

PAPER – 1 : FINANCIAL REPORTING

Question No. 1 is compulsory. Answer any five out of the remaining questions.

Working notes should form part of the answer.

Wherever necessary, suitable assumptions may be made by the candidates.

Question 1

Answer any four out of the following:

(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
Useful life period	10 years
Salvage value	Nil
Current carrying value	Rs. 27.30 lakhs
Useful life remaining	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 1.4.2008 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. capitalized Rs.19.50 crores for the accounting period ending on 31.3.2009. 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 the 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 advise.
- (d) Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements 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 recognized revenue of

FINAL EXAMINATION : JUNE, 2009

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 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? (4x5 = 20 Marks)

Answer

- (a) According to para 59 of AS 28 "Impairment of Assets", an impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

Impairment Loss and its treatment	Rs.
Current carrying amount (including revaluation amount of Rs.14 lakhs)	27,30,000
Less: Current recoverable amount	12,00,000
Impairment Loss	<u>15,30,000</u>
Impairment loss charged to revaluation reserve	14,00,000
Impairment loss charged to profit and loss account	1,30,000

As per para 61 of AS 28, "after the recognition of an impairment loss, the depreciation (amortization) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life."

In the given case, the carrying amount of the asset will be reduced to Rs.12,00,000 after impairment. This amount is required to be depreciated over remaining useful life of 3 years (including current year). Therefore, the depreciation for the current year will be Rs.4,00,000.

- (b) Para 10 of AS 16 'Borrowing Costs' states, "to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is

PAPER – 1 : FINANCIAL REPORTING

incorrect. The amount of borrowing costs capitalized for the financial year 2008-2009 should be calculated as follows:

Actual interest for 2008-2009 (11% of Rs.150 crores)	Rs.16.50 crores
Less: Income on temporary investment from specific borrowings	Rs. 3.50 crores
Borrowing costs to be capitalized during year 2008-2009	Rs. 13.00 crores

- (c) As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment* amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as follows:

Annuity Factor (Year 1 to Year 5)	3.36** (approx.)
Present value of minimum lease payments (for Rs.3 lakhs each year)	Rs.10.08 lakhs (approx.)

Thus, present value of minimum lease payments is Rs.10.08 lakhs and the fair value of the machine is Rs.30 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

- (d) Omega Limited

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	<u>21,00,000</u>	<u>23,00,000</u>	NIL	NIL
	<u>48,00,000</u>	<u>48,00,000</u>		

* In calculating the present value of minimum lease payments, the discount rate is the interest rate implicit in the lease.

** This is calculated using the following formula:

$$\frac{1}{(1+.15)^1} + \frac{1}{(1+.15)^2} + \frac{1}{(1+.15)^3} + \frac{1}{(1+.15)^4} + \frac{1}{(1+.15)^5}$$

FINAL EXAMINATION : JUNE, 2009

- (e) As per para 8.2 and 13 of Accounting Standard 4 'Contingencies and Events occurring after the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the date of balance sheet, that provide additional evidence to assist estimation of amounts relating to conditions existing at the Balance Sheet Date. Therefore, in the given case, full provision for bad debt amounting Rs.2 lakhs should be made to cover the loss arising due to insolvency in the final accounts for the year ended 31st March, 2009 as earthquake took place before the balance sheet date.

Question 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
10,000, 7% Preference shares of Rs.100 each	10,00,000	Stock	3,00,000
Sundry creditors	7,00,000	Debtors	7,50,000
Bank overdraft	3,00,000	Cash	1,50,000
		Preliminary expenses	1,00,000
		Profit and Loss A/c	7,00,000
	<u>40,00,000</u>		<u>40,00,000</u>

Additional Information:

Two years' preference share dividend is 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, agreed to by all concerned, is as follows:

- (i) Creditors agreed to forego 50% of their claim.
- (ii) 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.
- (iii) Bank has agreed to convert overdraft into term loan to the extent required for making current ratio to 2:1.
- (iv) Revalued amount for plant and machinery was accepted as Rs.15,00,000.
- (v) Debtors to the extent of Rs.4,00,000 were considered as good.
- (vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reconstruction.

