

In the absence of Securities Premium it is assumed that Premium on Buy is funded out of Free Reserves. Premium on Buy Back = Buy Back Price Rs.25 – Face Value Rs.10 = Rs.15 × 1 Lakh Shares Bought Back = Rs.15 Lakhs.

- **Source for Buy Back:** It is assumed that the entire buy back was funded from the Opening Balance in Free Reserves. Therefore, CRR created out of Free Reserves is also Pre Acquisition Reserve.

(b) A Ltd (Associate Company) (Rs.Lakhs) (1 Mark)

Particulars	Rs.
Closing Net Worth (as at 31.03.2009)	50.00
Less: Net Worth on the date of Acquisition (01.04.2008)	(40.00)
Increase in Net Worth = Profits for the Post Acquisition Period	10.00

3. Analysis of Net Worth of Subsidiary (1½ Marks)

Particulars	Total	Group Interest	Minority Interest
	100%	75%	25%
(a) Equity Capital	40.00	30.00	10.00
(b) Pre Acquisition Reserves			
• Free Reserves	15.00		
• Capital Redemption Reserve	10.00		
Total Pre Acquisition Reserve	25.00	18.75	6.25
(c) Post Acquisition Reserves – Free Reserves	60.00	45.00	15.00
Minority Interest			31.25
Less: Unrealized Profit on Upstream Transaction (7 – 5) Lakhs × 25%			(0.50)
Minority Interest			30.75

4. Cost of Control (2 ½ Marks including ½ for Treatment of Unrealized Profit)

Particulars	Investment in			
	S Ltd		A Ltd	
Cost of Investment in Equity Shares		60.00		15.00
Less: Nominal Value of Equity Capital (For A Ltd Rs.40 × 30%)	30.00			
Share in Capital Profit	18.75	48.75		12.00
Goodwill on Consolidation		11.25		3.00
Add: Unrealized Profit on Upstream Transaction during Pre Acquisition Period [7 – 5] × 75% [See Note]		1.50		
Goodwill on Consolidation		12.75		3.00
Total Goodwill on Consolidation		15.75		

Note: Unrealized Profits are from Pre Acquisition Period, and therefore Gain or Loss should be adjusted in Pre Acquisition Reserves, and not against Post Acquisition Reserves. Since Pre Acquisition Reserves are adjusted against Investment to determine Cost of Control, such profits are adjusted here.

5. Carrying Amount of Investment in Associate (A Ltd) [Rs. Lakhs] (1 Mark)

Particulars	Rs.
Share of Net Worth on DOA [Rs.40 Lakhs × 30%]	12.00
Add: Share in Post Acquisition Profits (Rs.10 Lakhs × 30%)	3.00
Carrying Amount of Investment	15.00

6. Group Reserves for Consolidation Balance Sheet (Rs. Lakhs) (1 Mark)

Particulars	Rs
Balance as per H Ltd's Balance Sheet	320.00
Add: Share in Post Acquisition Free Reserves of S Ltd	45.00
Add: Share in Post Acquisition Free Reserves of A Ltd	3.00
Total Free Reserve	368.00

Question 4(a) – Corporate Restructuring – Demerger – 12 Marks

Given below is the Balance Sheet of ADAG Ltd as at 31st December, consisting of two divisions –

Liabilities	Rs.Lakhs	Assets	Rs.Lakhs
8.00 Crore Equity Shares of Rs.10 each	8,000	Fixed Assets	
10 Lakh 5% Preference Shares of Rs.100 each	1,000	Tangible Fixed Assets	26,000
General Reserve	15,500	Intangible Fixed Assets	500
Profit & Loss A/c	8,500	Capital Work in Progress	12,500
Securities Premium	5,000	Investments	
15% Term Loans	12,500	In Mutual Funds	500
12% Debentures	7,500	In Lands	1,500
Working Capital Loan	5,000	Current Assets	
Current Liabilities	7,000	Advances and Deposits	5,000
		Current Receivables	6,500
		Inventories	7,000
		Cash and Bank	10,500
Total	70,000	Total	70,000

