Question No. 1

(a) Following is the information of two companies for the year ended 31st March, 2009.

Particulars	*Aikya Ltd. Rs.*	**Bakya Ltd. Rs.**
Equity shares of Rs. 10 each	8,00,000	10,00,000
10 per cent Preference shares of Rs. 10 each	6,00,000	4,00,000
Profit after tax	3,00,000	3,00,000

Assume that the market expectation is 18% and 80% of the profits are distributed as dividends.

i. What is the rate you would pay to the equity shares,

   a. If you are buying a small lot?

   b. If you are buying a controlling interest in shares?

ii. If you plan to invest only in Preference shares, which company's preference share would you choose?

(b) From the following particulars of three companies, ascertain the value of goodwill. Terms and conditions are as follows:

i) Assets are to be revalued.

ii) Goodwill is to be valued at four years' purchase of average super profits for three years. Such average is to be calculated after adjustment of depreciation at ten percent on the amount of increase/decrease on revaluation of fixed assets. Income tax is to be ignored.

iii) Normal profit on capital employed is to be taken at 10%, capital employed being considered on the basis of net revaluation amounts of tangible assets.

The summarized balance Sheet and relevant information are given below:

(Rs. in '000)

Liabilities	*P Ltd.*	*Q Ltd.*	*R Ltd.*	*Assets*	*P Ltd.*	*Q Ltd.*	*R Ltd.*
Equity shares of Rs. 10 each	1,200	1,400	600	Goodwill	--	100	--
Reserves	200	100	200	Net tangible Block	1,600	1,200	1,000
10 percent debentures	400	--	200	Current Assets	600	500	200
Trade and Expenses creditors	400	300	200				
Total	**2,200**	**1,800**	**1,200**	**Total**	**2,200**	**1,800**	**1,200**

	P Ltd.	Q Ltd.	R Ltd.
Revaluation of Tangible Block	2,000	1,000	2,400
Revaluation of current assets	700	280	160
Average Annual profit for three years before charging Debenture Interest	360	288	156

Solution :

a)

i.

a. If the holding is for small lot:

80% of the profits distributed would result in

Particulars	*Aikya Ltd*	*Bakya Ltd*
Profit after tax	3,00,000	3,00,000
Preference dividend	60,000	40,000
Equity earnings	2,40,000	2,60,000
Payout	80%	80%
Dividend	1,92,000	2,08,000
Equity Capital	8,00,000	10,00,000
Dividend rate	24%	20.8%

V / Share = [Co's Rate / Market rate] x Paid up value

Aikya = [24 / 18] x 10 = Rs.13.33

Bakya = [20.8 / 18] x 10 = Rs.11.56

b. If the payment is to be made for controlling interest, then ROE shall be the basis on which valuation is to be attempted.

Company	*PAT*	*Preference dividend*	*Earnings*	*ROE On Capital*		*V/Share*
Aikya	3,00,000	60,000	2,40,000	30.00% $\frac{2,40,000}{8,00,000} \times 100$	[30 / 18 x 10]	16.67
Bakya	3,00,000	40,000	2,60,000	26.00% $\frac{2,60,000}{10,00,000} \times 100$	[26 / 18 x 10]	14.44

Alternatively

	Market value		No. of Shares	V/Share
Aikya	2,40,000 / 18%	= 13,33,333	80,000	16.67
Bakya	2,60,000 / 18%	= 14,44,444	1,00,000	14.44

In whichever company the investment is made, 10% dividend is provided. What appears as no significance in the question, if one could read deeply, it is a very much a valid question.

ii. Preference dividend coverage ratio.

Co	PAT	Preference Dividend	Coverage ratio	Rank
Aikya	3,00,000	60,000	5	2
Bakya	3,00,000	40,000	7.5	1

Since the coverage ratio is better in case of Company Bakya, it is better to invest in company Bakya.

It can be interpreted that Company Bakya need to earn only Rs.40,000 to payoff preference dividend whereas Company Aikya should earn Rs.60,000. Chances of earning Rs.40,000 are better than earning Rs.60,000.

b)

Step 1: Actual Capital Employed

(Rs. in 000s)

	X	Y	Z
Tangible Block	2,000	1,000	1,200
Current Assets	700	280	160
Debentures	(400)	-	(200)
Creditors	(400)	(300)	(200)
Net Block	**1,900**	**980**	**960**

Step 2: Actual Profit

	X	Y	Z
Average Profit	360	288	156
Debenture Interest	(40)	-	(20)
Profit After Interest	320	288	136
Additional / Ex. Depreciation	(40)	20	(20)
Revised Profit	**280**	**308**	**116**

Step 3: Expected Profit

	X	Y	Z
CE	**1,900**	**980**	**960**
ROCE @ 10%	**190**	**98**	**96**

Step 4: Super Profit

	X	Y	Z
Actual	280	308	116
Expected	190	98	96
Super Profit	**90**	**210**	**20**

Step 5: Goodwill

	X	Y	Z
Super Profit	90	210	20
No. of years of purchases	4	4	4
Goodwill	**360**	**840**	**80**

Question No. 2

Agni Ltd. and Bayu Ltd. both engaged in similar merchanting activities since 2006, decide to amalgamate their business. A holding company, Chandrama Ltd. would be formed on 1st January, 2008 to acquire the entire shares in both the companies.