PAPER – 1 : FINANCIAL REPORTING

You are required to show the following:

- (a) Total loss to be borne by the equity and preference shareholders for the reconstruction.
- (b) Share of loss to the individual class of shareholders.
- (c) New structure of share capital after reconstruction.
- (d) Working capital of the reconstructed company, and
- (e) A Performa Balance Sheet after reconstruction. (16 Marks)

Answer

- (a) Loss to be borne by Equity and Preference Shareholders

	Rs.
Profit and loss account (debit balance)	7,00,000
Preliminary expenses	1,00,000
Goodwill	2,00,000
Plant and machinery (Rs. 18,00,000 – Rs. 15,00,000)	3,00,000
Debtors (Rs. 7,50,000 – Rs. 4,00,000)	<u>3,50,000</u>
Amount to be written off	16,50,000
Less: 50% of Sundry Creditors	<u>3,50,000</u>
Total loss to be borne by the equity and preference shareholders*	<u>13,00,000</u>

- (b) Share of loss to preference shareholders and equity shareholders

Total loss of Rs. 13,00,000 being more than 50% of equity share capital i.e. Rs.10,00,000	
Preference shareholders' share of loss = 20% of Rs. 10,00,000 =	Rs. 2,00,000
Equity shareholders' share of loss (Rs. 13,00,000 – Rs. 2,00,000)=	<u>Rs. 11,00,000</u>
Total loss	<u>Rs. 13,00,000</u>

- (c) New structure of share capital after reorganisation

	Rs.
Equity shares:	
20,000 equity shares of Rs. 45 each, fully paid up (Rs. 20,00,000 – Rs. 11,00,000)	9,00,000
Preference shares:	
10,000, 9% preference shares of Rs. 80 each, fully paid up (Rs. 10,00,000 – Rs. 2,00,000)	<u>8,00,000</u>
	<u>17,00,000</u>

* Two years' preference dividend (arrears) has been ignored in the computation of loss to be borne by equity and preference shareholders.

FINAL EXAMINATION : JUNE, 2009

(d) Working capital of the reorganized company

Current Assets:	Rs.	Rs.
Stock		3,00,000
Debtors		4,00,000
Cash		<u>1,50,000</u>
		8,50,000
Less: Current liabilities:		
Creditors	3,50,000	
Bank overdraft **	<u>75,000</u>	<u>4,25,000</u>
Working capital		<u>4,25,000</u>

(e) Balance Sheet of Munna Ltd. (and reduced)

as on 31st March, 2009

Liabilities	Rs.	Assets	Rs.
Share Capital Authorised (issued and paid up)		Fixed Assets	
20,000 equity shares of Rs. 45 each	9,00,000	Plant and Machinery	15,00,000
10,000, 9% preference shares of Rs. 80 each	8,00,000	Current Assets	
Unsecured loan		Stock	3,00,000
Term loan with Bank	2,25,000	Debtors	4,00,000
Current liabilities		Cash	1,50,000
Bank overdraft	75,000		
Creditors	<u>3,50,000</u>		
	<u>23,50,000</u>		<u>23,50,000</u>

Question 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)			

** Current ratio shall be 2 : 1, i.e. total current liabilities shall be 50% of Rs. 8,50,000 (i.e. Rs. 3,00,000 + 4,00,000 + 1,50,000) = Rs. 4,25,000. Therefore, Bank overdraft = Rs. 75,000 (Rs. 4,25,000 less creditors Rs. 3,50,000).

PAPER – 1 : FINANCIAL REPORTING

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 debentures of Sun Ltd.	-	-	42
Current assets	1,059	369	336
Profit and loss account	288	108	63
	<u>2,262</u>	<u>849</u>	<u>597</u>
Liabilities			
Equity share capital (Rs.10 each fully paid up)	180	144	120
7.5% Cumulative preference share capital (Rs.100 each fully paid)	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
	<u>2,262</u>	<u>849</u>	<u>597</u>

Other information are as follows:

- (a) 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.
- (b) 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.
- (c) Current assets of Moon Ltd. and Star Ltd. includes Rs.12 lakhs and Rs.18 lakhs respectively being current account balance against Sun Ltd. (16 Marks)

FINAL EXAMINATION : JUNE, 2009

Answer

Consolidated Balance Sheet of Sun Limited and its subsidiaries as on 31st March, 2009

