FINANCIAL REPORTING - NEW SYLLABUS
SUGGESTED ANSWERS - JUNE 2009

Question No. 1

(a) From the following details of an asset

i. Find out impairment loss

ii. Treatment of impairment loss

iii. Current year depreciation

Particulars of asset:	
Cost of asset	Rs.56 lakhs
Life period useful	10 years
Salvage value	Nil
Current carrying value	Rs.27.30 lakhs
Life remaining useful	3 years
Recoverable amount	Rs.12 lakhs
Upward revaluation done in last year	Rs.14 lakhs

(b) Rainbow Limited borrowed an amount of Rs.150 crores on 01-04-2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalised Rs.19.50 crores for the accounting period ending on 31-03-2009. Due to surplus fund out of Rs.150 crores, an income of Rs.3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(c) Suraj Limited wishes to obtain a machine costing Rs.30 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd. for a lease rental for Rs.3 lakhs p.a. payable in arrears and that implicit rate of interest is

15%. The chief accountant of Suraj Limited is not sure about the treatment of these lease rentals and seeks your advice.

(d) Omega Limited is working on different projects those are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statement during 2006, 2007 and 2008 for Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of Rs.7,00,000, Rs.18,00,000 and Rs.23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

(e) While preparing its final accounts for the year ended 31st March, 2009, a company made a provision for bad debts @ 5% of its total debtors. In the last week of February 2009, a debtor for 2 lakhs had suffered heavy loss due to an earthquake. The loss was not covered by any insurance policy. In April, 2009, the debtor became bankrupt. Can the company provide for full loss arising out of insolvency of debtor in the final accounts for year ended 31st March, 2009?

Solution :

(a)

(i)

Carrying amount (CA)	27.30 lakhs
Revaluation Reserve	14.00 lakhs
Recoverable amount (RA)	12.00 lakhs
Impairment Loss (CA – RA)	15.30 lakhs

(ii) **Treatment of Impairment Loss**

(Rs. in lakhs)

Revaluation Reserves	Dr.		14.00
Profit & Loss A/c	Dr.		1.30
To Impairment Loss		15.30	

(iii)

New Carrying amount (27.30 – 15.30)	12 Lakhs
Remaining years of life	3 Years
Depreciation for the Current Year	4 Lakhs

(b) When the actual borrowing cost is only 11% capitalizing at 13% the WACC is not correct.

Capitalize the net borrowing cost after adjusting income from investments made out of surplus funds.

Amount of borrowing cost	=	16.5 Lakhs
Income from Investing	=	3.5 Lakhs
Net amount to be capitalized	=	13.0 Lakhs

(c) It is a clear case of operating lease as

i) The lease term is only 5 years against the economic life of 14 years and

ii) The Present Value of MLP is only 10.06 lakhs [3.3522 (AF @ 15% p.a. for 5 years) x 3 Lakhs] against the fair value of Rs. 30 Lakhs

Moreover there is no automatic transfer of ownership to lessee at the end of lease term. The lessee is not making any alteration in the machine so as to render unusable by anybody without major modifications in the machine and the end of lease term.

(d)

(Rs. in Lakhs)

Year	*Revenue*	*Recognition*	*TD*	*Type*	*Deferred Liability*	*Tax*
2006	11	7	4	Originating	1.4	1.4
2007	16	18	(2)	Reversing	(0.7)	0.7
2008	21	23	(2)	Reviewing	(0.7)	Nil
	48	48				

(e)

- There was a condition on the balance sheet as on 31-3-2009
- The condition in the balance sheet is the doubtfulness of recovery of the debt.
- Doubt arose on account of accidental loss (Heavy) reported by the customer.
- Heavy loss occurred on account of earth quake suffered by the customer.
- Insolvency is the event occurred after Balance Sheet Date.
- Insolvency is the adjusting event having bearing as the financial position of the company on the recoverability of the debits as on 31-03-2009
- The company shall write off instead of providing for the loss.

Question No. 2

The Balance Sheet of Munna Ltd. as on 31st March, 2009 is as follows:

Liabilities	*Rs.*	*Assets*	*Rs.*
Authorised and issued Share Capital		Goodwill	2,00,000
20,000 equity shares of Rs.100 each, fully paid	20,00,000	Plant & Machinery	18,00,000
		Stock	3,00,000
10,000, 7% Preference shares of Rs.100 each	10,00,000	Debtors	7,50,000
		Cash	1,50,000
Sundry Creditors	7,00,000	Preliminary expenses	1,00,000
Bank overdraft	3,00,000	Profit and Loss A/c	7,00,000
	40,00,000		**40,00,000**

Additional information:

Two years preference share dividends are in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend, provided the capital base is reduced.

