FINAL
GROUP-I PAPER-1
FINANCIAL REPORTING

Roll No. ....

NOV 2011

Total No. of Questions – **7**

Total No. of Printed Pages –**12**

Time Allowed – **3** Hours

Maximum Marks – **100**

BRS

Answers to questions are to be given only in English, except in case of candidates who have opted for Hindi Medium. The answers if any in Hindi, of any candidate who has not opted for Hindi medium, shall not be valued.

Question No. **1** is compulsory.

Candidates are also required to answer any **FIVE** questions from the remaining **SIX** questions.

Working notes should form part of the respective answers.

Wherever necessary, candidates are permitted to make suitable assumptions which should be disclosed by way of a note.

4×5 =20

Marks

1. (a) Primus Hospitals Ltd. had acquired 40 units of Doppler scan machines from Holiver USA at a cost of US $ 165,100 per unit in the beginning of Financial Year 2008-09. The prevailing rate of exchange was ₹ 50 to the US $. The acquisition was partly funded out of a government grant of ₹ 5 crore. The grant relating to such machines was given with a rider that in the event of a change in management, the entity is bound to return the grant. In April 2011, 51% control in the company was taken over by an overseas investor. The expected productive period of such an asset is normally reckoned at 5 years. The depreciation rate adopted was 20% p.a. S.L.M. basis. The company had incurred expenditure of US $ 4000 towards Bank charges and ₹ 7500 per unit as sea freight. You are also informed that neither Capital Reserve nor deferred Income account has been maintained by the company. You are required to suggest the accounting treatment as a result of the return of the grant, in the light of the relevant AS. **5**

(b) The following balances are extracted from the Books of Ram Ltd. a real estate company on 31st March, 2011 5

	DR (₹ in '000)	CR (₹ in '000)
Lease hold premises	42	
Equipment, fixtures and fittings at cost on 1.4.10	264	
Depreciation on equipment, fixtures and fittings on 1.4.10.		164

The following additional informations are also provided.

1. Depreciation on equipment, fittings and fixtures is provided @ 15% on written down value.
2. On 1st October 2010, the company moved to a new premises. The premises are on a 12 year lease and the lease premium paid amounted to ₹ 42,000. The company used sub-contract labour of ₹ 40,000 and materials at cost of ₹ 38,000 in the refurbishment of the premises. These are to be considered as part of the cost of lease hold premises.

   You are required to prepare the 'Notes to accounts' including significant accounting policies forming part of the financial statements, for disclosure of above facts and information provided.

(c) On 1st April, 2010, A company offered 100 shares to each of its 500 employees at ₹ 50 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under the plan (ESPP) shall be subject to lock-in on transfers for three years from grant date. The market price of shares of the company on the grant date is ₹ 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 56 per share. 5

On 30th April, 2010, 400 employees accepted the offer and paid ₹50 per share purchased. Nominal value of each share is ₹ 10.

Record the issue of shares in the book of the company under the aforesaid plan.

(d) From the following details, compute the total value of human resources of skilled and unskilled group of employees according to Lev and Schwartz (1971) model. **5**

		Skilled	Unskilled
(i)	Annual average earning of an employee till the retirement age.	₹ 60,000	₹ 40,000
(ii)	Age of retirement	65 years	62 years
(iii)	Discount rate	15%	15%
(iv)	No. of employees in the group	30	40
(v)	Average age	62 years	60 years

2. Kim and Kin floated a new company KimKin Ltd. on 1st April 2010 with a capital of ₹ 5 lakhs represented by 50,000 ordinary shares of ₹ 10/- each, subscribed equally by both groups. **16**

Kimkin Ltd. made the following acquisitions on the same date :

(1) 3000 shares of ₹ 10/- each in Klean Ltd. at ₹ 35,000.

(2) 10,000 shares of ₹ 10/- each in Klinic Ltd. for ₹ 72,000.

(3) 8,000 equity shares of ₹ 10/- each in Klear Ltd. for ₹ 92,000 and 200 8% Cumulative Preference shares @ ₹ 140/- per share.