From the information given below you are required to prepare:

a. A statement of purchase consideration, supported by requisite working notes,

b. Balance Sheet of Chandrama Ltd. after the transactions has been completed.

i) The terms of the offer were:

- Rs. 100, 15 per cent debentures for every Rs. 100 of net assets owned by each company on 31st December, 2007.
- Rs.100 equity shares based on two years purchase of profit before taxation. The profit is to be determined by taking weighted average profits of 2006 and 2007, weights being 1 and 2 respectively.

ii) It was agreed that the accounts of Bayu Ltd for the two years ended 31st December 2007 be adjusted, where necessary, to conform to the accounting policies followed by Agni Ltd.

iii) The Pre-tax profits, including investment income, of the two companies were as follows:

	2006 Rs.	***2007 Rs.***
Agni Ltd.	16,38,000	18,36,000
Bayu Ltd.	17,88,300	25,74,000

iv) Agni Ltd. values its stock on FIFO basis while Bayu Ltd. used a different basis. To bring Bayu Ltd.'s values in line with those of Agni Ltd., value of its stock will require to be reduced by Rs. 36,000 at the end of 2006 and Rs. 1,02,000 at the end of 2007.

v) Both the companies use straight line method of depreciation.

vi) Bayu Ltd. deducts 1% from trade debtors as a general provision against doubtful debts.

vii) Prepaid expenses in Bayu Ltd., include advertisement expenditure carried forward of Rs. 1,80,000 in 2006 and Rs. 90,000 in 2007, being part of initial advertising in 2006, which is being written off over three years. Similar expenditure in Agni Ltd. has been fully written off in 2006.

viii) To bring Director's remuneration on to a comparative basis, the profits of Bayu Ltd. are to be reduced by Rs. 1,20,000 in 2006 and Rs.1,80,000 in 2007 and the net assets are also to be adjusted accordingly.

Balance Sheets as at 31st December, 2006 and 2007 were as follows:

Agni Ltd.

Liabilities	***2006 Rs.***	***2007 Rs.***	***Assets***	***2006 Rs.***	***2007 Rs.***
Share capital Issued and subscribed: 12,000 shares of Rs. 100 each fully paid	12,00,000	12,00,000	Fixed Assets: Furniture and fixtures: At cost	6,90,000	6,90,000
			Less: Depreciation	(69,000)	(1,38,000)
Reserves and Surplus: Capital Reserve	--	2,10,000	Investments: (Quoted investments at market value)	--	7,80,000
Revenue Reserve	7,98,300	16,74,000	Current assets:		
Current Liabilities and Provisions: Sundry Creditors	15,02,700	18,21,000	Stock at cost	18,30,000	21,75,000
Provision for taxation	8,40,000	9,60,000	Sundry Debtors	18,00,000	22,20,000
			Prepaid expenses	30,000	42,000
			Cash at Bank	60,000	96,000
	43,41,000	**58,65,000**		**43,41,000**	**58,65,000**

Bayu Ltd.

Liabilities	***2006 Rs.***	***2007 Rs.***	***Assets***	***2006 Rs.***	***2007 Rs.***
Share capital: Issued and subscribed 15,000 equity shares of Rs. 100 each fully paid	15,00,000	15,00,000	Fixed Assets: Furniture and fixtures: At cost	9,60,000	9,60,000
			Less: Depreciation	(1,44,000)	(2,88,000)
Reserves and Surplus: Revenue Reserve	8,58,000	21,42,000	Investments: (Quoted investments (market value Rs. 14,70,000))	--	12,00,000

Current Liabilities and Provisions:			Current assets: Stock at cost	17,91,000	22,26,000
Sundry Creditors	14,70,000	14,82,000	Sundry Debtors Less Provision	17,82,000	26,73,000
Bank overdraft	--	5,10,000	Prepaid expenses	2,16,000	1,44,000
Provision for taxation	9,30,000	12,90,000	Cash at Bank	1,53,000	9,000
	47,58,000	**69,24,000**		**47,58,000**	**69,24,000**

Solution :

Statement of Adjusted net profits of Bayu Ltd.