Other Information:

- The Company has two divisions – Electronic Retail and Telecommunication Tower Business.
- Telecommunication Tower is a newly started division, whose assets and liabilities are as follows –

Tangible Fixed Assets	5,000
Intangible Fixed Assets	500
Investment in Land	1,500
Advances	4,000
Bank Balances	6,000
15% Term Loans	7,000
Current Liabilities	4,000

- The Company in its EGM has decided to demerge the Telecommunication Tower Business into a new Company, AB Teletowers Ltd (ABTL) at the following terms –
 - Consideration will be paid on Net Assets basis directly to the shareholders by issue of adequate number of equity shares at Rs.10 per share.
 - Investment in Land will be transferred at Rs.2,500 Lakhs
- In its EGM 10% of its Equity Shareholders opposed the Demerger, and based on Court Ruling, their shares will be bought back before demerger at the prevailing market price of Rs.75 per Share.
- The buy back would be funded by sale of investments at Rs.800 (Lakhs), realization of Short Term Deposits of Rs.800 Lakhs (included in Advances).

Required –

- Journal Entries in the books of ADAG Ltd
- Balance Sheet of AB Teletowers Ltd.

Solution:**1. Journal Entries in the books of ADAG Ltd**

S No	Particulars	Dr	Cr
	BUY BACK OF SHARES OF DISSENTING SHAREHOLDERS		

	(6 Marks)		
1	Bank A/c To Investment in Mutual Funds To Profit and Loss A/c (Sale of investment in Mutual Funds at a Profit of Rs.300 Lakhs)	Dr. 	800 500 300
2	Bank A/c To Short Term Deposits A/c (Realisation of maturity proceeds of Short Term Deposits)	Dr. 	800 800
3	Equity Share Capital A/c (80 Lakhs Shares × Rs.10) Premium on Buy Back A/c (80 Lakhs Shares × Rs.65) To Equity Share Holders A/c (Amount to be paid to Shareholders on buy back transferred to Shareholders Account)	Dr. Dr. 	800 5,200 6,000
4.	Equity Shareholders A/c To Bank A/c (Amount due to Shareholders paid)	Dr. 	6,000 6,000
5.	Securities Premium A/c General Reserve A/c To Premium on Buy Back (Free reserves and Securities Premium utilized for sourcing Premium on buy back of Equity Shares)	Dr. Dr. 	5,000 200 5200
6.	General Reserves A/c To Capital Redemption Reserve A/c (Transfer to Capital Redemption Reserve for an amount equivalent to Paid Up Capital bought back)	Dr. 	800 800
	DEMERGER OF TELECOMMUNICATION BUSINESS (3 Marks)		
7.	AB Teletowers Ltd A/c To Tangible Fixed Assets A/c To Intangible Fixed Assets A/c To Investment in Land A/c To Advances A/c To Bank Balances A/c To Capital Reserve A/c (Transfer of Assets to AB Tele Towers Ltd consequent to a scheme of demerger approved by Court Order dated. Gain on transfer of Investment in Land of Rs.1,000 Lakhs transferred to Capital Reserve, since consideration is not realized in cash)	Dr. 	18,000 5,000 500 1,500 4,000 6,000 1,000
8.	15% Term Loan A/c Current Liabilities A/c To AB Tele Towers Ltd A/c (Transfer of liabilities to AB Tele Towers pursuant to a scheme of Demerger approved by Court Order dated ...)	Dr. Dr. 	7,000 4,000 11,000
9.	Members A/c To AB Tele Towers Ltd A/c (Net amount due from AB Tele Towers Ltd transferred to Members Account, since consideration is paid directly to the members)	Dr. 	7,000 7,000
10.	General Reserve A/c Capital Reserve A/c To Members A/c	Dr. Dr. 	6,000 1,000 7,000

(Balance in Members Account adjusted first against Capital Reserve on Demerger, and balance against Free Reserves, as it represents assets distributed to Members)		
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(Without narration or inappropriate, 2 Marks will be reduced in aggregate)