An internal reconstruction scheme was agreed to by all concerned, those are as follows:

1. Creditors agreed to forego 50% of their claim.
2. Preference shareholders withdrew arrear dividend claim. They also agreed to lower down their capital claim by 20% by reducing nominal value in

consideration of 9% dividend effective after reconstruction, in case equity shareholder's loss exceeded 50% on the application of the scheme.

3. Bank has agreed to convert overdraft into term loan to the extent required for making current ratio to 2 : 1.
4. Revalued amount for plant and machinery was accepted as Rs.15,00,000.
5. Debtors to the extent of Rs.4,00,000 were considered as good.
6. Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reconstruction.

You are required to show the following:

1) Total loss to be borne by the equity and preference shareholders for the reconstruction.
2) Share of loss to the individual class of shareholders.
3) New structure of share capital after reconstruction.
4) Working capital of the reconstructed company, and
5) A proforma Balance Sheet after reconstruction.

Solution :

1. Since arrears of Preference Dividend are not given accounting status, waiver of claim towards Preference Dividend will not be recorded in the books under internal reconstruction.
2. Loss to be borne by Equity Shareholders

Profit and Loss account	7,00,000
Preliminary expenses	1,00,000
Goodwill	2,00,000
Plant and Machinery	3,00,000

Debtors	3,50,000
Creditors	(3,50,000)
	13,00,000
Equity Share Capital	20,00,000
% of Loss to Capital	65%

Since the loss is exceeding 50% Preference Shareholders would participate in the reconstruction programme.

Preference Shareholders sacrifice	2,00,000 (20% x 10 Lakhs)
Balance borne by Equity Shareholders	11,00,000

				Reduced value
Share of loss to Equity Shareholders	11,00,000	Per share	55	45
Share of loss to Preference Shareholders	2,00,000	Per share	20	80

	Nos.	***Paid up***	***Amount***
New structure of ESC	20,000	45	9,00,000
New structure of PSC	10,000	80	8,00,000

Current Assets	
Stock	3,00,000
Debtors	4,00,000
Cash	1,50,000
	8,50,000

Current Ratio	2:1
Current Liabilities	4,25,000
Creditors	3,50,000
BOD	75,000
Existing BOD	3,00,000
Term Loan	2,25,000
WC	4,25,000

Question No. 3

From the following details, prepare a consolidated Balance Sheet of Sun Limited and its subsidiaries as on 31st March, 2009:

(Rs. in lakhs)

Assets	***Sun Ltd.***	***Moon Ltd.***	***Star Ltd.***
Fixed assets (net)	816	312	126
Investment (at cost)			
7,50,000, equity shares of Moon Ltd.	75	--	--
2,40,000, equity shares of Star Ltd.	24	--	--
4,80,000 equity shares of Star Ltd.	--	60	--
30,000, cumulative preference shares of Sun Ltd.	--	--	30
4,500, mortgage debenture of Sun Ltd.	--	--	42
Current assets	1,059	369	336
Profit and Loss Account	288	108	63
	2,262	**849**	**597**
Liabilities			
Equity Share capital (Rs.10 each fully paid up)	180	144	120
7 ½ % cumulative preference share capital (Rs.100 each fully paid up)	45	36	30

Capital reserve (revaluation of fixed assets)	360	--	--
General reserve	75	45	30
7,500, 8% mortgage debenture bonds of Rs.1,000 each	75	--	--
Secured loans and advances:			
From banks	513	249	165
Unsecured loans:			
From Moon Ltd.	--	--	36
From Star Ltd.	45	--	--
Current Liabilities and provisions:			
Inter-company balances	27	--	--
Other liabilities	942	375	216
	2,262	**849**	**597**

Other information are as follows:

1. Moon Ltd. Subscribed for 2,40,000 shares of Star Ltd. at par at the time of first issue and further acquired 2,40,000 shares from the market at Rs.15 each, when the Reserve and Surplus account of Star Ltd. stood at Rs.15 lakhs.
2. Sun Ltd. subscribed for shares of Moon Ltd. and Star Ltd. at par at the time of first issue of shares by both the companies.
3. Current assets of Moon Ltd. and Star Ltd. includes Rs.12 lakhs and Rs.18 lakhs respectively being Current account balance against Sun Ltd.

