

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) On 30.6.2007, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment. Also, on 30.7.2007, the company paid Rs. 60,000 for property taxes assessed for the calendar year 2007. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30.9.2007.
- (b) M/s XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are Rs. 10.00 crs. Segment X has Rs. 2.00 crs., segment Y has Rs. 3.00 crs. and segment Z has Rs. 5.00 crs. Deferred tax assets included in the assets of each segments are X- Rs. 0.50 crs., Y—Rs. 0.40 crs. and Z—Rs. 0.30 crs. The accountant contends that all the three segments are reportable segments. Comment.
- (c) M/s Dinesh & Company signed an agreement with workers for increase in wages with retrospective effect. The out-flow on account of arrears was for 2005-06—Rs. 10.00 lakhs, for 2006-07—Rs. 12.00 lakhs and for 2007-08—Rs. 12.00 lakhs. This amount is payable in September, 2008. The accountant wants to charge Rs. 22.00 lakhs as prior period charges in financial statement for 2008-09. Discuss.
- (d) M/s Prima Co. Ltd. sold goods worth Rs. 50,000 to M/s Y and Company. M/s Y and Co. asked for discount of Rs. 8,000 which was agreed by M/s Prima Co. Ltd. The sale was effected and goods were despatched. After receiving, goods worth Rs. 7,000 was found defective, which they returned immediately. They made the payment of Rs. 35,000 to M/s Prima Co. Ltd. Accountant booked the sales for Rs. 35,000. Please discuss.
- (e) Himalayas Ltd. is showing an intangible Asset at Rs. 72 lakhs as on 01.04.2007 and that item was required for Rs. 96 lakhs on 01.04.2004 and that item was available for use from that date. Himalayas Ltd. has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. Comment on the accounting treatment of the above with reference to relevant accounting standard.

(4x5= 20 Marks)

Answer

- (a) According to Para 10 of AS 25 "Interim Financial Reporting", If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2007, Asmitha Ltd., would report the entire Rs.2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since Rs.60,000 Property Tax payment relates to entire calendar year 2007, Rs.30,000 would be reported as an expense for six months ended on 30th September, 2007 while remaining Rs.30,000 would be reported as prepaid expenses.
- (b) According to AS 17 "Segment Reporting", segment assets do not include income tax assets. Therefore, the revised total assets are 8.8 crores [10 crores – (0.5+0.4+0.3)]. Segment X holds total assets of 1.5 crores (2 crores – 0.5 crores); Segment Y holds 2.6 crores (3 crores – 0.4 crores); and Segment Z holds 4.7 crores (5 crores – 0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.
- (c) According to AS 5(Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", the term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Para 12 of AS 5 (Revised), when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

- (d) As per Para 4.1 of AS 9 "Revenue Recognition", revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.

In the given case, M/s Prima Co. Ltd. should record the sales at gross value of Rs.50,000. Discount of Rs.8,000 in price and goods returned worth Rs.7,000 are to be

adjusted by suitable provisions. M/s Prime Co. Ltd. might have sent the credit note of Rs. 15,000 to M/s Y & Co. to account for these adjustments. The contention of the accountant to book the sales for Rs.35,000 is not correct.

- (e) As per Para 63 of AS 26 "Intangible Assets", the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Himalayas Ltd. has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified under AS 26. Accordingly, Himalayas Ltd. would be required to restate the carrying amount of intangible asset as on 1.4.2007 at Rs.96 lakhs less Rs. 28.8 lakhs (Rs. 9.6 lakhs × 3 years) = Rs. 67.2 lakhs. If amortisation had been as per AS 26, the carrying amount would have been Rs.67.2 lakhs. The difference of Rs. 4.8 lakhs i.e. (Rs. 72lakhs – 67.2 lakhs) would be required to be adjusted against the opening balance of revenue reserves. The carrying amount of Rs.67.2 lakhs would be amortised over 7 (10 less 3) years in future.