Liabilities	Rs.	Assets	Rs.	Rs.
Share capital		Goodwill		3,00,000
(18,00,000 Equity Shares of Rs.10 each)	180,00,000	Fixed assets		12,54,00,000
15,000, 7½% Cumulative Preference shares of Rs. 100 each	15,00,000	Current assets	17,64,00,000	
Minority interest	132,18,750	Less: Inter-company owing	<u>81,00,000</u>	
Reserves and surplus			16,83,00,000	
Capital reserve	360,00,000	Less: Inter-company balances	<u>27,00,000</u>	16,56,00,000
Secured loan		Profit and loss account		264,18,750
8% Mortgage debentures	30,00,000			
Loans and advances				
Secured loan from bank	927,00,000			
Current liabilities and provisions	<u>15,33,00,000</u>			
	<u>31,77,18,750</u>			<u>31,77,18,750</u>

Working Notes:

(1) Shareholding Pattern	In Moon Ltd.	In Star Ltd.
(i) Sun Limited	$\frac{25}{48}$	$\frac{2}{10}$
(ii) Moon Limited		$\frac{4}{10}$
(iii) Minority Interest	$\frac{23}{48}$	$\frac{4}{10}$
(2) Analysis of Profits	Capital	Revenue
(a) Star Limited	Rs.	Rs.
Balance at acquisition	15,00,000	
Balance as per P&L A/c	(63,00,000)	
General reserve	30,00,000	
Profit on debentures	<u>3,00,000</u>	
Net loss as on 31.3.09	(30,00,000)	
Less: Capital profit	<u>(-15,00,000)</u>	
	<u>(45,00,000)</u>	<u>(45,00,000)</u>

PAPER – 1 : FINANCIAL REPORTING

	Minority interest (4/10)	6,00,000	(18,00,000)
	Share of Moon Limited (4/10)	6,00,000	(18,00,000)
	Share of Sun Limited (2/10)	3,00,000	(9,00,000)
(b)	Moon Limited		
	P&L A/c as on 31.3.09		(1,08,00,000)
	General Reserve		45,00,000
			(63,00,000)
	Share of revenue loss in Star Ltd.		(18,00,000)
			(81,00,000)
	Minority Interest (23/48)		(38,81,250)
	Sun Limited (25/48)		(42,18,750)
(3)	Goodwill/Capital Reserve	Moon Ltd.	Star Ltd.
	Cost of investment	75,00,000	84,00,000
	Less: Share capital	75,00,000	72,00,000
	Capital profit	<u>3,00,000</u>	<u>6,00,000</u>
	Capital reserve/Goodwill	(3,00,000)	6,00,000
	Goodwill Rs.6,00,000 less Rs.3,00,000	3,00,000	
(4)	Minority Interest		
	Share capital	69,00,000	48,00,000
	Capital profit	-	6,00,000
	Revenue profit	(38,81,250)	(18,00,000)
	Preference shares (36,00,000+30,00,000)	-	66,00,000
		<u>30,18,750</u>	<u>1,02,00,000</u>
	Total		<u>1,32,18,750</u>
(5)	Profit and Loss Account – Sun Ltd.		
	Balance as on 31.03.2009	(2,88,00,000)	
	General reserve	75,00,000	
	Share of Star Limited	(9,00,000)	
	Share of Moon Limited	<u>(42,18,750)</u>	
		<u>(2,64,18,750)</u>	

FINAL EXAMINATION : JUNE, 2009

Question 4

- (a) On 1.4.2008, a mutual fund scheme had 18 lakh units 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 30.9.2008, 2 lakh units were sold at a "NAV" of Rs.70.

Pass Journal entries for sale of units and distribution of dividend at the end of 2008-09.

- (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
General reserve	6,00,000	Plant	10,00,000
Profit and Loss account	4,00,000	Investment in 10% stock	4,80,000
15% debentures	10,00,000	Stock-in-trade	6,00,000
Creditors	8,00,000	Debtors	4,00,000
		Cash	1,00,000
		Preliminary expenses	2,20,000
	<u>48,00,000</u>		<u>48,00,000</u>

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

Ascertain the value of each equity share under fair value method. (6+10= 16 Marks)

PAPER – 1 : FINANCIAL REPORTING

Answer

(a)

Allocation of Earnings	Old Unit Holders	New Unit Holders	Total
	[18 Lakh Units]	[2 Lakh Units]	
	Rs. in Lakhs	Rs. in Lakhs	Rs. in Lakhs
First half year (Rs.5 per unit)	90.00	Nil	90.00
Second half year (Rs.3.60 per unit)	64.80	7.20	72.00
	154.80	7.20	162.00
Add: Equalization payment recovered	-	-	10.00
Available for distribution			172.00

Equalization Payment:- Rs.90 lakhs ÷ 18 Lakhs = Rs.5 per unit.