	2006		2007	
	Plus	**Minus**	**Plus**	**Minus**
Reported Net profit	-	17,88,300	-	25,74,000
Reduction in Stock in trade	36,000	-	1,02,000	36,000
Sundry Debtors	-	18,000	-	27,000
Advertising	1,80,000	-	-	90,000
Director's Remuneration	1,20,000	-	1,80,000	-
Depreciation	-	48,000	-	48,000
Appreciation in Investments	-	-	-	2,70,000
	3,36,000	**18,54,300**	**2,82,000**	**30,45,000**
Adjusted	-	15,18,300	-	27,63,000

(a)

Issue of Equity Shares equal to two year's purchase of average profits:

Year	*Rs.*	*Agni Ltd.*		*Bayu Ltd.*		
		Weight	**Rs.**	**Rs.**	**Weight**	**Rs.**
2006	16,38,000	1	16,38,000	15,18,300	1	15,18,300
2007	18,36,000	2	36,72,000	27,63,000	2	55,26,000
			53,10,000			**70,44,300**

	Agni Ltd.	*Bayu Ltd.*	*Chandrama Ltd.*
Average Profits	17,70,000	23,48,100	
Two years purchase	35,40,000	46,96,200	82,36,200
Net Assets as Adjusted (12,00,000+2,10,000+ 16,74,000)	30,84,000	35,43,000	66,27,000
Total Purchase Consideration	66,24,000	82,39,200	1,48,63,200

Working Notes :

(i) Shares will be issued for goodwill and 15% debentures for net assets.

(ii) Adjustment to net assets of Bayu Ltd.

	Rs.	*Rs.*
Furniture and Fixtures	9,60,000	
Less: Depreciation @ 10% for 2 years	1,92,000	7,68,000
Quoted investments		14,70,000
Stock (22,26,000 – 1,02,000)		21,24,000

Debtors (26,73,000 + 27000)		27,00,000
Prepaid exp. (1,44,000 – 90,000)		54,000
Cash at Bank		9,000
		71,25,000
Less: Current Liabilities	32,82,000	
Liability for directors' remuneration	3,00,000	35,82,000
		35,43,000

(b) Balance Sheet of Chandrama Ltd. as on …..

Liabilities	***Rs.***	***Assets***	***Rs.***
Share Capital		Investments at cost	
Issued & Subscribed:	82,36,200	Shares in A Ltd.	66,24,000
82,362 shares of Rs. 100 each fully paid (Issued for consideration other than cash)		Shares in B Ltd.	82,39,200
Secured loans			
66,270 Debentures of Rs. 100 each fully paid	66,27,000		
	1,48,63,200		**1,48,63,200**

Question No. 3

(a) Parikshit Ltd. holds Rs. 1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs. 1,10,000.

The company securitise the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs. 1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs. 3,500. The remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs. 6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

(b) The annuity fund of Patiala University accepts an annuity – based gift from an alumnus who specifies that he receives a monthly payment of Rs. 25,000 for the remainder of his life. The gift consists of cash of Rs. 20 lakh and securities having a market value of Rs. 15 lakh at the time of the gift. The investment income of annuity fund for a particular month comes to Rs. 38,500.

Draft journal entries in the University's books.

(c) From the following information taken from the books of Sunagarik Ltd. relating to staff and community benefits, you are required to prepare a statement classifying the various items under the appropriate heads, required under corporate social reporting:

Particulars	***Rs. in Lakhs***
Environmental improvements	36.18
Medical facilities	9.00
Training programmes	18.45
Generation of job opportunities	109.35
Municipal taxes	19.26
Increase in cost of living in the vicinity due to company's operations	29.79
Concessional transport, water-supply etc.	20.25
Generation of business	45.00
Leave encashment and leave travel benefits	93.60
Education facilities for children of staff members	38.88
Subsidised canteen facilities	25.92
Extra work put in by staff and officers for drought relief	33.30

Solution :

a) Fair Value of securitized component of the loan

	Rs.	***Rs.***
Fair Value of loan		1,10,000
Less: Fair value of servicing asset	3,500	
Fair value of interest strip	6,500	10,000
Fair value of securitized component of loan		**1,00,000**

Apportionment of carrying amount based on relative fair values

Particulars	***Fair Values***	***% age based on Total Fair Values***	***Carrying Amount/ Cost***
Securitized Component of loan	1,00,000	9,100	91,000
Servicing Asset	3,500	318	3,180
Interest Strip Receivable	6,500	592	5,920
	1,10,000	**10,000**	**1,00,000**