Question 2

System Ltd. and HRD Ltd. decided to amalgamate as on 01.04.2008. Their Balance Sheets as on 31.03.2008 were as follows: (Rs. in '000)

Particulars	System Ltd.	HRD Ltd.
Source of Funds :		
Equity share capital (Rs. 10 each)	150	140
9% preference share capital (Rs. 100 each)	30	20
Investment allowance reserve	5	2
Profit and Loss Account	10	6
10 % Debentures	50	30
Sundry Creditors	25	15
Tax provision	7	4
Equity Dividend Proposed	<u>30</u>	<u>28</u>
Total	<u>307</u>	<u>245</u>
Application of Funds :		
Building	60	50
Plant and Machinery	80	70
Investments	40	25

Sundry Debtors	45	35
Stock	36	40
Cash and Bank	40	25
Preliminary Expenses	<u>6</u>	<u>----</u>
Total	<u>307</u>	<u>245</u>

From the following information, you are to prepare the draft Balance Sheet as on 01.04.2008 of a new company, Intranet Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

- (i) 50 % Debentures are to be converted into Equity Shares of the New Company.
- (ii) Out of the investments, 20% are non-trade investments.
- (iii) Fixed Assets of Systems Ltd. were valued at 10% above cost and that of HRD Ltd. at 5% above cost.
- (iv) 10 % of sundry Debtors were doubtful for both the companies. Stocks to be carried at cost.
- (v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
- (vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of Rs. 10 each of the new company at a premium of Rs. 5 per share.

Amalgamation is in the nature of purchase.

(16 Marks)

Answer

M/s Intranet Ltd.

Draft Balance Sheet as at 1.4.2008

Liabilities	Rs.	Assets	Rs.
Equity share capital		Building	
27,799 Equity shares of Rs.10 each, fully paid up	2,77,990	(Rs. 66,000+Rs. 52,500))	1,18,500
(25,133 + 2,666) (W.N.2)		Plant and machinery	
		(Rs. 88,000+Rs. 73,500)	1,61,500
9% Preference share capital		Investments	
(Share of Rs.100 each) (W.N.2)	50,000	(Rs. 40,000+ Rs. 25,000)	65,000
Securities premium		Stock	
(1,25,665 + 13,330) (W.N.2)	1,38,995	(Rs. 36,000+ Rs. 40,000)	76,000
Investment allowance reserve		Sundry debtors	
(Rs. 5,000+ Rs. 2,000)	7,000	90% of (Rs.45,000+ Rs. 35,000)	72,000

10% Debentures (50% of Rs. 80,000)	40,000	Cash and Bank (Rs.40,000+ Rs.25,000 – Rs.15)	64,985
Sundry creditors (Rs. 25,000+ Rs. 15,000)	40,000	Amalgamation adjustment account	7,000
Tax provision (Rs. 7,000+ Rs. 4,000)	<u>11,000</u>		
	<u>5,64,985</u>		<u>5,64,985</u>

Working Notes:

- Calculation of value of equity shares issued to transferor companies

	System Ltd. Rs.	HRD Ltd. Rs.
Assets taken over:		
Building	66,000	52,500
Plant and machinery	88,000	73,500
Investments (trade and non-trade)	40,000	25,000
Stock	36,000	40,000
Sundry Debtors	40,500	31,500
Cash & Bank	<u>40,000</u>	<u>25,000</u>
	3,10,500	2,47,500
Less: Liabilities:		
10% Debentures	50,000	30,000
Sundry Creditors	25,000	15,000
Tax Provision	<u>7,000</u>	<u>4,000</u>
	2,28,500	1,98,500
Less: Preference Share Capital	<u>30,000</u>	<u>20,000</u>
	<u>1,98,500</u>	<u>1,78,500</u>

- Number of shares issued to equity shareholders, debenture holders and preference shareholders

	System Ltd.	HRD Ltd.	Total
Equity shares issued @ Rs.15 per share (including Rs.5 premium)			
1,98,500 divided by 15	13,233 shares ¹		
1,78,500 divided by 15		11,900 shares	25,133 shares

¹ Cash paid for fraction of shares = Rs. 1,98,500 less Rs. 1,98,495 = Rs. 5

Equity share capital @ Rs.10	Rs. 1,32,330	Rs.1,19,000	Rs. 2,51,330
Securities premium @ Rs.5	<u>Rs. 66,165</u>	<u>Rs. 59,500</u>	<u>Rs. 1,25,665</u>
	<u>Rs.1,98,495</u>	<u>Rs. 1,78,500</u>	<u>Rs. 3,76,995</u>
50% of Debentures are converted into equity shares @ Rs.15 per share			
25,000 divided by 15	1,666 shares ²		
15,000 divided by 15		1,000 shares	2,666 shares
Equity share capital @ Rs.10	Rs. 16,660	Rs.10,000	Rs. 26,660
Security premium@ Rs.5	<u>Rs. 8,330</u>	<u>Rs. 5,000</u>	<u>Rs. 13,330</u>
	<u>Rs. 24,990</u>	<u>Rs. 15,000</u>	<u>Rs. 39,990</u>
9% Preference share capital issued	Rs. 30,000	Rs. 20,000	Rs. 50,000