Solution :

Step 1: Cut Off

	Sun in Moon	*Sun in Star*	*Moon in Star*

Date of acquisition	Since incorporation	2nd acquisition	2nd acquisition
% of Holding	7,50,000 / 14,40,000	2,40,000 / 12,00,000	4,80,000 / 12,00,000
	52.083%	20%	40%
		60%	
Minority Interest	47.917%	40%	

Step 2: Classification

Reserves & Surplus of Star Ltd.

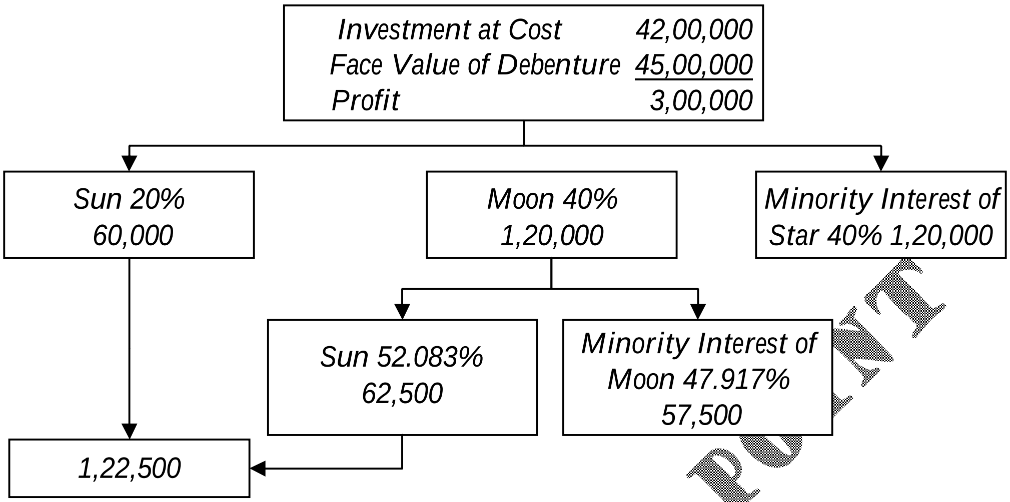
General Reserve 30,00,000
Profit and Loss Account (63,00,000)
(33,00,000)

Date of Acquisition 15,00,000 → *Capital*

After Acquisition (48,00,000) → *Revenue*

Reserves & Surplus of Moon Ltd.

All Reserves & Surplus are revenue as the acquisition was made since inception



Profit on Cancellation of Debentures

Step 3:

Chart A: Classification of reserves and Minority Interest

	Sun 20%		Minority Interest	
	Moon 52.083%	*Star* 40%	*Moon* 47.917%	*Star* 40%
(i) Capital Profit	Nil	15,00,000		
Less: Minority Interest	-	6,00,000		6,00,000
	Nil	9,00,000		
(ii) **Revenue Reserves & Surplus**				
Since acquisition [45,00,000 + (108,00,000)]	(63,00,000)	(48,00,000)		

	Less / Add : Transfer 40% Indirect Method	19,20,000	19,20,000		
		(82,20,000)	(28,80,000)		
	Less: Minority Interest	39,38,760	19,20,000	(39,38,760)	(19,20,000)
		(42,81,240)	**(9,60,000)**		
(iii)	**Equity Share Capital**	1,44,00,000	1,20,00,000		
	Less: Minority Interest	69,00,000	48,00,000	69,00,000	48,00,000
		75,00,000	72,00,000		
				29,61,240	**34,80,000**
	Add: Share of profit on cancellation of Debentures			57,500	1,20,000
	Minority Interest			**30,18,740**	**36,00,000**

Chart B : Goodwill / Capital Reserve

Investment by Sun in Moon	75,00,000		
Investment by Sun in Star	24,00,000	99,00,000	
Investment by Moon in Star	60,00,000		
Investment by Star in Moon (PSC)	30,00,000	90,00,000	1,89,00,000
Less:			
Nominal Value in Moon (ESC)	75,00,000		
Nominal Value in Star (ESC)	72,00,000		
Nominal Value in Sun (PSC)	30,00,000	1,77,00,000	
Capital Profit in Star Ltd.		9,00,000	1,86,00,000
Goodwill			**3,00,000**