The profit arising on securitization should be computed as follows:

	Rs.
Net proceeds of securitization	1,00,000
Less: Cost(apportioned carrying amount)	91,000

of securitised component of loan	
Profit on securitization	**9,000**

Based on the above, the following journal entries would be passed in the books of originator:

1. To record securitization of principal plus right to 14% interest

Cash A/c	Dr.	1,00,000	
To Loans A/c (cost of securitised component)			91,000
To Profit on securitization			9,000

2. To record the creation of servicing asset and interest strip receivable.

Servicing asset A/c	Dr.	3,500	
Interest strip A/c	Dr.	6,500	
To Loans A/c			10,000

b)

(i)	**Receipt of annuity-based gift**			
	Bank A/c	Dr.	20,00,000	
	Investment A/c	Dr.	15,00,000	
	To Annuity Bank			35,00,000
	(Being the equity to record annuity-based gift)			
(ii)	**Monthly Investment Income**			
	Bank A/c	Dr.	38,500	
	To Annuity Payable A/c			25,000
	To Annuity Fund			13,500
	(Being the receipt of monthly income. Surplus transferred to fund)			
(iii)	**Monthly Annuity Payment**			
	Annuity Payable A/c	Dr.	25,000	
	To Bank A/c			25,000
	(Being the entry for monthly annuity payment)			

c)

F Ltd. Statement relating to Staff and Community Benefits

I. Social Benefits and Cost to Staff

A	***Social Benefit to Staff***	***Rs. in lakhs***
1	Medical facilities	9
2	Training Programmes	18.45

3	Concessional transport, water supply	20.25
4	Leave encashment and leave travel benefits	93.60
5	Educational facilities for children of staff members	38.88
6	Subsidised canteen facilities	25.92
	Total	**206.10**

B	***Social Cost of Staff***	***Rs. in lakhs***
1	Extra work put in by staff and officers for drought relief	33.30
2	Net social benefits to staff (A-B)	172.80

II. Social Benefits and Cost to Community

A	***Social Benefit to Staff***	***Rs. in lakhs***
1	Environmental Improvements	36.18
2	Generation of Job Opportunities	109.35
3	Municipal Taxes	19.26
4	Generation of business	45.00
	Total	**209.79**

B	***Social Cost to Community***	***Rs. in lakhs***
1	Increase in cost of living in the vicinity due to a thermal power station	29.79
2	Net social benefits to staff (A-B)	180.00

Question No. 4

(a) The borrowings profile of Santra Pharmaceuticals Ltd. set up for the manufacture of antibiotics at Navi Mumbai is as under:

Date	***Nature of borrowings***	***Amount borrowed***	***Purpose of borrowings***	***Incidental expenses***
1st January, 2008	15% demand loan	60 lakhs	Acquisition of fixed assets	8.33%
1st July, 2008	14.5% Term loan	40 lakhs	Acquisition of Plant & Machinery	5%
1st October, 2008	14% bonds	50 lakhs	Acquisition of Fixed assets	8%

The incidental expenses consist of commission and service charges for arranging the loans and are paid after rounding off to the nearest lakh.

Fixed assets considered as qualifying assets are as under:

	Rs.
Sterile Manufacturing shed	10,00,000
Plant and Machinery (Total)	90,00,000

Other fixed assets	10,00,000

The Project is completed on 1st January, 2009 and is ready for commercial production. Show the capitalization of the borrowing costs.

(b) A company is engaged in the business of ship building and ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and the amount. Customer scrutinizes the invoice and any variation is informed to the company. Negotiations take place between the company and the customer. The negotiations may result in a deduction being allowed from the invoiced amount either as a lump sum or as a percentage of the invoiced-amount. The accounting treatment followed by the company is as follows:

(i) When the invoice is raised, the customer's account is debited and ship repair income account is credited with the invoice amount.

(ii) Deduction, if any, arrived after negotiation is treated as trade discount by debiting the ship repair Income account.

(iii) At the close of the year, negotiation in respect of certain invoices had not been completed. In such cases, based on past experience, a provision for anticipated loss is created by debiting the Profit and Loss account. The provision is disclosed in Balance Sheet.

Following two aspects are settled in the negotiations:

(i) Errors in billing arising on account of variation between the quantities as per work completion certificate and invoice and other clerical errors in preparing the invoice.

(ii) Disagreement between the company and customer about the rate/cost on which prior agreement has not been reached between them.

Comment:

(i) Whether the accounting treatment of deduction as trade discount is correct? If not, state the correct accounting treatment.

(ii) Whether the disclosure of the provision for anticipated loss in Balance Sheet is correct; if not, state the correct accounting treatment.