Question 3

The following are the Balance Sheets of Ram Ltd., Shyam Ltd. and Tom Ltd. as on 31.03.2008:

	Rs. in '000		
Particulars	Ram Ltd.	Shyam Ltd.	Tom Ltd.
Liabilities			
Equity Share Capital (Rs. 100 each)	8,000	4,000	1,600
General Reserve	1,600	280	-
Profit and Loss Account	1,360	960	-
Current Liabilities	<u>1,280</u>	<u>3,000</u>	<u>1,120</u>
Total	<u>12,240</u>	<u>8,240</u>	<u>2,720</u>
Assets			
Investments :			
32,000, shares in Shyam Ltd.	4,800	-	-
4,000, shares in Tom Ltd.	200	-	-
12,000, shares in Ram Ltd.	-	720	-
Profit and Loss Account	-	-	640
Current Assets	<u>7,240</u>	<u>7,520</u>	<u>2,080</u>
Total	<u>12,240</u>	<u>8,240</u>	<u>2,720</u>

² Cash paid for fraction of shares = Rs. 25,000 less Rs. 24,990 = Rs. 10

From the following information, prepare consolidated Balance Sheet of Ram Ltd. and its subsidiaries as on 31.03.2008 :

- (i) Shyam Ltd. has advanced Rs. 8,00,000 to Tom Ltd.
- (ii) Current Liabilities of Ram Ltd. includes Rs. 4,00,000 due to Tom Ltd.
- (iii) Shyam Ltd. and Tom Ltd. have not paid any Dividend.
- (iv) Ram Ltd. acquired its investments on 01.04.2007 from Shyam Ltd. and then amount standing to credit of General reserve and Profit and Loss account were Rs. 2,80,000 and Rs. 5,20,000 respectively.
- (v) Ram Ltd. acquired investments in Tom Ltd. on 01.04.2007, when the debit balance in Profit and Loss account in books of Tom Ltd. was Rs. 4,80,000.
- (vi) Shyam Ltd. acquired its investments in Tom Ltd. on 01.04.2005 and then the Debit balance in profit and Loss account was Rs. 1,60,000.
- (vii) Shyam Ltd.'s stock includes stock worth Rs. 4,80,000 which was invoiced by Ram Ltd. at 20% above cost. (16 Marks)

Answer

Consolidated Balance Sheet of Ram Ltd. and its subsidiaries Shyam Ltd and Tom Ltd.

as on 31.3.2008

Liabilities	Rs. in '000	Assets	Rs. in '000
Share Capital	8,000	Goodwill (W. N. 5)	688
Minority Interest (W. N. 7)	952	Current Assets	
General Reserve	1,600	Ram Ltd.	7,240
Profit and Loss A/c (W. N. 6)	1,496	Shyam Ltd.	7,520
Current Liabilities		Tom Ltd.	<u>2,080</u>
Ram Ltd.	1,280		16,840
Shyam Ltd.	3,000	Less: Mutual Owings	<u>1,200</u>
Tom Ltd.	<u>1,120</u>		15,640
	5,400	Less: Unrealised Profit	<u>80</u>
Less: Mutual Owings	<u>1,200</u>		<u>15,560</u>
	<u>4,200</u>		<u>16,248</u>
	<u>16,248</u>		<u>16,248</u>

Working Notes:

1. General Reserve and Profit and Loss Account of Shyam Ltd.

General Reserve Account of Shyam Ltd.

			Rs.'000				Rs.'000
31.3.08	To	Balance c/d	<u>280</u>	1.4.07	By	Balance b/d	<u>280</u>

Profit and Loss Account of Shyam Ltd.

