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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE PROGRAMME

YEAR II SEMESTER I (Intake II/III – Group A)

END SEMESTER EXAMINATION – JANUARY 2016

AFM 20630 Advanced Financial Accounting

Date	:	01st February 2016
Time	:	9.00 a.m. – 12.00 p.m.
Duration	:	Three (03) hours

Instructions to Candidates:

- Answer **ALL** the questions
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Question No. 01

Abridged balance sheets of Home Ltd and Brick Ltd., as at 31.3.2015 are given below.

	Home Ltd	Brick Ltd
Non-Current Assets	**Rs. '000**	**Rs. '000**
Property Plant and Equipment	600,000	380,000
Investments	300,000	
Current Assets		
Inventories	80,000	15,000
Trade Receivables	190,000	45,000
Cash and Cash Equivalent	30,000	60,000
Total Assets	***1,200,000***	***500,000***
Equity		
Stated Capital	800,000	200,000
Revaluation Reserves		50,000
Retained Earnings	220,000	155,000
General Reserves		70,000
Liabilities		
Loans	100,000	
Trade Payables	70,000	10,000
Accruals	10,000	15,000
Total Equity and Liabilities	***1,200,000***	***500,000***

Additional Information

- Home Ltd Acquired 60% of Brick Ltd's equity by investing Rs. 300 million in 600,000 shares on 31.3.2014 when Brick Ltd had total net assets of Rs. 400 million as per books (Before incorporating the revalued amounts). Reserves of Brick Ltd as at 31.3.2014 consisted of the following.
  Retained Earnings - Rs. 150 million
  General Reserve - Rs. 50 million

- Land and Buildings of Brick Ltd were revalued first time at the time of acquisition and it generated an increase of Rs. 50 million and a decrease of Rs. 10 million from land and building respectively. Revalued amounts were incorporated in the books of accounts of

Brick Ltd accordingly. Group policy is to depreciate buildings at 10% per annum on cost or revaluation.

- Inventories of Home Ltd as at 31.3.2015 included Rs. 12 million worth of goods purchased from Brick Ltd. Brick Ltd keeps a gross profit margin of 25% on selling price and had sold goods to Home Ltd for R. 100 million during the year.

- Home Ltd transferred a machine to Brick Ltd for Rs. 20 million on 2.4.2014 by keeping a profit margin of Rs. 5 million. Group policy is to depreciate machineries at 20% per annum on cost.

- Trade Receivables of Brick included Rs. 8 million of sales made to Home Ltd during the year. However, the corresponding amount shown as trade payables in Home Ltd was Rs. 5 million. The difference was due to omission of a sales invoice from Brick Ltd. However, the corresponding inventories have reached the Home Ltd before 31.3.2015. In addition Trade receivables of Brick Ltd included a loan of Rs. 25 million given to Home Ltd during the year.

- Market price of a share of Brick Ltd as at 31.3.2014 was Rs. 450 (Non-Controlling Interest (NCI) for consolidation purpose should be valued at Fair Value

Required

1. Calculation of goodwill by separately showing the amount of goodwill applicable to NCI
2. Calculation of consolidated Retained Earnings as at 31.3.2015
3. Statement of Financial Position of the group of Home Ltd and Brick Ltd as at 31.3.2015

(Total 30 Marks)

Question No. 02

a. ABC Ltd issued had stated capital of Rs. 200 million as at 1.4.2014. The total number of ordinary shares outstanding at that date was 10 million. The company made a right issue of shares on the basis of one (1) new ordinary share for every five (5) shares held as at 1.4.2014 at a price of Rs. 12 per share. Market price of a share at the time of announcement of right issue was Rs. 30. Expenses of the right issue amounted to Rs. 2 million. ABC had also given an option for employees after the right issue of shares, to purchase the shares of the company at a price of Rs. 15 per share on or before 31.3.2015. Total number of shares offered in the option scheme was 1 million. Employees are entitled to get a loan equivalent to 50% of their investment if they exercise the option. Only 50% of the employees' rights for option were exercised by 31.3.2015 and all obtained the loan entitled from the company.

Required

1. Theoretical Ex-right Price immediately after the announcement of right issue of shares
2. Stated Capital immediately after the right issue of shares
3. Total number of ordinary shares outstanding as at 31.3.2015
4. Stated Capital as at31.3.2015
5. Net cash inflow as a result of the right issue
6. Net cash inflow as a result of exercising the Share option

(12 Marks)

b. PQR Ltd is in the process of preparing its financial statements for the year ended 31.3.2015. Drafted income statement showed a profit of Rs. 25 million for the year then ended. The cost of physical inventory balance has been considered in preparing draft financial statements.

Following specific cases were identified **after** preparing the draft financial statements.