Chart C : Consolidated Profit and Loss Account and General Reserve

General Reserve of Sun	75,00,000	
Profit & Loss Account	(2,88,00,000)	(2,13,00,000)
Add: Share of Loss from Moon	(42,81,240)	
" " Star	(9,60,000)	(52,41,240)
		(2,65,41,240)
Less: Profit on Cancellation of Debentures		1,22,500
Balance to appear in Consolidated Balance Sheet		**(2,64,18,740)**

Consolidated Balance sheet of Sun Ltd. and its Subsidiaries

Liabilities		***Amount***	***Assets***		***Amount***
Equity Share		1,80,00,000	Goodwill		3,00,000
Capital			(Chart B)		
7 ½	45,00,000		Fixed		
Cumulative			Assets:	8,16,00,000	
Preference			Sun	3,12,00,000	
Share Capital			Moon		
Less:	30,00,000	15,00,000	Star	1,26,00,000	12,54,00,000
Investment					
Minority			Receivable		
Interest: (Chart			in Transit		3,00,000
A)					
Moon	30,18,740		Current Assets:		
Star	36,00,000	66,18,740	Sun	10,59,00,000	
Minority			Moon	3,69,00,000	
Interest:			Star	3,36,00,000	
Moon –	36,00,000			17,64,00,000	
Preference					
Share					
Capital			Less:		
Star -			Mutual		
Preference	30,00,000	66,00,000	Owings -		
Share					
Capital			Unsecured		
Capital		3,60,00,000	loan	81,00,000	
Reserve					

Mortgage Bonds (75-45)	30,00,000	Company Owings	30,00,000	16,53,00,000
Unsecured Loan (459+213+156)	8,28,00,000	Profit & Loss A/c		2,64,18,740
Debentures	99,00,000			
Other liabilities (942+375+216)	15,33,00,000			
Total	**31,77,18,740**	**Total**		**31,77,18,741**

Note: Arrears of preference dividend of Rs.28,80,000 is payable by group.

Sun = 7.5% x [45,00,000 - 30,00,000) x 8] + 7.5% x [(36,00,000 + 30,00,000) x 4] = 28,80,000

Question No. 4

(a) On 01-04-2008, a mutual fund scheme had 18 lakhs of unit of face value of Rs.10 each was outstanding. The scheme earned Rs.162 lakhs in 2008-09, out of which Rs.90 lakhs was earned in the first half of the year. On 30-09-2008, 2 lakhs of unit were sold at a "NAV" of Rs.70.

Pass Journal entries for sale of units and distribution of dividend at the end of 2008-2009.

(b) Following is the Balance Sheet of Rampal Limited as on 31st March, 2009:

Liabilities	***Rs.***	***Assets***	***Rs.***
1,00,000 equity shares of Rs.10 each	10,00,000	Goodwill	5,00,000
10,000, 12% preference shares of Rs.100 each	10,00,000	Buildings	15,00,000
		Plant	10,00,0000
General reserve	6,00,000	Investment in 10% stock	4,80,000
Profit and Loss account	4,00,000	Stock-in-trade	6,00,000
15% debentures	10,00,000	Debtors	4,00,000
Creditors	8,00,000	Cash	1,00,000
		Preliminary expenses	2,20,000
	48,00,000		**48,00,000**

Additional information are given below:

(a) Nominal value of investment is Rs.5,00,000 and its market value is Rs.5,20,000.

(b) Following assets are revalued:

(i) Building Rs.32,00,000

(ii) Plant Rs.18,00,000

(iii) Stock-in-trade Rs.4,50,000

(iv) Debtors Rs.3,60,000

(c) Average profit before tax of the company is Rs.12,00,000 and 12.50% of the profit is transferred to general reserve, rate of taxation being 50%.

(d) Normal dividend expected on equity shares is 8% while fair return on closing capital employed is 10%.

(d) Goodwill may be valued at three year's purchase of super profits.

Ascertain the value of each equity share under fair value method.

Solution :

a)

Allocation of Earnings

(Rs. in Lakhs)

	Old Unit Holders	*New Unit Holders*	*Total Earning*
	18 Lakhs	2 Lakhs	
First Half Year (Rs. 5.00/ Unit)	90.0	-	90.0
Second Half Year (Rs. 3.60/ Unit)	64.8	7.2	72.0
	154.8	7.2	162.0
Add: Equalisation Payment Received			10.0
Total available for distribution			**172.0**

Note: Equalisation payment = Rs.90 lakhs / 18 lakhs = Rs.5 per unit.