			Rs. '000				Rs. '000
31.3.08	To	Balance c/d	960	1.4.07	By	Balance b/d	520
					By	Profit earned during the year (Bal. Fig.)	<u>440</u>
			<u>960</u>				<u>960</u>

2. Profit and Loss Account of Tom Ltd.

			Rs.'000				Rs.'000
1.4.05	To	Balance b/d	<u>160</u>	31.3.06	By	Balance c/d	<u>160</u>
			<u>160</u>				<u>160</u>
1.4.06	To	Balance b/d	160	31.3.07	By	Balance c/d	480
	To	Loss incurred during the year (Bal. Fig.)	<u>320</u>				
			<u>480</u>				<u>480</u>
1.4.07	To	Balance b/d	480	31.3.08	By	Balance c/d	640
	To	Loss incurred during the year (Bal. Fig.)	<u>160</u>				
			<u>640</u>				<u>640</u>

3. Analysis of Profits of Tom Ltd.

		Capital Profits Rs.'000	Revenue Profits Rs'000
(i)	From the viewpoint of Shyam Ltd.		
	Debit Balance in Profit and Loss Account as on 1.4.2005	(160)	
	Loss incurred between 1.4.2005 to 31.3.2008		
	[(320 + 160) – Refer W.N. 2]		<u>(480)</u>
		<u>(160)</u>	<u>(480)</u>
	Share of Shyam Ltd.-75% [carried forward to W. N. 4]	<u>(120)</u>	<u>(360)</u>

(ii) From the view point of Ram Ltd.		
Debit Balance of Profit and Loss Account as on 1.4.07	(480)	
Loss during the year 2007-08	<u> </u>	<u>(160)</u>
	<u>(480)</u>	<u>(160)</u>
Share of Ram Ltd. (25%)	<u>(120)</u>	<u>(40)</u>

4. Analysis of Profits of Shyam Ltd. (From the viewpoint of Ram Ltd.)

	Capital Profits Rs.'000	Revenue Profits Rs.'000
General Reserve as on 1.4.07	280	
Profit and Loss Account Balance as on 1.4.07	520	
Profit earned during 2007-08 (W.N.1)		440
Brought forward Shyam Ltd.'s share of loss in Tom Ltd. [W. N. 3(i)]	(120)	(360)
Share of Shyam Ltd. in revenue loss of Tom Ltd. for the period 1.4.05 to 31.3.07 [75% of (360- 40)] being treated as capital loss from view point of Ram Ltd.	<u>(240)</u>	<u>240</u>
	440	320
Less:Share of Minority Interest (20%)	<u>88</u>	<u>64</u>
Balance taken to Ram Ltd. (80%)	<u>352</u>	<u>256</u>

5. Cost of Control Rs. '000

Investment by Ram Ltd. in		.
Shyam Ltd.	4,800	
Tom Ltd.	200	
Investment by Shyam Ltd. in		
Tom Ltd.	<u>720</u>	5720
Less: Paid up value of shares of:		
Shyam Ltd.	3,200	
Tom Ltd. (400 + 1,200)	<u>1,600</u>	
	4,800	

Capital loss of Ram Ltd. in Tom Ltd. [W.N. 3(ii)]	(120)	
Capital Profit of Ram Ltd. in Shyam Ltd. (W.N. 4)	<u>352</u>	<u>5,032</u>
Goodwill		<u>688</u>
		Rs. '000

6. Consolidated Profit and Loss A/c of Ram Ltd.

Profit and Loss A/c Balance	1,360
Post acquisition share of loss from Tom Ltd.	(40)
Post acquisition share of profit from Shyam Ltd.	<u>256</u>
	1,576
Less: Unrealised Profit on Stock ($\frac{1}{6}$ th of 480)	<u>80</u>
	<u>1,496</u>

7. Minority Interest

	Rs.'000
Paid up value of shares in Shyam Ltd. (20% of 4,000)	800
Share of Capital Profit (W.N. 4)	88
Share of Revenue Profit (W.N. 4)	<u>64</u>
	<u>952</u>

Question 4

- (a) A Mutual Fund raised funds on 01.04.2007 by issuing 10 lakhs units @ 17.50 per unit. Out of this Fund, Rs. 160 lakhs invested in several capital market instruments. The initial expenses amount to Rs. 9 lakhs. During June, 2007, the Fund sold certain securities worth Rs. 100 lakhs for Rs. 125 lakhs and it bought certain securities for Rs. 90 lakhs. The Fund Management expenses amounting to Rs. 5 lakhs per month. The dividend earned was Rs. 3 lakhs. 80% of the realised earnings were distributed among the unitholders. The market value of the portfolio was Rs. 175 lakhs. Determine Net Asset value (NAV) per unit as on 30.06.2007.