Solution :

a)

Incidental Expenses

(Rs. in lacs)

Date	***Loan/Borrowings***		***Rate***	***Incidental Exp (Rounded off)***	
	Specific	**General**		**Specific**	**General**
1.1	-	60	8.33%	-	5
1.7	40	-	5%	2	-

1.10	-	50	8%	-	4
	40	**110**		**2**	**9**

Application of incidental expenses to Individual Qualifying Assets

	Total Cost	***Specific Loan***	***General Loan***	***Specific Loan***	***General Loan***	***Total***
Shed	10	-	10	-	$\frac{9}{110}x10 = 81{,}818$	81,818
Plant & Machinery	90	40	50	2,00,000	$\frac{9}{110}x50 = 4{,}09{,}091$	6,09,091
Other fixed assets	10	-	10	-	$\frac{9}{110}x10 = 48{,}1{,}818$	81,818
	110	**40**	**70**	**2,00,000**	**5,72,727**	**7,72,727**

Balance Incidental expenses should be transferred to Profit and Loss A/c - 3,27,273
[11,00,000 – 7,72,727]

Date	**Total Borrowing**	**Specific Borrowing**	**General Borrowing**	**Period of Interest computation**	**Effective borrowing (on time utilized basis converted to on annualized basis)**		**Total borrowing Cost**		**Specific borrowing (related cost to be capitalized)**	**General borrowing (to be used for capitalization rate)**
					Specific	General	%	Rs.		
1.1	60	-	60	12/12	-	60.0	15.0	9.00	-	9.00
1.7	40	40	-	6/12	20	-	14.5	2.90	2.90	-
1.10	50	-	50	3/12	-	12.5	14.0	1.75	-	1.75
	150	40	110		20	72.5		13.65	2.90	10.75

Capitalization rate (for general borrowing) = $\frac{10.75}{72.5}x100 = 14.83\%$

Application of borrowing cost (excluding Incidental Expenses) to Individual Qualifying Assets

Item	***Total Cost***	***Specific***	***General***	***Borrowing Cost***		***Total***
				Specific	**General Borrowing**	
Shed	10	-	10	-	$\frac{72.50}{110}x10x14.83$ = 0.98	0.98
Plant & Machinery	90	40	50	2.90	$\frac{72.5}{110}x50x14.83$ = 4.89	7.79
Other fixed Assets	10	-	10	-	$\frac{72.5}{110}x10x14.83$ = 0.98	0.98
	110	**40**	**70**	**2.90**	**6.85**	**9.75**

Balance borrowing cost to be transferred to Profit and Loss A /c 3.90 [10.75 – 6.85]

Items	Capital cost		Interest cost		Incidental Charges		Total
	Specific	General	Specific	General	Specific	General	
Shed	-	10	-	0.98	-	0.81	1.79
Plant & Machinery	40	50	2.90	4.89	2	4.09	13.88
Other fixed	-	10	-	0.98	-	0.81	1.79
							17.46

Assumptions:

- It is assumed that qualifying assets are built out of borrowed funds either out of specific borrowings or out of general borrowings. There is no equity participation.
- Capital expenditure is assumed to be incurred as and when loans are availed.
- Since the date of expenditure is not clearly stated, the ratio of effective borrowings [72.5] to the total borrowings [110] is taken as the base for applying capitalisation rate.

b)

(i) Trade discount means a deduction given on the sales amount for reasons other than prompt payment. The rate and amount of discount is known at the time of raising invoice. i.e. the amount of trade discount can be quantified. Normally trade discount is adjusted at the rate of billing itself for greater quantities off taken. There is no special journal entry passed for trade discount as the revenue recognized only for the net amount at the time of invoicing.

Here, the deduction given is not known at the time of raising invoice, although it may be a lumpsum or a percentage of invoiced amount. i.e. the amount of deduction cannot be quantified at the time of raising invoice.

Hence the deduction allowed on negotiation on the price cannot be treated as Trade Discount. It may be recorded like sales returns.

The deduction arising out of errors in billing and other clerical errors can however be deducted from the income already recorded.

(ii) According to AS 9 Revenue recognition, when the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

Since the deduction in invoiced amount is certain to occur, but the amount of deduction cannot be quantified with certainty it is appropriate to create a provision at the year end which may be based on past experience.

Therefore the accounting treatment of the company is correct.