Distribution of earning per unit

	Old Unit holders Rs.	***New Unit holders Rs.***
Dividend distributed	8.60	8.60
Less: Equalisation payment		5.00
Net distributed income	8.60	3.60

Date		**Rs. lakh**	**Rs. lakh**
30-09-2008	Bank (2 lakh x Rs.70)	140	
	To Unit Capital (2 lakh x Rs.10)		20
	To Reserves (2 lakh x Rs.55)		110
	To Dividend Equalisation (2 lakh x Rs.5)		10
31-03-2009	Dividend Equalisation	10	
	To Revenue A / c		10
31-03-2009	Revenue A / c	172	
	To Bank (20 lakh x Rs.8.60)		172

b)

Step 1 : Actual Capital Employed

(Rs. in '000s)

Building	32,00,000
Plant	18,00,000
Investment	5,20,000
Stock	4,50,000
Debtors	3,60,000
Cash	1,00,000
Preference Share Capital	(10,00,000)
15% Debentures	(10,00,000)
Creditors	(8,00,000)
Actual Capital Employed	**36,30,000**

Step 2 : Actual Profit

PBT	12,00,000
T	6,00,000
PAT	6,00,000
Preference Dividend	1,20,000
Equity Earnings	4,80,000

Step 3 : Expected Profit

Expected profit = 10% x 36,30,000 = 3,63,000

Step 4 : Super Profit

Actual Profit	4,80,000

Expected Profit	3,63,000
Super Profit	1,17,000

Step 5 : Goodwill

Goodwill = Number of years x super profit

= 3 x 1,17,000 = 3,50,000

Step 6 : Value of Business

Capital employed	36,30,000
Goodwill	3,51,000
Value of Business	**39,81,000**

Step 7 : Value per share

Net Assets Basis

Value of Business	39,81,000
No. of Equity Shares	1,00,000
Value per share	**39.81**

Market value basis

$$\text{Value per Share} = \frac{\text{Company's rate}}{\text{MarketRate}} \times \text{Paidup value}$$

$$= \frac{32}{8} \times 10 = \textbf{Rs.40}$$

Company's Rate:

Earnings to Equity Share Holders	4,80,000

Retained profits 12 ½ %	60,000
Declared as dividend	3,20,000
Rate of dividend 3,20,000 / 10,00,000 =	32%

Fair Value Method

$$\text{FareValue} = \frac{NAV + MYV}{2} = \frac{39.81 + 40}{2} = Rs.39.91$$

Assumptions:

- Existing Goodwill is ignored.
- Investments are assumed as trade investments
- If it is assumed as non-trade investments then Value per share under NAV would have been 40.82 and fair value per share would have been Rs. 40.41.
- Depreciation on the changed value of Fixed Assets is ignored

Question No. 5

The Balance Sheet of R Ltd. for the year ended on 31st March, 2006, 2007 and 2008 are as follows:

(Rs. in thousands)

Liabilities	***31-03-2006***	***31-03-2007***	***31-03-2008***
3,20,000 equity shares of Rs.10 each, fully paid	3,200	3,200	3,200

General reserve	2,400	2,800	3,200
Profit and Loss account	280	320	480
Creditors	1,200	1,600	2,000
	7,080	**7,920**	**8,880**

Assets			
Goodwill	2,000	1,600	1,200
Building and Machinery less depreciation	2,800	3,200	3,200
Stock	2,000	2,400	2,800
Debtors	40	320	880
Bank balance	240	400	800
	7,080	**7,920**	**8,880**

Additional information:

(a) Actual valuations were as under:

Building and machinery less, depreciation	3,600	4,000	4,400
Stock	2,400	2,800	3,200
Net profit (including opening balance after writing off deprecation, goodwill, tax provision and transferred to general reserve)	840	1,240	1,640

(b) Capital employed in the business at market value at the beginning of 2005-2006 was Rs.73,20,000 which included the cost of goodwill. The normal annual return on average capital employed in the line of business engaged by R Ltd. as 12 ½ %.

(c) The balance in the general reserve on 1st April 2005 was Rs.20 lakhs.

(d) The goodwill shown on 31-03-2006 was purchased on 01-04-2005 for Rs.20 lakhs on which date the balance in the Profit and Loss account was Rs.2,40,000. Find out the average capital employed in each year.