I. Net Realizable Value of inventories as at 31.3.2015 was less by 2 million compared to its cost at the same date.

II. Cost of physical inventories was less by Rs. 500,000 compared to book balances. It was decided to recover Rs. 300,000 from the store keeper and the rest was decided to be written off

III. Land, Buildings and Machineries (LBM) were revalued at the second time for Rs. 100 million as at 31.3.2015. Cost and accumulated depreciation of LBM at 31.3.2015 were Rs. 120 million and Rs. 40 million respectively. Only with respect to the class of machineries, it had been a decrease of Rs. 5 million at the first revaluation. The increase in revaluation of the class of machineries at the second revaluation was Rs. 3 million. The net increase from revaluation of Land and Buildings at the first time was Rs. 12 million

IV. The entire lease rental of Rs. 1.5 million paid on 31.3.2015 in connection with a finance lease of a car entered into on 31.3.2014 had been deducted from the lease liability account. Interest included in the lease rental was Rs. 600,000. The Fair value of the car at the time of lease was Rs. 6 million. The lease term is five years and the total rental should be paid in 5 equal annual installments. The useful life of this motor car is five years and the residual value is zero. Depreciation on lease has not been taken into account.

V. Company offers loyalty points to customers and the total amount of loyalty point offered during the year was Rs. 2 million. The balance of the provision for loyalty points account as at 31.3.2014 was Rs. 800,000. During the year ended 31.3.2015, the total amount of loyalty points redeemed was Rs. 1 million and this Redeemed amount was duly deducted from sales. Points amounting to Rs. 300,000 arisen from the previous year are expired as at 31.3.2015. The experience of the company indicates that Rs. 500,000 offered during the current year is unlikely to be claimed in the next year.

VI. Income tax liability for the previous year had been under provided by Rs. 700,000

Required

1. Journal Entries to record the cases referred in II, IV and V
2. Items with values to be shown under other comprehensive income
3. Total profit for the year ended 31.3.2015
4. Total comprehensive Income for the year ended 31.3.2015
5. Revaluation reserve account for the year ended 31.3.2015

(18 Marks)

(Total 30 Marks)

Question No. 03

Partnership business between A and B was converted to a limited liability company on 31.3.2015. Partners' current accounts and capital accounts balances as at 31.3.2015 were as follows. A and B were sharing profits in the ratio of 3:1 respectively.

	A (Rs'000)	B(Rs'000)
Capital Account	5,000	3,000
Current Account	1,000	2,000

Fair values of the assets and liabilities of the partnership as at 31.3.2015 were ascertained as follows. All the assets and liabilities except the once taken over by partners were transferred to AB Ltd at fair values.

Assets	Rs. '000
Property Plant and Equipment (PPE)	12,000
Inventories	1,500
Trade receivables	3,500
Cash and cash equivalent	800
Liabilities	
Bank Loan	1,000
Payables	1,200

Additional Information

- Partner A agreed to take the responsibility of paying the loan
- Motor car with a fair value of Rs.2.2 million was taken by partner B at an agreed price of Rs. 1.7 million. The book value of this motor can as at 31.3.2015 was Rs. 1.2 million
- Partner B undertook the responsibility of collecting a part of receivables with a fair value of Rs. 1 million at a discount of Rs. 100,000. (The book value of these debtors as at 31.3.2015 was as same as the fair value)
- Formation expenses of the company amounted to Rs. 1.2 million and it should be boned by the company.
- New company was incorporated as AB Ltd by issuing equal number of shares to A and B by making the initial stated capital to be Rs. 30 million. Additional cash investment should

be made by A and B as necessary on the same day. Issue price of a share of AB Ltd is Rs. 10

Required

1. Business Conversion Account
2. Total equity entitlement of A and B for the purpose of conversion before issuing shares to them
3. Total number of shares to be issued to A and B
4. Additional cash invested by A and B in AB Ltd
5. Balance sheet of AB Ltd after the conversion

(Total 30 Marks)

Question No. 04

a. S Ltd and T Ltd are similar size companies operating in the same industry for almost same period of time. The following information of both companies pertaining to ratios is given below.

	S Ltd	**T Ltd**
Profit Margin on Sales %	20	30
Return on Total Assets %	30	24
Debt Collection Period (Days)	15	40
Payable Settlement Period (Days)	30	35
Inventory Turnover Ratio (Times)	20	12
Debt Equity Ratio	0.65	0.35

Required

1. Assess the profitability of two companies and state which companies doing better relative to the other with reasons
2. Calculate operating Cycles of both companies in terms on number of days and Comment about the operating efficiency of each company

3. Explain the possible impact of Debt Equity Ratios of each company on its Profitability and Solvency

(8 Marks)

b. Briefly explain the relationship between cash flows from operating activities of an entity and its operating profit shown in the income statement

(2 Marks)

(Total 10 Marks)