	Old Unit Holders	New Unit Holders
	Rs.	Rs.
Dividend distributed	8.60	8.60
Less: Equilisation payment	-	5.00
	8.60	3.60

Journal Entries		(Rs. in lakhs)
30.9.2008	Bank A/c	Dr. 150.00
	To Unit Capital A/c	20.00
	To Reserves A/c	120.00
	To Dividend Equilisation A/c	10.00
	(Being the amount received on sale of 2 lakhs unit at a NAV of Rs.70/- per Unit)	
31.3.2009	Dividend Equalization A/c	Dr. 10.00
	To Revenue A/c	10.00
	(Being the amount transferred to Revenue Account)	
	Revenue A/c	Dr. 172.00
	To Bank A/c	172.00
	(Being the amount distributed among 20 lakhs unit holders @ Rs.8.60 per unit)	

FINAL EXAMINATION : JUNE, 2009

(b)

1.	Capital Employed	Rs.	Rs.
	Assets:		
	Buildings		32,00,000
	Plant		18,00,000
	Stock		4,50,000
	Debtors		3,60,000
	Cash		1,00,000
			<u>59,10,000</u>
	Less: Liabilities:		
	Creditors	8,00,000	
	Debentures	<u>10,00,000</u>	<u>18,00,000</u>
	Capital Employed		<u>41,10,000</u>
2.	Actual Profit		
	Average Profit		12,00,000
	Less: Income from investment		<u>50,000</u>
			11,50,000
	Less: Income Tax @ 50%		<u>5,75,000</u>
	So, Actual Profit		<u>5,75,000</u>
3.	Profit for Equity Shareholders		
	Actual Profit		5,75,000
	Less: Transfer to reserves @ 12.50%		71,875
	Less: Preference Dividend		<u>1,20,000</u>
	Profit available to Equity Shareholders		<u>3,83,125</u>
4.	Normal Profit	= 10% of Capital Employed = 10% of Rs.41,10,000 = Rs.4,11,000	
5.	Super Profit	= Actual profit – Normal profit	
		= Rs.5,75,000 – 4,11,000 = Rs.1,64,000	
6.	Goodwill	= Rs.1,64,000 × 3 = Rs.4,92,000	
7.	Net Assets for equity shareholders	= Capital Employed + Goodwill + Investment – Preference Share Capital	
		= Rs.(41,10,000+4,92,000+4,80,000- 10,00,000)	
		= Rs.40,82,000	

PAPER – 1 : FINANCIAL REPORTING

8. Value per Share (Intrinsic Value Method) = Rs.40,82,000 ÷ 1,00,000 = Rs.40.82

9. Value per Share (Yield Method)

$$\begin{aligned} \text{Yield on equity shares} &= \frac{\text{Pr ofit for Equity Shareholders}}{\text{Equity Capital}} \times 100 \\ &= \frac{\text{Rs.3,83,125}}{10,00,000} \times 100 = 38.31\% \end{aligned}$$

$$\text{Value per Share (Yield Method)} = \frac{38.31}{8} \times 10 = \text{Rs.47.89}$$

10. Value of equity share under Fair Value Method

$$\frac{(\text{Intrinsic Value} + \text{Yield Value})}{2} = \frac{(40.82 + 47.89)}{2} = \text{Rs.44.36 (approx.)}$$

Question 5

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

	(Rs. in thousands)		
	31.3.2006	31.3.2007	31.3.2008
Liabilities			
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
	<u>7,080</u>	<u>7,920</u>	<u>8,880</u>
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
	<u>7,080</u>	<u>7,920</u>	<u>8,880</u>

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			

FINAL EXAMINATION : JUNE, 2009

- writing off depreciation, 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 2005-06 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. is 12½%.
- (c) The balance in the general reserve on 1st April, 2005 was Rs.20 lakhs.
- (d) The goodwill shown on 31.3.2006 was purchased on 1.4.2005 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). Find out the total value of the business as on 31.3.2008. (16 Marks)

Answer

1. Average Capital Employed at the end of each year

	31.3.2006	31.3.2007	31.3.2008
	Rs.	Rs.	Rs.
Goodwill	20,00,000	16,00,000	12,00,000
Building and Machinery (Revaluation)	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	<u>2,40,000</u>	<u>4,00,000</u>	<u>8,00,000</u>
Total Assets	82,80,000	91,20,000	104,80,000
Less: Creditors	<u>12,00,000</u>	<u>16,00,000</u>	<u>20,00,000</u>
Closing Capital	70,80,000	75,20,000	84,80,000
Add: Opening Capital	<u>73,20,000</u>	<u>70,80,000</u>	<u>75,20,000</u>
Total	<u>144,00,000</u>	<u>146,00,000</u>	<u>160,00,000</u>
Average Capital	<u>72,00,000</u>	<u>73,00,000</u>	<u>80,00,000</u>

Since the goodwill has been purchased, it is taken as a part of Capital employed.

