit).

Show adjustment for equity method and redraft the consolidated balance sheet of the group as on 31.3.2012. (10+6= 16 Marks)

6. (a) Lal Ltd. granted 500 options to each of its 500 employees in 2007 at an exercise price of ₹ 50 when the market price was the same. The contractual life (vesting and exercise period) of the options granted is 6 years with the vesting period and exercise period being 3 years each. The expected life is 5 years and the expected annual forfeitures are estimated at 3 per cent. The fair value per option is arrived at ₹ 15. Actual forfeitures in 2007 were 5 per cent. However at the end of 2007 the management of Lal Ltd. still expects that the actual forfeitures would average only 3 per cent over the entire vesting period. During 2008 the management revises its estimated forfeiture rate to 10 per cent per annum. Of the 500 employees 380 employees have completed the 3 year vesting period. 200 employees exercise their right to obtain shares vested in them in pursuance of ESOP at the end of 2011 and 100 employees exercise their right at the end of 2012. The rights of the remaining employees expire unexercised at the end of 2012. The face value per share is ₹ 10. Show the necessary journal entries with suitable narrations. Workings should form part of the answer.
- (b) On January 1, 2011, Santa Ltd. sold equipment to Banta Ltd. for ₹ 6,14,460. The carrying amount of the equipment on that date was ₹ 1,00,000. The sale was a part of the package under which Banta Ltd. leased the asset to Santa Ltd. for a ten-year term. The economic life of the asset is estimated at 10 years. The minimum lease rents payable by the lesser has been fixed at ₹ 1,00,000 payable annually beginning December 31, 2011. The incremental borrowing interest rate of Santa Ltd. is estimated at 10% per annum. Calculate the net effect on the profit and loss account? (10+6=16 Marks)
7. (a) Can UC Ltd. a wire netting company, while valuing its finished stock at the year end include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses?
- (b) Mahindra Finance Ltd. is a non-banking finance company. The extracts of its balance sheet are given below:

Liabilities	Amount	Assets	Amount
	₹ in lakhs		₹ in lakhs
Paid up equity share capital	100	Leased out Assets Investment:	800
Free Reserves	500	In shares of subsidiaries and	
Loans	400	group companies	100
Deposits	400	In debentures of subsidiaries and	

		group companies	100
		Cash and Bank balances	200
		Deferred Expenditure	<u>200</u>
	<u>1,400</u>		<u>1,400</u>

You are required to compute Tier – I Capital of Mahindra Finance Ltd. according to NBFC Prudential Norms (RBI) Directions 1998.

- (c) An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 70,000. How is the asset to be accounted for ?
- (d) Apple Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2012. The company seeks your advice when the Company's sales tax assessment for assessment year 2009-10 has been completed on 14th February, 2012 with a demand of ₹ 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.
- (e) Smart Ltd. issued ₹ 1,00,00,000 worth of 8% Debentures of face value ₹ 100 each on par value basis on 1st January, 2011. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for ordinary shares of Smart Ltd. on 1:1 basis. The interest rate for similar debentures that do not carry conversion entitlement is 12%. You are required to calculate the value of the debt portion of the above compound financial instrument. The present value of the rupee at the end of years 1 to 4 at 8% and 12% are supplied to you as:

	8%	12%
End of year 1	0.926	0.893
End of year 2	0.857	0.797
End of year 3	0.794	0.712
End of year 4	0.735	0.636

(4 x 4 = 16 Marks)