- (b) The Balance Sheet of Gunshot Ltd. as on 31.3.2008 is given :

(Rs. in '000)

Liabilities	Amount	Fixed Assets	Amount
Share Capital :		Fixed Assets	2,700
Equity shares of Rs. 10 each	800	Non-trade Investments	300
Securities Premium	100	Stock	600

General Reserve	780	Sundry Debtors	360
Profit and Loss Account	120	Cash and Bank	160
10% Debenture	2,000		
Creditors	<u>320</u>		
	<u>4,120</u>		<u>4,120</u>

Gunshot Ltd. buy back 16,000 shares of Rs. 20 per share. For this purpose, the Company sold its all non-trade investments for Rs. 3,20,000. Give Journal Entries with full narrations effecting the buy back. (8 x 2= 16 Marks)

Answer

(a) Total Funds raised by Mutual Fund = 17.5 x10 Lakhs = 175 Lakhs

		(Rs. In lakhs)
	Rs.	Rs.
Opening Bank Balance(175-160-9)	6	
Add: Proceeds from sale of securities	125	
Add: Dividend received	<u>3</u>	
Less:		134
Cost of securities purchased	90	
Management expenses (Rs. 5 lakhs x3 months)	15	
Realised gains distributed [80% of (Rs. 125 lakhs – Rs. 100 lakhs)]	20	
Dividend distributed (80% of Rs. 3 lakhs)	<u>2.40</u>	<u>127.40</u>
Closing Bank Balance		6.60
Closing Market value of portfolio		<u>175.00</u>
Closing Net Assets		<u>181.60</u>
No. of Units (Lakh)		10.00
Closing NAV = Rs. 181.60 lakhs divided by 10 lakh units	=	Rs.18.16

(b) Journal Entries for Buy-back of shares of Gun Shot Ltd.

(i) Bank A/c	Dr.	3,20,000	
To Non-trade Investments			3,00,000
To Profit & Loss A/c			20,000
(Being the entry for sale of Non-trade Investments)			

(ii)	Shares Buy back A/c (16,000 x Rs. 20)	Dr.	3,20,000	
	To Bank A/c			3,20,000
	(Being purchase of 16,000 shares @ Rs.20 per share)			
(iii)	Equity Share Capital A/c (16,000 x Rs.10)	Dr.	1,60,000	
	Buy-back Premium (16,000 x Rs.10)	Dr.	1,60,000	
	To Shares Buy-back A/c			3,20,000
	(Being cancellation of shares bought back)			
(iv)	Securities Premium A/c	Dr.	1,00,000	
	General Reserve	Dr.	60,000	
	To Buy-back Premium			1,60,000
	(Being adjustment of buy-back premium)			
(v)	General Reserve	Dr.	1,60,000	
	To Capital Redemption Reserve			1,60,000
	(Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)			

Question 5

Dawn Ltd. was incorporated to take over Arun Ltd., Brown Ltd. and Crown Ltd. Balance Sheets of all the three companies as on 31.03.2008 are as follows:

	Rs. in '000		
Particulars	Arun Ltd.	Brown Ltd.	Crown Ltd.
Liabilities :			
Equity Share Capital (Share of Rs. 10 each)	1,800	2,100	900
Reserve	300	150	300
10 % Debentures	600	---	300
Other Liabilities	<u>600</u>	<u>450</u>	<u>300</u>
Total	<u>3,300</u>	<u>2,700</u>	<u>1,800</u>
Assets :			
Net Tangible Block	2,400	1,800	1,500

Goodwill	-	150	-
Other Assets	<u>900</u>	<u>750</u>	<u>300</u>
Total	<u>3,300</u>	<u>2,700</u>	<u>1,800</u>

From the following information you are to:

- (a) Work out the number of Equity shares and Debentures to be issued to the shareholders of each company.
- (b) Prepare the Balance Sheet of Dawn Ltd. as on 31.03.2008.