2. Total value of business	Rs.
Total Net Assets as on 31.3.2008	84,80,000
Less: Goodwill as per Balance Sheet	12,00,000
Add: Goodwill as calculated in Working Note	<u>41,12,500</u>
Value of Business	<u>113,92,500</u>

PAPER – 1 : FINANCIAL REPORTING

Working Note:

Valuation of Goodwill

(i) Future Maintainable Profit	31.3.2006	31.3.2007	31.3.2008
	Rs.	Rs.	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
Adjustment for Valuation of Opening Stock	-	4,00,000	4,00,000
Add: Adjustment for Valuation of closing stock	4,00,000	4,00,000	4,00,000
Goodwill written off	-	4,00,000	4,00,000
Transferred to General Reserve	<u>4,00,000</u>	<u>4,00,000</u>	<u>4,00,000</u>
Future Maintainable Profit	14,00,000	17,60,000	21,20,000
Less: 12.50% Normal Return on average capital	<u>9,00,000</u>	<u>9,12,500</u>	<u>10,00,000</u>
(ii) Super Profit	<u>5,00,000</u>	<u>8,47,500</u>	<u>11,20,000</u>
(iii) Average Super Profit = Rs.(5,00,000 + 8,47,500+11,20,000) ÷ 3 = Rs.8,22,500			
(iv) Value of Goodwill at five years' purchase= Rs.8,22,500 × 5 = Rs.41,12,500.			

Question 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 31.3.2009:

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	<u>2,40,000</u>
Gross Profit	15,00,000
Operating expenses	9,00,000
Depreciation	3,60,000
Interest on loan	1,20,000
Provision for tax	1,80,000
Net profit	90,000
Dividend (proposed)	1,50,000
Retained profit	30,000
	1,20,000

FINAL EXAMINATION : JUNE, 2009

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
		(8 Marks)

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

(i)	Share capital	Rs.2,000 lakhs
(ii)	Reserve 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
		(8 Marks)

Answer

(a) Current Cost Profit and Loss Account of Raj Kumar Ltd.
for the year ended 31.3.2009

	Rs.	Rs.
Trading profit before interest and tax under historical cost system		
Gross profit less (Operating expenditure + Depreciation)		
Rs. 9,00,000 – (Rs. 3,60,000 + Rs.1,20,000)		4,20,000
Less: Current cost adjustments		
Depreciation adjustment	18,000	
Cost of sales adjustment	37,998	
Monetary working capital adjustment	<u>13,500</u>	69,498
Current cost operating profit		3,50,502
Less: Interest on loan	1,80,000	
Gearing adjustment	<u>20,232</u>	<u>1,59,768</u>
Current cost profit before tax		1,90,734
Less: Provision for tax		<u>90,000</u>

PAPER – 1 : FINANCIAL REPORTING

Current cost profit after tax	1,00,734
Less: Dividend	<u>30,000</u>
Retained current cost profit for the year	<u>70,734</u>

(b) Vinod Limited

Computation of Economic Value Added

<u>Economic Value Added</u>	Rs. in Lakhs
Net Operating Profit after Tax (Refer Working Note 5)	1,372.00
Add: Interest on Long-term Fund (Refer Working Note 2)	<u>28.00</u>
	1,400.00
Less: Cost of Capital Rs. 6,400 lakhs × 15.77% (Refer working notes 3 and 4)	<u>1,009.28</u>
Economic Value Added	<u>390.72</u>

Working Notes:

- (1) Cost of Equity = Risk free Rate + Beta Factor (Market Rate – Risk Free Rate)

$$9\% + 1.05 (16 - 9) = 9\% + 7.35\% = 16.35\%$$

- (2) Cost of Debt

Interest Rs.40 lakhs

Less: Tax (30%) Rs.12 lakhs

Interest after Tax Rs.28 lakhs

$$\text{Cost of Debt} = \frac{28}{400} \times 100 = 7\%$$

- (3) Weighted Average Cost of Capital

Cost of Equity Rs. 6,000 lakhs × 16.35% (W.N.1) Rs. 981 lakhs

Cost of Debt Rs. 400 lakhs × 7% (W.N.2) Rs. 28 lakhs

Rs. 1,009 lakhs

$$\text{WACC} = \frac{1,009}{6,400} \times 100 = 15.77\% \text{ (approx.)}$$

4. Capital Employed

	Rs. in Lakhs
Share Capital	2,000
Reserves and Surplus	4,000
Long term debts	400
	<u>6,400</u>