2. Balance Sheet of AB Tele Towers Ltd as at 31st December (3 Marks)

Liabilities	Rs.Lakhs	Assets	Rs.Lakhs
Equity Capital (700 Lakhs Shares of Rs10 Each) (See Note)	7,000	Tangible Fixed Assets	5,000
15% Term Loans	7,000	Intangible Fixed Assets	500
Current Liabilities	4,000	Investment in Land	2,500
		Advances and Deposits	4,000
		Cash and Bank Balances	6,000
	18,000		18,000

Note: Equity Shares issued = Net Assets Taken Over

Particulars	Rs.Lakhs
Tangible Fixed Assets	5,000
Intangible Fixed Assets	500
Investment in Lands	2,500
Advances and Deposits	4,000
Cash and Bank	6,000
Less: 15% Term Loan	(7,000)
Less: Current Liabilities	(4,000)
Net Assets Taken Over	7,000

Question 4(b) – Amalgamation – Computation of Purchase Consideration – 4 Marks

Trimurthi Company Ltd was incorporated for the purpose of acquiring Brahma Ltd, Vishnu Ltd and Shiva Ltd. The Balance Sheet of these companies as on 30th June of a financial year is as follows:

Particulars	Brahma Ltd	Vishnu Ltd	Shiva Ltd
Tangible Fixed Assets at Cost Less Depreciation	5,00,000	4,00,000	3,00,000
Goodwill	–	60,000	–
Other Assets	2,00,000	2,80,000	85,000
Total Assets	7,00,000	7,40,000	3,85,000
Liabilities:			
Issued Ordinary Share Capital shares of Rs.10 each	4,00,000	5,00,000	2,50,000
Profit and Loss Account	1,50,000	1,10,000	60,000
10% Debentures	70,000	–	40,000
Sundry Creditors	80,000	1,30,000	35,000
Total Liabilities	7,00,000	7,40,000	3,85,000
Average Annual Profits before Debenture Interest	90,000	1,20,000	50,000
Professional Valuation of Tangible Assets on 30 th June	6,20,000	4,80,000	3,60,000

- The Directors in their negotiations agreed that (i) the recorded Goodwill of Vishnu Ltd is valueless; (ii) The Other Assets of the Brahma Ltd are worth Rs.30,000; (iii) the valuation of 30th June in respect of Tangible Fixed Assets should be accepted; (iv) these adjustments are to be made by the individual Company before the completion of the acquisition.
- The acquisition agreement provides for the issue of 12% Unsecured Debentures to the value of the Net Assets of the companies Brahma Ltd, Vishnu Ltd and Shiva Ltd and for the issuance of Rs.10

nominal value Ordinary Shares for the capitalized average profits of each acquired Company in excess of the Net Assets contributed. The Capitalization rate is taken at 10%.

You are required to calculate Purchase Consideration and show the Purchase Consideration as discharged.

Solution:

1. Computation of Net Assets and Debentures to be issued (1 Mark)

Particulars	Brahma	Vishnu	Shiva
Tangible Fixed Assets (as per Valuation)	6,20,000	4,80,000	3,60,000
Other Assets (as per agreement)	30,000	2,80,000	85,000
Total Assets	6,50,000	7,60,000	4,45,000
Less: Sundry Creditors	80,000	1,30,000	35,000
Debentures	70,000	—	40,000
Net Assets	5,00,000	6,30,000	3,70,000

2. Settlement of Purchase Consideration (3 Marks)

Particulars	Brahma	Vishnu	Shiva
Average Annual Profits	90,000 – 7,000 = 83,000	1,20,000	50,000 – 4,000 = 46,000
Capitalisation at 10%	8,30,000	12,00,000	4,60,000
Less: Net Assets as calculated above	5,00,000	6,30,000	3,70,000
Excess to be settled by Shares	3,30,000	5,70,000	90,000
Issue by Trimurthi Ltd			
Equity Shares (for the excess portion)	3,30,000	5,70,000	90,000
12% Debentures (for the Net Assets)	5,00,000	6,30,000	3,70,000
Total Purchase Consideration	8,30,000	12,00,000	4,60,000