Information :

- (i) Assets are to be revalued and the revalued amount of Tangible Block and other Assets are as follows :

	Tangible Block	Other Assets
Arun Ltd.	Rs. 30,00,000	Rs. 10,50,000
Brown Ltd.	Rs. 15,00,000	Rs. 4,20,000
Crown Ltd.	Rs. 18,00,000	Rs. 2,40,000

- (ii) Normal profit on capital employed is to be taken at 10%
- (iii) Average amount of profit for three years before charging interest on Debentures are:

Arun Ltd.	Rs. 5,40,000
Brown Ltd.	Rs. 4,32,000
Crown Ltd.	Rs. 3,12,000
- (iv) Goodwill is to be calculated at three years' purchase of average super profits for three years, such average is to be calculated after adjustment of 10% depreciation on Increase/ Decrease on revaluation of Fixed Assets (Tangible Block).
- (v) Capital employed being considered on the basis of net revaluation of Tangible Assets.
- (vi) Equity Shares of Rs. 10 each fully paid up in Dawn Ltd. are to be distributed in the ratio of average profit after adjustment of depreciation on revaluation of Tangible Block.
- (vii) 10% Debentures of Rs. 100 each fully paid up are to be issued by Dawn Ltd. for the balance due.
- (viii) The ratio of issue of Equity shares and debentures of Dawn Ltd. are to be maintained at 3:1, towards the take over companies.
- (ix) The amount required for preliminary expenses of Rs. 1,50,000 and for payment to existing Debenture holders, were provided by issuing Equity shares of Rs. 10 each in Dawn Ltd.

(16 Marks)

Answer

- (a) Number of Equity shares and Debentures to be issued to the shareholders of each company

	Arun Ltd.	Brown Ltd.	Crown Ltd.	Total paid by Dawn Ltd. in 3:1
	Rs.	Rs.	Rs.	Rs.
Equity shares of Rs.10/- each in the ratio of adjusted profits (420:462:252)	20,65,000	22,71,500	12,39,000	55,75,500
10% Debentures [Balance of purchase consideration] – Refer W.N. 2	<u>11,90,000</u>	<u>1,43,500</u>	<u>5,25,000</u>	<u>18,58,500</u>
	<u>32,55,000</u>	<u>24,15,000</u>	<u>17,64,000</u>	<u>74,34,000</u>
No. of shares of Rs.10 each	2,06,500	2,27,150	1,23,900	5,57,550
10% Debentures of Rs.100 each in numbers	11,900	1,435	5,250	18,585

- (b)

Balance Sheet of Dawn Ltd.as at 31.3.2008

Liabilities	Rs.	Assets	Rs.
Share capital		Goodwill	16,74,000
6,62,550 equity shares of Rs.10 each, fully paid up (Including 5,57,550 shares of Rs.10 each issued for consideration other than cash)	66,25,500	Tangible Assets Block	63,00,000
		Current Assets	17,10,000
18,585, 10% Debentures of Rs.100 each	18,58,500	Preliminary Expenses	1,50,000
Current Liabilities	<u>13,50,000</u>		
	<u>98,34,000</u>		<u>98,34,000</u>

Working Notes:

1. Computation of Goodwill

	Arun Ltd.	Brown Ltd.	Crown Ltd.	Total
	Rs.	Rs.	Rs.	Rs.
Profit	5,40,000	4,32,000	3,12,000	12,84,000
Debenture Interest	<u>(60,000)</u>	<u>-</u>	<u>(30,000)</u>	<u>(90,000)</u>
Profit after Debenture Interest	4,80,000	4,32,000	2,82,000	11,94,000
Adjustment for increase/decrease in depreciation due to revaluation	<u>(60,000)</u>	<u>30,000</u>	<u>(30,000)</u>	<u>(60,000)</u>
	4,20,000	4,62,000	2,52,000	11,34,000
Less: Normal Profit @ 10% on Capital employed as per Working Note 2	<u>2,85,000</u>	<u>1,47,000</u>	<u>1,44,000</u>	<u>5,76,000</u>
Super Profits	<u>1,35,000</u>	<u>3,15,000</u>	<u>1,08,000</u>	<u>5,58,000</u>
Goodwill on 3 years of super profits	<u>4,05,000</u>	<u>9,45,000</u>	<u>3,24,000</u>	<u>16,74,000</u>

2. Statement showing calculation of Capital Employed and Purchase Consideration

	Arun Ltd.	Brown Ltd.	Crown Ltd.	Total
	Rs.	Rs.	Rs.	Rs.
Fixed Assets	30,00,000	15,00,000	18,00,000	63,00,000
Current Assets	<u>10,50,000</u>	<u>4,20,000</u>	<u>2,40,000</u>	<u>17,10,000</u>
	40,50,000	19,20,000	20,40,000	80,10,000
Less: Debentures	6,00,000	---	3,00,000	9,00,000
Current Liabilities	<u>6,00,000</u>	<u>4,50,000</u>	<u>3,00,000</u>	<u>13,50,000</u>
Capital Employed	28,50,000	14,70,000	14,40,000	57,60,000
Goodwill	<u>4,05,000</u>	<u>9,45,000</u>	<u>3,24,000</u>	<u>16,74,000</u>
Purchase consideration	<u>32,55,000</u>	<u>24,15,000</u>	<u>17,64,000</u>	<u>74,34,000</u>