FINAL EXAMINATION : JUNE, 2009

5. Net Operating Profit after Tax

Profit before Interest and Tax	2,000
Less: Interest	<u>40</u>
	<u>1,960</u>
Tax 30% on 1,960 Lakhs	588
Net Operating Profit after Tax	1,372

Question 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 Standards and IFRS:
 - (i) Discontinued operations – definition and measurement
 - (ii) Acquired intangible assets.
- (d) Non-performing asset in the context of NBFC.
- (e) Forward contract. (4x4 = 16 Marks)

Answer

- (a) The following are the objectives of financial reporting:
 - (i) To provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.
 - (ii) To provide information to help investors, creditors, and others to assess the amount, timing and uncertainty of prospective net cash inflows to the related enterprise.
 - (iii) To 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.
 - (iv) To provide information about an enterprise's financial performance during a period.
 - (v) To give information about an enterprise's performance provided by measures of earnings and its components.
 - (vi) To 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.

PAPER – 1 : FINANCIAL REPORTING

- (vii) To 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.
- (viii) To 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:–

$$\frac{\text{Total market value of all Mutual Fund holdings} - \text{All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each 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. 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 keeps on changing with change in market value of portfolio under the scheme.

- (c) Treatment under Indian Accounting Standard and IFRS

		Indian Accounting Standards	IFRS
(i)	Discontinuing operation - definition and measurement	Operations and cash flows that can be clearly distinguished for financial reporting and represent major line of business or geographical area of operations are discontinued operations. Measurement of discontinued operations is based on AS 24.	Definition of discontinued operations under IFRS is similar to Indian Accounting Standards. However, it also includes a subsidiary acquired exclusively with a view to resale. Discontinued operations are measured at lower of carrying amount and fair value less cost to sell.
(ii)	Acquired intangible assets	If recognition criteria are satisfied then it can be capitalized. All intangibles are amortized over useful life with rebuttable presumption of not exceeding 10 years. Revaluations are not permitted.	If recognition criteria are satisfied then it can be capitalized. It is amortized over useful life. Intangibles assigned an indefinite useful life are not amortized but reviewed at least annually for impairment. Revaluations are permitted in rare circumstances.

FINAL EXAMINATION : JUNE, 2009

- (d) “Non–Performing Asset” as per NBFC Prudential Norms (RBI) directions means:
- (i) An asset, in respect of which, interest has remained past due for six months;
 - (ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;
 - (iii) A bill which remained overdue for six months;
 - (iv) The interest in respect of a debt or the income on receivables under the head ‘other current assets’ in the nature of short term loans/advances that remained overdue for a period of six months;
 - (v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;
 - (vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;
 - (vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

- (e) A forward contract is an agreement between two parties whereby one party agrees to buy from, or sell to, the other party an asset at a future time for an agreed price (usually referred to as the ‘contract price’). The parties to forward contracts may be individuals, corporates or financial institutions. At maturity, a forward contract is settled by delivery of the asset by the seller to the buyer in return for payment of the contract price. For example, a person (X) may enter into a forward contract with another person (Y) on June 15, 20x3 to buy 10 kgs. of silver at the end of 90 days at a price of Rs. 8,200 per kg. At the end of the 90 days, Y will deliver 10 kgs. of silver to X against payment of Rs. 82,000. If the price of silver, at the end of the 90 days, is Rs. 8,300 per kg., X would make a profit of Rs. 1,000 and Y would lose Rs. 1,000, as X could sell silver bought at Rs. 82,000 for Rs. 83,000, whereas Y would have to buy silver for Rs. 83,000 and sell for Rs. 82,000. On the other hand, if the price of silver at the end of the 90 days is Rs. 7,800 per kg., X would lose Rs. 4,000, whereas Y would make a profit of Rs. 4,000, as X would have to sell silver bought at Rs. 82,000 for Rs. 78,000, whereas Y would buy silver for Rs. 78,000, which he would sell to X at Rs. 82,000.