Question No. 5

(a) Santhosh Ltd. granted 500 options to each of its 2,500 employees in 2003 at an exercise price of Rs. 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 Rs. 15. Actual forfeitures in 2003 were 5 per cent. However at the end of 2003 the management of Santhosh Ltd. still expects that the actual forfeitures would average only 3 per cent over the entire vesting period. During 2004 the management revises its estimated forfeiture rate to 10 per cent per annum. Of the 2,500 employees 1,900 employees have completed the 3 year vesting period. 1,000 employees exercise their right to obtain shares vested in them in pursuance of ESOP at the end of 2007 and 500 employees exercises their right at the end of 2008.The rights of the remaining employees expire unexercised at the end of 2008. The face value per share is Rs. 10. Show the necessary journal entries with suitable narrations. Workings should form part of the answer.

(b) On 1st February, 2008, an Indian Company sold goods to an American Company at an invoice price of US, $ 20,000 when the spot market rate was Rs. 48.10 to a U.S. dollar. Payment was to be made in three months time, namely, by 1st May, 2008.

To avoid the risk of foreign exchange fluctuations the Indian exporter acquired a forward contract to sell U.S. $ 20,000 at Rs. 47.90 per U.S. dollar on 1st May, 2008.

The Indian company's accounting year ended on 31st March, 2008 and the spot rate on this date was Rs. 47.20. per U.S. dollar. The· spot rate on 1st May, 2008, the date by which the money was due from the American buyer, was Rs. 50 per dollar.

Show what accounting entries will have to be made in the books of the Indian exporter at the relevant period of time.

Solution :

a)

Year 1

No. of Options Expected to Vest (500x2,500x(97%)^3)	11,40,841
Fair Value of Options Expected to vest (11,40,841x15)	171,12,615

Employees Compensation Expenses	Dr.	57,04,205	
To Stock Options Outstanding			57,04,205
(Being Compensation Expenses recognised in respect of the ESOP)			

Year 2

Revised No. of Options Expected to Vest (500 x 2,500 x (90%)^3)	9,11,250

Revised Fair Value of Options Expected to vest (9,11,250 x 15)	1,36,68,750
Revised Cumulative Expenses at the end of Year 2 (1,36,68,750 x 2/3)	91,12,500
Less: Expenses already recognised in year 1	57,04,205
Expenses to be recognised in year 2	34,08,295

Employees Compensation Expenses	Dr.	34,08,295	
To Stock Options Outstanding			34,08,295
(Being Compensation Expenses recognised in respect of the ESOP)			

Year 3

No. of Options actually Vested (1,900x500)	9,50,000
Fair Value of Options actually Vested (9,50,000x15)	1,42,50,000
Less: Expenses already recognised	91,12,500
Excess Expenses recognised	51,37,500

Employees Compensation Expense	Dr.	51,37,500	
To Stock Option Outstanding			51,37,500
(Being Compensation Expenses recognised in respect of the ESOP)			

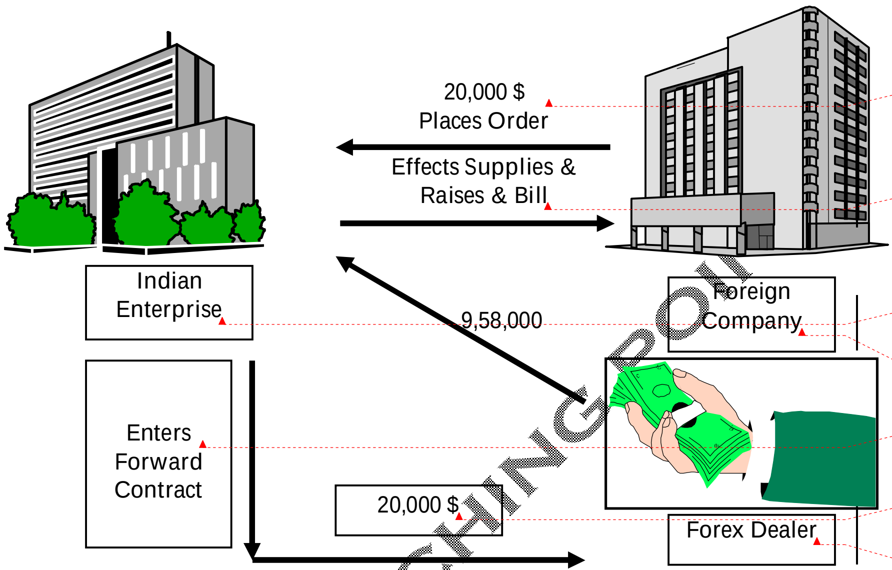
Amount to be recorded in the Share Capital A/c and the Securities Premium A/c upon the issuance of shares