(e) Goodwill is to be valued at 5 year's purchase of Super profit (Simple average method). Also find out the total value of the business as on 31-03-2008.

Solution :

Working Notes:

1. Since goodwill has been paid for, it is taken as part of capital employed. Capital employed at the end of each year is shown below.

2. Assumed that the building and machinery figure as revalued is after considering depreciation.

	31-03-2006	***31-03-2007***	***31-03-2008***
	Rs.	***Rs.***	***Rs.***
Goodwill	20,00,000	16,00,000	12,00,000
Building and Machinery (revalued)	36,00,000	40,00,000	44,00,000
Stock (revalued)	24,00,000	28,00,000	32,00,000

Debtors	40,000	3,20,000	8,80,000
Bank Balance	2,40,000	4,00,000	8,00,000
Total Assets	82,80,000	91,20,000	1,04,80,000
Less: Creditors	12,00,000	16,00,000	20,00,000
Closing Capital	70,80,000	75,20,000	84,80,000
Opening Capital	73,20,000	70,80,000	75,20,000
	1,44,00,000	1,46,00,000	1,60,00,000
Average Capital	**72,00,000**	**73,00,000**	**80,00,000**

Maintainable profit has to be found out after making adjustments as given below:

	31-03-2006 ***Rs.***	***31-03-2007*** ***Rs.***	***31-03-2008*** ***Rs.***
Net Profit as given	8,40,000	12,40,000	16,40,000
Less: Opening Balance	2,40,000	2,80,000	3,20,000
	6,00,000	9,60,000	13,20,000
Add: Under valuation of closing stock	4,00,000	4,00,000	4,00,000
	10,00,000	13,60,000	17,20,000
Less: Adjustment for valuation in opening stock	--	4,00,000	4,00,000
	10,00,000	9,60,000	13,20,000
Add: Goodwill written-off	--	4,00,000	4,00,000
Add: Transfer to Reserves	4,00,000	4,00,000	4,00,000
	14,00,000	17,60,000	21,20,000
Less: 12 ½% Normal Return	9,00,000	9,12,500	10,00,000
Super Profit	5,00,000	8,47,500	11,20,000
Average super profits	= (Rs.5,00,000	+ Rs.8,47,500	+ Rs.11,20,000)

/ 3

= 24,67,500 / 3 = Rs.8,22,500

Goodwill at 5 years purchase	**= Rs.8,22,500 x 5 = Rs.41,12,500**

	Rs.
Total Net Assets (31-03-2008)	84,80,000
Less: Goodwill	12,00,000
	72,80,000
Add: Goodwill	41,12,500
Value of Business	**1,13,92,500**

Question No. 6

(a) Rajkumar Ltd. is adopting historical cost system. From the following details furnished, prepare current cost Profit and Loss account for the year ended on 31-03-2009:

Statement of Profit and Loss:

(Rs.)

Sales		24,00,000
Cost of sales:		
Opening Stock	1,80,000	
Purchases	15,60,000	
Less: Closing stock	2,40,000	15,00,000
Gross Profit		9,00,000
Operating Expenses		3,60,000
Depreciation		1,20,000

Interest on loan	1,80,000
Provision for tax	90,000
Net profit	1,50,000
Dividend (proposed)	30,000
Retained profit	1,20,000

The chief finance officer of Rajkumar Ltd. furnished the additional information as below:

(a)	Gearing adjustment for the year	Rs.20,232
(b)	Cost of sales adjustment for the year	Rs.37,998
(c)	Depreciation adjustment for the year	Rs.18,000
(d)	Monetary working capital adjustment for the year	Rs.13,500

(b) From the following information of Vinod Ltd., compute the economic value added:

(i)	Share capital	Rs.2,000 lakhs
(ii)	Reserves and surplus	Rs.4,000 lakhs
(iii)	Long-term debt	Rs.400 lakhs
(iv)	Tax rate	30%
(v)	Risk free rate	9%
(vi)	Market rate of return	16%
(vii)	Interest	Rs.40 lakhs
(viii)	Beta factor	1.05
(ix)	Profit before interest and tax	Rs.2,000 lakhs

Solution :

a)

Current Cost Profit and Loss Account of Rajkumar Ltd.