3. Total number of equity shares issued

	Equity Shares
For purchase consideration	5,57,550
preliminary expenses (Rs. 1,50,000/ Rs. 10)	15,000
payment of existing debenture holders (Rs. 6,00,000 + Rs. 3,00,000) /Rs. 10	<u>90,000</u>
	<u>6,62,550</u>

Question 6

- (a) P Ltd. started its business on 01.04.2007, It issued one lac Equity Shares of Rs. 10 each at par and 30,000, 9% Debentures of Rs. 50 each, both were fully subscribed. It purchased Plant and Machinery for worth Rs. 15 Lac and goods for trading worth Rs. 12 lac @ Rs. 100 per unit. Estimated life of plant and machinery was 10 years with no scrap value. Goods were sold at Profit of 40% on selling price. Collection from Debtors outstanding as on 31.3.2008 amounted to Rs. 5 lac. Goods sold were replaced at a cost of Rs. 120 per unit, the number of units being the same. Trade Creditors outstanding as on 31.3.2008 were Rs. 3 lac. The replaced goods were entirely in stock on 31.3.2008, replacement cost of goods was considered to be Rs. 140 per unit. Replacement cost of machine was Rs. 20 lac as on 31.3.2008. Draft Profit and Loss Account and Replacement reserve on replacement cost basis.
- (b) Prepare a value added statement for the year ended on 31.3.2008 and reconciliation of total value added with profit before taxation, from the Profit and Loss Account of Futures Ltd. for the year ended on 31.3.2008 :

(Rs. in '000)

Income:		
Sales	24,400	
Other Income	<u>508</u>	
		24,908
Expenditure :		
Operating cost	21,250	
Excise duty	1,110	
Interest on Bank Overdraft	75	
Interest on 9% Debentures	<u>1,200</u>	
		<u>23,635</u>
Profit before Depreciation		1,273
Depreciation		<u>405</u>
Profit before tax		868
Provision for tax		<u>320</u>
Profit after tax		548
Proposed Dividend		<u>48</u>
Retained Profit		<u>500</u>

The following additional Information are given :

- (i) Sales represents Net sales after adjusting Discounts, Returns and Sales tax.

(ii) Operating cost includes Rs. 82,50,000 as wages, salaries and other benefits to Employees.

(iii) Bank overdraft is temporary. (8x2= 16 Marks)

Answer

(a)

M/s P Ltd.

Profit & Loss Account for the year ended 31.03.2008

	Rs.
Sales	20,00,000
Less: Cost of sales (Refer W.N. 1)	<u>14,40,000</u>
Gross Profit	5,60,000
Less: Depreciation (Refer W.N. 2)	<u>1,75,000</u>
Profit before Interest	3,85,000
Less: Debenture Interest (Refer W.N. 3)	<u>1,35,000</u>
Profit after charging depreciation and interest	<u>2,50,000</u>

Replacement Reserve

	Realised Gain Rs.	Unrealised Gain Rs.
Stock:		
Sold (Rs. 14,40,000 – Rs. 12,00,000)	2,40,000	
Unsold goods 12,000 x (Rs. 140 – Rs. 120)		2,40,000
Plant & Machinery Depreciation (Rs. 1,75,000 – Rs.1,50,000)	25,000	
Book value of asset		
[(Rs.20,00,000- Rs.2,00,000) less (Rs.15,00,000-Rs.1,50,000)]	<u> </u>	<u>4,50,000</u>
	<u>2,65,000</u>	<u>6,90,000</u>

Replacement Reserve = Rs. 2,65,000 +Rs. 6,90,000 = Rs. 9,55,000

Working Notes:

1. Sales and Cost of sales

Sale Price @ 40% profit on Selling Price = Rs. 12,00,000 x (100/60) = Rs. 20,00,000

Cost of Sales = 12,000 x Rs. 120 = Rs. 14,40,000

2. Depreciation under replacement cost basis

Under replacement cost basis, depreciation is calculated (on average basis) which can be shown as follows:

$$\frac{15,00,000 + 20,00,000}{2} = 10\% \text{ of Rs. } 17,50,000 = \text{Rs. } 1,75,000$$

3. Debenture Interest

$$30,000 \times \text{Rs. } 50 \times 9\% = \text{Rs. } 1,35,000$$

(b) Value Added Statement of M/s Futures Ltd.