Marks

The following are the summarized Balance sheets of the three companies as on 31.03.2011.

LIABILITIES	**Klean Ltd**	**Klinic Ltd**	**Klear Ltd**
Equity Share Capital	40,000	1,20,000	1,00,000
8% Cumulative Preference Capital (₹ 100/- shares)			25,000
Reserves (31.03.2010)	3,000		7,500
Profit & Loss Account	6,000		15,000
Sundry Creditors	2,900	8,000	7,500
	51,900	1,28,000	1,55,000
ASSETS			
Goodwill (Self Generated)	4,000		15,000
Freehold Land	8,000	52,000	50,000
Plant & Machinery	16,000	19,000	37,000
Inventories	8,900	25,000	26,000
Sundry Debtors	4,000	12,000	15,500
Bank	11,000	2,000	11,500
Profit & Loss A/c		18,000	
	51,900	1,28,000	1,55,000

You are supplied with the following information and requested to compile the consolidated Balance Sheet as on 31st March 2011 of the entire Group.

1. The Freehold Land of Klear Ltd carries a Fair Value of ₹ 65,000 as on 1-04-2010.
2. The Plant & Machinery of Klinic Ltd to be depreciated by ₹ 3,000/-.
3. Inventories of Klean Ltd are undervalued by ₹ 2,000.
4. On Balance Sheet date Kimkin Ltd owed Klean Ltd ₹ 10,500 and is owed ₹ 8,200 by Klinic Ltd. Klear Ltd is owed ₹ 1,300 by Klean Ltd and ₹ 2,000 by Klinic Ltd.

Marks

5. The balances in P&L A/c on date of acquisition were: Klean Ltd. ₹ 2,000 (Cr) ; Klinic Ltd. ₹ 12,000 (Dr) and Klear Ltd ₹ 4,000 (Cr).

   The Credit balances of Klean Ltd & Klear Ltd were wholly distributed as Dividends in June '2010.

6. During 2010-11 Klean Ltd & Klear Ltd declared and paid interim dividends of 8% and 10% respectively.

7. Klear Ltd has discharged dividend obligations towards its Preference Shareholders up-to March 2009.

3. As part of its expansion Strategy White Ltd has decided to amalgamate its business with that of Black Ltd and a new company Black & White Ltd being incorporated on the 1st of September 2010 having an authorized equity capital of 2 crore shares of ₹ 10/- each. M/s Black & White Ltd. shall in turn acquire the entire ownership of White Ltd and Black Ltd in consideration for issuing its equity at 25% premium on 1st Oct. 2010. It is also agreed that the consideration shall be based on the product of the profits available to equity shareholders of each entity, times its PE multiple. The Preference Shareholders & Debenture holders are to be satisfied by the issue of similar instruments in Black & White Ltd on 1-10-2010 in lieu of their existing holdings. Accordingly the relevant information is supplied to you as under : 16

	White Ltd	Black Ltd
Paid up Equity of ₹ 10 class (Nos)	3 Lakh	1.2 Lakhs
8% Preference Shares ₹ 10/- paid (Nos)	------	1 Lakh
5% Redeemable Debentures 2015 of ₹ 10/- each (Nos)	------	0.8 Lakh
Profits before Interest & Taxation (Rupees)	6,00,000	4,40,000
Price to Earnings Multiple	15	10

To augment the Cash retention level of Black & White Ltd it is decided that on 1st Oct 2010 Black & White Ltd. shall collect full share application money for the issue 20,00,000 equity shares @ 40% premium under Private Placement. The allotment of the shares will be made on 31-12-2010 and such shares shall qualify for dividend from 2011 only.

Black & White Ltd also shall avail a 12.50% TOD of ₹ 15 lakhs to meet its preliminary expenses and cost of working which amount to ₹ 12 lakhs and ₹ 2 lakhs respectively. The TOD will be availed on 1st Nov 2010 and closed on 31st Dec. 2010. Preliminary expenditure is tax deductible @ 20% each year.