Particulars	**Exercise date Year end 5**	**Exercise date Year end 6**
No. of Employees Exercising the option	1,000	500
No. of Shares issued @ 500 per employee	5,00,000	2,50,000
Exercise Price Received @ Rs.50 per share	2,50,00,000	1,25,00,000
Amount recognised in the Stock Options Outstanding A/c (Rs.15 per share)	75,00,000	37,50,000
Total Consideration	3,25,00,000	1,62,50,000
Amount to be recorded in Share Capital A/c (Rs.10 per share)	50,00,000	25,00,000
Amount to be recorded in Securities Premium A/c (Rs.55 per share)	2,75,00,000	1,37,50,000
Total	3,25,00,000	1,62,50,000

Year 5			
Bank A/c	Dr.	2,50,00,000	
Stock Options Outstanding	Dr.	75,00,000	
To Share Capital A/c			50,00,000
To Securities Premium A/c			275,00,000
(Being shares issued to the employees against the options vested in them in pursuance of the ESOP)			
Year 6			
Bank A/c	Dr.	1,25,00,000	
Stock Options Outstanding	Dr.	37,50,000	
To Share Capital A/c			25,00,000
To Securities Premium A/c			1,37,50,000
(Being shares issued to the employees against the options vested in them in pursuance of the ESOP)			
Stock Options Outstanding [(1,900 – 1,500) x 500 x 15]	Dr.	30,00,000	
To General Reserve			30,00,000
(Being the balance standing to the credit of the Stock Options Outstanding A/c in respect of vested options expired unexercised transferred to the general reserve)			

Note: Since the market price is not given, the problem is dealt in fair value method

b)



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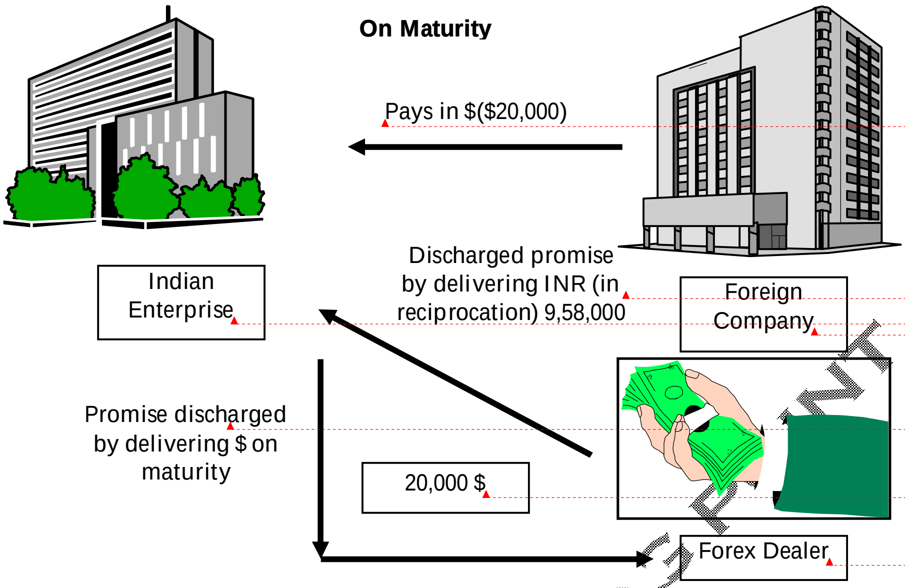

Journal Entries :

01-02-2008	Foreign Customer A / c	Dr.	9,62,000	
	To Sales A / c			9,62,000
01-02-2008	FWD Contract Receivable A / c	Dr.	9,58,000	
	Discount A / c	Dr.	4,000	
	To Foreign Currency payable A / c			9,62,000
31-03-2008	Ex-Loss A / c	Dr.	18,000	
	To Foreign Customer A / c			18,000
	20,000 x (48.10 – 47.20)			
31-03-2007	Foreign Currency Payable A / c	Dr.	18,000	
	To Ex - Gain A / c			18,000
31-03-2007	P & L A / c	Dr.	2,667	
	To Discount A / c			2,667
31-03-2007	P & L A / c	Dr.	18,000	
	To Ex-Loss A / c			18,000
31-03-2007	Ex-Gain A / c	Dr.	18,000	
	To P & L A / c			18,000
01-05-2008	Cash A / c	Dr.	10,00,000	

	To For Customer A / c			9,44,000
	To Ex Gain			56,000
01-05-2008	Foreign Currency Payable A / c	Dr.	9,44,000	
	Ex-Loss A / c	Dr.	56,000	
	To Cash A / c			10,00,000
01-05-2008	Cash A / c	Dr.	9,58,000	
	To Fwd Contract Receivable A / c			9,58,000
01-05-2008	P & L A / c	Dr.	1,333	
	To Discount A / c			1,333
01-05-2008	P & L A / c	Dr.	56,000	
	To Ex-Loss A / c			56,000
01-05-2008	Ex-Gain	Dr.	56,000	
	To P & L A / c			56,000

Question No. 6

(a) Pilot Ltd. supplies the following information using which you are required to calculate the economic value added.