	Rs. in ' 000		
Sales	24,400		
Less: Operating cost - Cost of bought in material & services (Rs. 21,250 – Rs. 8,250)	13,000		
Excise duty	1,110		
Interest on bank overdraft	<u>75</u>	<u>14,185</u>	
Value added by trading and manufacturing activities		10,215	
Add: Other income		<u>508</u>	
Total value added		<u>10,723</u>	
Application of value added			%
To pay Employees:			
Wages, salaries and other benefits	8,250	76.94	
To Pay Government : Corporate tax	320	2.98	
To pay providers of capital:			
Interest on 9% debentures	1,200		
Dividends	<u>48</u>	1,248	11.64
To Provide for maintenance and expansion of the company:			
Depreciation	405		
Retained profit	<u>500</u>	<u>905</u>	<u>8.44</u>
		<u>10,723</u>	<u>100.00</u>
<u>Reconciliation</u>			
Profit before tax	868		
Depreciation	405		
Wages, salaries and other benefits to employees	8,250		
Debenture interest	<u>1,200</u>		
		<u>10,723</u>	

Question 7

Write short notes on any four from the following :

- (a) State the treatment of the following items with reference to 'Indian Accounting Standards' (AS) and International Financial Reporting Standards (IFRS) :
 - (i) Extra ordinary items
 - (ii) Contingencies.
- (b) Reversal of an Impairment Loss.
- (c) Market value Added.
- (d) What are the types of Employees benefit and what is the objective of Introduction of this Standard i.e. AS-15?
- (e) What are Timing differences and Permanent differences? (4 x 4= 16 Marks)

Answer

(a)

Indian Accounting Standards

International Financial Reporting Standards

Extraordinary Items

Events or transactions, clearly distinct from the ordinary activities of the entity, which are not expected to recur frequently and regularly, are termed as extra-ordinary items. Disclosure of the nature and amount of such item is required in the income statement to perceive the impact of current and future profits.

Not allowed.

Contingencies

Contingent Liabilities are disclosed unless the probability of outflows is remote.

Unrecognised possible losses and possible gains are disclosed.

Contingent gains are neither recognised nor disclosed.

(b) Reversal of an Impairment Loss

As per AS 28 on Impairment of Assets, an enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

In assessing whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased, an enterprise should consider, as a minimum, the following indications:

External sources of information

- (a) the asset's market value has increased significantly during the period;
- (b) significant changes with a favourable effect on the enterprise have taken place during the period, or will take place in the near future, in the technological market, economic or legal environment in which the enterprise operates or in the market to which the asset is dedicated;
- (c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially.

Internal sources of information

- (d) significant changes with a favourable effect on the enterprise have taken place during the period, or are expected to take place in the near future, to the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure that has been incurred during the period to improve or enhance an asset in excess of its originally assessed standard of performance or a commitment to discontinue or restructure the operation to which the asset belongs; and
- (e) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

(c) Market Value Added (MVA)

Market value added is the market value of capital employed in the firm less the book value of capital employed. Market value added is calculated by summing up the paid up value of equity and preference share capital, Retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt.

Market value added measures cumulatively the performance of corporate entity.

A High market value added means that the company has created substantial wealth for share holders. On the other hand negative MVA means that the value of management's actions and investments are less than the value of the capital contributed to the company by the capital market or that the wealth and value has been destroyed.

- (d) There are four types of employee benefits according to AS 15 (Revised 2005). They are:
 - (a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for

medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

- (b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;
- (c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and
- (d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Statement establishes separate requirements for each category.

The objective of AS 15 is to prescribe the accounting and disclosure for employee benefits. The statement requires an enterprise to recognise:

- (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- (b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

(e) Timing and Permanent Differences

AS 22 states that timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Unabsorbed depreciation and carry forward of losses which can be set off against future taxable income are also considered as timing differences and result in deferred tax assets subject to consideration of prudence i.e., deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.