for the year ended 31-03-2009

Retained Profit under HCA		1,20,000
Less:		
Gearing Adjustment	(20,232)	
Cost of Sales Adjustment	37,998	
Depreciation Adjustment	18,000	
Monetary Working Adjustment	13,500	49,266
		70,734

b)

(1) $K_e = R_f + (r_{m-r}f) \times \beta$

$= 9 + [(16 - 9) \times 1.05] = 16.35\%$

(2) Net operating before tax = 2,000 x 70% = 1,400 Lakhs

(3) Capital employed and WACC

Sources	***Amount in Lacs***	***Proportion***	***K***	***WACC***
Equity Share Capital	2,000			
Reserves & Surplus	4,000			
Equity	6,000	93.75%	16.35	15.33
@ 10% Debenture*	400	6.25%	7	0.44
			(10 x 70%)	
	6,400			15.77

* 40 / 400

$$IRR = \frac{1,400}{6,400} x100 = 21.875$$

(4)

Economic Value added = [IRR – K_0] x Capital Employed

= (21.875 – 15.77) % x 6,400 = 390.72 lacs

Question No. 7

Write short notes on any four from the following:

(a) What are the objectives of Financial Reporting?

(b) What do you mean by "net asset value" (NAV) in case of mutual fund units?

(c) State the treatment of the following items with reference to Indian Accounting Standard and IFRS:

(i) Discontinued operations – definition and measurement

(ii) Acquired intangible assets

(d) Non-performing assets

(e) Forward contract.

Solution :

a)

1. Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.
2. Financial reporting should provide information to help investors, creditors, and others to assess the amount, timing and uncertainly of prospective net cash inflows to the related enterprise.
3. Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events and circumstances that change resources and claims to those resources.

4. Financial reporting should provide information about an enterprise's financial performance during a period.
5. The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
6. Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise's resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.
7. Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it.
8. Financial reporting should provide information that is useful to managers and directors in making decisions in the interest of owners.

b) Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV) which is calculated as under –

$$\frac{\text{The market value of all MF holdings} - \text{All MF liabilities}}{\text{Unit Size}}$$

NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (Rs.10), it means your money has appreciated and vice versa.

NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. The Net Asset value

(NAV) is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keep on changing with change in market value of portfolio under the scheme. The day of valuation of NAV is called the valuation day.

c) (i)

Particulars	***Indian Accounting Standard***	***IFRS***
Name	AS 24 - Discontinuing Operations	IFRS 5 - Non Current Assets held for sale and Discontinued Operations.
Definition	A discontinuing operation is a component of an enterprise that the enterprise, pursuant to a single plan, is disposing of substantially in its entirety, or disposing of piecemeal or terminating through abandonment; and that represents a separate major line of business or geographical area of operations and that can be distinguished operationally and for financial reporting purposes.	A discontinued operation is a component of an entity that either has been disposed off or is held for sale. It may be a subsidiary, or a major line of business or geographical area.
Measurement	Measurement of discontinued operations is based on AS 28 and 29.	Measured at lower of carrying amount and fair value less costs to sell.

(ii)

Indian Accounting Standard	***IFRS***
If recognition criteria are satisfied then it can be capitalized.	If recognition criteria are satisfied then it can be capitalized. It is amortised over useful life.
All intangibles are amortised over useful life with a rebuttable presumption of not exceeding 10 years.	Intangibles assigned an indefinite useful life are not amortised but reviewed atleast annually for impairment.
Revaluations are not permitted.	Revaluations are permitted in rare circumstances.

d) Non-performing asset (NPA) means any asset, in respect of which, interest has remained past due for six months.

- A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months or on which interest amount remained past due for six months.
- A bill, which remains overdue for six months.
- The interest in respect of a debt or the income on a receivable under the head Other Current Assets' in the nature of short term loans/advances, which facility remained over due for a period of six months.
- Any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months.
- The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months.
- Balance outstanding under the credit facilities (including accrued interest) made available to the borrower/beneficiary in the same capacity, when any of the credit facilities to the same borrower becomes non-performing asset.

e)

- ✓ It is a contract entered at spot for a future transaction/settlement to take place
- ✓ The end users (exporters/importers) would like to know how much to pay or receive in Indian Rupees for their foreign currency denominated payables / receivables.
- ✓ Such contract would remove the uncertainty involved in the settlement.
- ✓ Hence it is a hedging tool.

- ✓ The end users and the authorized dealers are expected to honour the commitment on the maturity date without prejudicing the other parties' interest.