Due to an accounting omission the opening inventory of Black Ltd of ₹ 5 Lakh & the closing stock of White Ltd. of ₹ 2.20 lakh was understated & overstated by 5% and 10% respectively.

The dividend schedule proposed is that all companies would pay interim dividend for equity, for the period from 1st Oct 2010 to 31st Dec. 2010. The rates of dividend being White Ltd. @ 5%, Black Ltd @ 2% and Black & White Ltd @ 3.5%. The preference Shareholders & debenture holders dues for the post take over period are discharged on 31.12.2010.

It is proposed that in the period Oct–Dec 2010 Black & White Ltd would carry out trade in futures that would generate an absolute post tax return of 18% by using the funds generated from the Private Placement. The trades would be squared off on 31-12-2010. Proceeds from such transactions are not liable to withholding taxes.

You are required to prepare a projected Profit & Loss A/c for the period ended 31st Dec. 2010 and a Balance Sheet on that date for Black & White Ltd.

The corporation tax rate for the company is 40%.

Marks

4. (a) Prepare a value added statement for the year ended on 31-03-2011 and reconciliation of total value added with profit before taxation, from the profit and loss account of Paradise Ltd. for the year ended on 31-03-2011. 8

(₹ In Lakhs)

INCOME :	
Sales	254.00
Other income	6.00
	260.00
EXPENDITURE :	
Operating cost	222.00
Excise duty	11.20
Interest on Bank overdraft	1.00
Interest on 9% debenture	15.00
	249.20
Profit before depreciation	10.80
Depreciation	4.10
Profit before tax	6.70
Provision for tax	2.40
Profit after tax	4.30
Proposed dividend	0.30
Retained profit	4.00

The following additional information are given :

(i) Sales represents net sales after adjusting discounts, returns and sales tax.

(ii) Operating cost includes ₹ 82.00 lakhs as wages, salaries and other benefits to employees.

(iii) Bank overdraft is temporary.

Marks

(b) Eagle Ltd had acquired 51% in Sparrow Ltd for ₹ 75.80 lakhs on April, 1st 2010. On date of the acquisition Sparrow's Assets stood at ₹ 196 lakhs and liabilities at ₹ 16 lakhs. The Net asset position of Sparrow Ltd as on 31st March, 2011 & 30th September 2011 were ₹ 280 lakhs & ₹ 395 lakhs respectively, the increase resulting from profits earned during the period. **8**

On 1st Oct, 2011 25.5% holdings were sold for ₹ 125 lakhs. You are required explain the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship. The profit arising on part sale of investment, carrying value of the portion unsold & goodwill/capital reserve that arises on change in nature of the investment may also be worked out by you.

5. The following is the Balance Sheet of BAT Ltd. as on 31st March, 2010 : **16**

BALANCE SHEET

LIABILITIES	₹	ASSETS	₹
3,00,000 Equity shares of ₹ 10 each fully paid	30,00,000	Goodwill	3,00,000
12.5% Redeemable preference shares of ₹ 100 each fully paid	20,00,000	Building	20,00,000
General Reserve	15,00,000	Plant & Machinery	22,00,000
Profit & Loss A/c	3,00,000	Furniture	10,00,000
Secured Loan	10,00,000	Investments	16,00,000
Creditors	30,00,000	Stock	12,00,000
		Debtors	20,00,000
		Bank Balance	4,00,000
		Preliminary Expenses	1,00,000
	108,00,000		**108,00,000**

Additional Information :

(i) Fixed assets are worth 20% more than book value. Stock is overvalued by ₹ 1,00,000. Debtors are to be reduced by ₹ 40,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.

(ii) Trade investments were purchased on 1.4.2009. 50% of non-trade investments were purchased on 1.4.2008 and the rest on 1.4.2009. Non-trade investments yielded 15% return on cost.

(iii) In 2008-2009 Furniture with a book value of ₹ 1,00,000 was sold for ₹ 50,000. This loss should be treated as non-recurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In 2007-2008 new machinery costing ₹ 2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 20% in similar business.

(vi) Goodwill is to be valued at two years purchase of super profits based on simple average profits of last four years.