Question 5(a) – AS 20 – Earnings Per Share – Buy Back and Share Split – 10 Marks

In a reporting period (calendar year) Pathanga Ltd a listed company, announced a scheme to buyback a maximum of 5% of its Equity Shares (of Rs. 10 Each) at a price of Rs. 25 per share. The market price of the shares immediately prior to the buyback is Rs. 22. The following additional information is given –

Particulars	This Year	Last Year
Net Profit	Rs. 8,00,000	Rs. 6,00,000
Number of Shares on January 1	1,00,000	1,00,000
Bought –back and cancelled on 30th September	(4,000)	–

Also, a share split of 1:1 was announced during the reporting period on the 1st of December. Compute the Basic EPS.

Solution:

Step	Computation / Description	Value
1	Number of Equity Shares outstanding prior to the Buyback	1,00,000
2	Number of Shares bought back at an exercise price of Rs. 25 = Given	4,000
3	Fair Value of Equity Share prior to Buy Back	Rs.22.00
4	Theoretical Ex-Buyback Fair Value per share is calculated as under – (1½ Mark) $\left(\frac{\text{Shares Before Buy Back} \times \text{Fair Value Before}}{\text{Buy Back}} \right) - \left(\frac{\text{Shares Bought Back} \times \text{Buy Back Price}}{\text{Buy Back}} \right)$ Shares Before Buy Back – Shares Bought Back	Rs.21.875

	$= \frac{(1,00,000 \times \text{Rs.}22) - (4,000 \times 25)}{1,00,000 - 4,000} = \frac{\text{Rs.}21,00,000}{96,000 \text{ Shares}}$	
5	Adjustment [or] Multiplier Factor (1 Mark) $= \frac{\text{Fair Value Prior to Buy Back}}{\text{Theoretical Ex - Buy Back Value}} = \frac{\text{Rs.}22.00}{\text{Rs.}21.875}$	1.0057
6	Weighted Average Number of Equity Shares for the current year (See Note Below)	1,98,856
7	Basic EPS for the current year = Net Profit ÷ Step 6 = Rs. 8,00,000 ÷ 1,98,856 (1 Mark)	Rs.4.02
8	EPS for the Previous year as originally reported = Rs.6,00,000 ÷ 1,00,000 = Rs 6.00 Adjusted EPS for the previous reporting period $= \frac{\text{Net Profit for Previous Year}}{\text{Number of Equity Shares} \times \text{Adjustment Factor} \times \text{Share Split Factor i.e.}2}$ $= \text{Rs.}6,00,000 \div (1,00,000 \times 1.0057 \times 2) = \text{Rs } 2.98$	(2 Mark)

Note: Computation of Weighted Average Number of Equity Shares for the current year **(3½ Marks, including 1 Mark for correct treatment of Share Split, and ½ Mark for Correct Treatment of Adjustment Factor)**

Period	Months	Time Weight	Adjustment Factor	No of Equity Shares Outstanding	Weighted Average Number of Shares
(1)	(2)	(3)	(4)	(5)	(6) = (3) × (4) × (5)
1 ST Jan – 30 th Sep	9	9 / 12	1.0057	1,00,000	75,428
1 st Oct – 30 th Nov	2	2 / 12	Not Applicable	96,000	16,000
1 st Dec – 31 st Dec	1	1 / 12	Not Applicable	(1,00,000 – 4,000) 96,000	8,000
Weighted Average Number of Shares outstanding during the period					99,428
Add: Additional Shares on account of Share Split (deemed to have been effected from the earliest available date)					99,428
Weighted Average Number of Equity Shares for EPS Purposes					1,98,856

Question 5(b) – AS 28 – Impairment of Assets – 6 Marks

Compute the Loss on Impairment for the following situations – Figures in Rs. Crores

Particulars	Situation 1	Situation 2	Situation 3	Situation 4
Carrying in Amount	42	18	25	85
Expected Annual Cash Flow – Pre Tax – Useful life being 5 years with no salvage value	14	5	7	24
Net Selling Price	50	28	45	75

The Cost of Capital of 14% can be assumed. A uniform tax rate of 30% is applicable across the four situations. Find out the amount of impairment Loss to be recognized in the reporting period.