Financial Leverage			1-4 times
Capital (equity and debt)	Equity shares of Rs. 1,000	34,000	
	Accumulated profit (Lakhs Rs.)	260	
	10% Debentures of Rs. 10 each	80 lakhs nos.	
Dividend expectation of equity shareholders			17.50%
Prevailing Corporate tax rate			30%

(b) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on "mark to market basis". For the financial year ended March, 2009 the investments which were acquired at a cost of Rs. 109 crores were reflected in the Balance Sheet at Rs. 89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.

(c) Good Drugs and Pharmaceuticals Ltd. acquired at sachet filling machine on 1st April, 2007 for Rs. 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs. 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs. 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs. 54 crores per annum and has a carrying amount of Rs. 3.46 crore. All such machines put together could fetch a sum of Rs. 4.44 crore if disposed. Discuss the applicability of Impairment loss.

(d) EXOS Ltd., is in the process of finalizing its accounts for the year ended 31st March, 2008. The company seeks your advice on the following:

i. The Company's sales tax assessment for assessment year 2005-06 has been completed on 14th February, 2008 with a demand of Rs. 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 ground of appeal cover tax on addition made in the assessment order for a sum of 2.10 crore.

ii. The company has entered into a wage agreement in May, 2008 whereby the labour union has accepted a revision in wage from June, 2007. The agreement provided that the hike till May 2008 will not be paid to the employees but settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2008.

Solution :

a)

I. Capital

Equity	***Rs.***	***Proportion (in %)***
Equity Share Capital 34,000 x 1,000	3,40,00,000	
Profit and Loss A/c Given	2,60,00,000	
	6,00,00,000	42.86%
Debt @ 10%	8,00,00,000	57.14%
	14,00,00,000	100%

II. Financial leverage $\frac{PBIT}{PBT} = 1.4$; Interest is 10% on 8,00,00,000 =Rs.80,00,000

	Ratio	***Ratio***	***Rs.***	***Rs.***
PBIT	1.4		?	280
1	?	0.4	80L	
PBT	1		?	200 [80L / 0.4]

Net operating profit after tax 280 x 70% = 196

III. IRR is $\frac{196}{1400} \times 100 = 14\%$

IV. Cost of Capital 42.86%x 17.5 + 57.14% x 10 x 70% = 11.5%

V. Economic value added
= (IRR $-K_o$) x Capital employed
= (14% - 11.5%) x 14,00,00,000 = 35,00,000

b) The Guidance note on Accounting for investments in the financial statements of Mutual Funds (GN (A) 13) provides that the investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. Clause 2(i) of the eleventh schedule provides that where the financial statements are prepared on a mark to market basis there need not be a separate provision for depreciation. However, keeping in view prudence as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments the guidance note recommends that the gross value of depreciation on investments should be reflected in the Revenue Account.

Hence depreciation should be separately disclosed in the financial statements although accounting policy for valuation of investments is disclosed.

c) The asset in question taken for the test of impairment is not generating cash inflows; hence it cannot be taken for the test of impairment independently. The next level of asset to which this asset is associated is referred to as cash generating unit. The carrying amount of the CGU (including the cost of the asset in question) is greater than the Recoverable amount of the CGU. There is no impairment loss of the asset.

d)

(i) Time since the demand for additional tax was levied before it is paid during the current year; it is presumed that the company had disclosed this issue as contingent liability indicating the amount.

As the sum is paid during the current year, no contingent liability exists on the balance sheet date. However the company did not lose the right of recovery of tax paid under protest by filing appeal before Appellate Authority, it gains the characteristic feature of contingent gain. It can be accounted as income only in the event of virtual certainty of recovery is present. As virtual certainty is not present as of now, the item paid shall be shown as expenditure of the current year.

A note to the effect of the case history and the present position etc shall be disclosed.

(ii) It is a clear case of no condition existed on the balance sheet date. The decision to revise the wage rate took place only by May 2008. The appropriate treatment is not to adjust but to disclose.

However AS 4, also states that certain events though non-adjusting, can be reflected in the financial statements because of statutory requirements or because of their special nature.

As per the prudence concept, all the anticipated losses should be provided for. Considering its special nature and in conformity with prudence concept, the expected revision in the wages attributable to 07-08 may be reflected by a way of provision instead of simply disclosing. (Ref para 8.5 and 14).