Profits of last four years are as under :

Year	Amount (₹)
2006-2007	13,00,000
2007-2008	14,00,000
2008-2009	16,00,000
2009-2010	18,00,000

(vii) It is assumed that preference dividend has been paid till date.

(viii) Depreciation on the overall increased value of assets (worth 20% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Find out the intrinsic value of the equity share. Ignore income tax and dividend tax.

6. (a) Life Industries Ltd (LIL) furnishes the following information from which you are required to calculate the Prevailing Economic Value Added of the company and also explain the reason for the difference, if any, between the EVA as calculated by you and the M.V.A. (Market Value Added) of LIL amounting to ₹ 14005 crore. 8

Common Shares of ₹ 1000/- Face Value	1,58,200
12% Debentures ₹ 10/- Face Value	50,00,000
Current Tax rate	30%
Financial Leverage	1.1 times
Share Premium Account (Lakh Rupees)	155
Free Reserves (Lakh Rupees)	154
Capital Reserve (Lakh Rupees)	109

It is a prevailing practice for companies in the industry to which LIL belongs to pay at least a dividend of 15% p.a. to its common shareholders.

(b) Sparrow Holdings is a S.E.B.I. Registered Mutual Fund which made its maiden N.F.O. (New Fund offer) on 10th April, 2010 @ ₹ 10/- Face Value per unit. Subscription was received for 90 lakhs units. An underwriting arrangement was also entered into with Affinity Capital Markets Ltd that agreed to underwrite the entire NFO of 100 lakh units on a commission of 1.5%. 8

Out of the monies received ₹ 892.50 lakhs was invested in various capital market instruments. The marketing expenses for the N.F.O. amounted to

₹ 11.25 lakhs. During the F.Y. ended March, 2011 the Fund sold securities having cost of ₹ 127.25 lakhs (FV 54.36 lakhs) for ₹ 141.25 lakhs. The fund in turn purchased securities for ₹ 130 lakhs. The management expenses of the fund are regulated by S.E.B.I. stipulations which state that the same shall not exceed 0.25% of the average funds invested during the year. The actual amount spent towards management expenses was ₹ 2.47 lakhs of which ₹ 47,000 was in arrear. The dividends earned on the investments held amounted to ₹ 2.51 lakhs of which a sum of ₹ 25,000 is yet to be collected. The fund distributed 80% of realized earnings. The closing Market Value of the Portfolio was ₹ 1120.23 lakhs.

You are required to determine the closing per unit NAV of the fund.

7. Answer any **four** parts of this question : 4×4 =16

(a) Mega Ltd. issued ₹ 100,00,000 worth of 8% Debentures of face value ₹ 100/- each on par value basis on 1st Jan, 2011. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for Ordinary shares of Mega 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 : 4

	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

(b) G Ltd acquired a machine on 1st April, 2005 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2009, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the YE March 2011 4

Marks

conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd. G Ltd had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

(c) FEE Ltd borrows a sum of ₹ 20 crore from COFEE Ltd repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market rate is 8% FEE Ltd paid an origination fee of ₹ 2.40 Crores to COFEE Ltd to compensate COFEE Ltd for the lower rate of interest. Apart from the above, there are no other transactions between the two parties. You are required to show the value at which COFEE Ltd would recognize the loan and the annual interest thereon. **4**

(d) On 1st Apri,l 2010. a mutual fund scheme had 9 lakh units, face value of ₹ 10 each outstanding. The scheme earned ₹ 81 lakhs in 2010-11. out of which ₹ 45 lakhs was earned in first half year. 1 lakh units were sold on 30th Sept., 2010. at NAV ₹ 60. **4**

Show important accounting entries for sale of units and distribution of dividend at the end of 2010-11.

(e) BEE Ltd. has entered into a contract by which it has the option to sell its identified property, plant and equipment (PPE) to AXE Ltd. for ₹ 100 lakhs after 3 years whereas its current market price is ₹ 150 lakhs. Is the put option of BEE Ltd. a financial instrument ? Explain. **4**