Answer:

1. An Asset is said to be impaired when the recoverable amount of the asset is lower than its carrying amount. The loss due to impairment of an asset is equal to the Recoverable Amount of the Asset Less the Carrying Amount.
2. The Recoverable Amount = Higher of Value in Use (i.e. PV of Future Cash Inflows over the Asset's Useful Life) or Net Selling Price.
3. Value in Use should be determined using Pre-Tax Discount Rate (Para 47 of AS 28). In the given question it is assumed, that Cost of Capital at 14% is Pre Tax. (Alternatively, it may be assumed to be post tax, and grossed upto 20% as Pre Tax Discount Rate). Annuity Factor at 14% for 5 Years = 3.433

4. Computation of Impairment Loss:

Particulars	Situation 1	Situation 2	Situation 3	Situation 4
(a) Value in Use	= 14×3.433 = 48.06	= 5×3.433 = 17.17	= 7×3.433 = 24.03	= 24×3.433 = 82.39
(b) Net Selling Price (Given)	50.00	28.00	45.00	75.00
(c) Recoverable Amount (Higher of VIU and NSP)	50.00	28.00	45.00	82.39
(d) Carrying Amount	42.00	18.00	25.00	85.00
(e) Impairment Loss	NIL	NIL	NIL	2.69

[For Each Situation – 1 Marks, 2 Marks for Briefly Explaining the Provisions of AS 28]

Question 6(a) – AS 22 – Taxes on Income – 4 Marks

Distinguish between Permanent Differences and Temporary Differences.

Answer:

Point	Permanent Differences	Timing Difference
Meaning	They originate in one period and do not reverse subsequently	They originate in one period and are capable of reversal in one or more subsequent periods.
Examples	- Cash Payments for revenue expenditure Rs. 20,000 is fully disallowed u/s 40A(3). - Payment of remuneration to partners in excess of amount allowed by the Partnership Deed - Goodwill written off not allowed as deductible expense. - Contribution to unapproved Provident Funds / Employee Welfare Funds.	- Expenditure of the nature mentioned in Sec 43B like taxes, duty, cess, fees etc. accrued but allowed for tax purposes on payment basis. - Payments accrued and recorded in books, but disallowed for tax purposes u/s 40(a)(i) and allowed when relevant tax is deducted or paid subsequently. - Provisions made in anticipation of Liabilities where the relevant Liabilities are allowed in subsequent years when they crystallize.
Effect under AS – 22	They do not result in Deferred Tax Assets (DTA) or Deferred Tax Liabilities (DTL) [Para 12]	They result in Deferred Tax Assets (when Current Accounting Income < Taxable Income) and Deferred Tax Liabilities (if Current Accounting Income > Taxable Income) [Para 11]

Question 6(b) – Accounting Standards – Basics – 4 Marks

Briefly discuss about the Expert Advisory Committee .

Answer:

- Constitution:** Expert Advisory Committee is constituted by the Council of the ICAI.
- Purpose:** EAC is constituted to answer queries on matters involving accounting and auditing principles and related areas.
- Significance of Opinions:** Opinions of the EAC provides interpretative framework of the established accounting and auditing principles, and also lays down principles in those areas in respect of which no authoritative pronouncements have been established so far
- Significance of EAC:** With the issuance of a number of accounting standards by the ICAI, which have been introduced for the first time, the clarificatory role of the Committee has assumed even greater importance.
- Features of EAC Opinion:**

- (a) The opinions of the Expert Advisory Committee represent the opinions of the members comprising the Committee.
- (b) The opinions are based on the facts and circumstances of the query as supplied by the querist, accounting /auditing principles and practices and the relevant laws applicable on the date the Committee finalise the particular opinion.

Question 6(c) – AS 29 – Provisions, Contingent Liabilities and Reimbursement – 4 Marks

X Ltd has a practice of not including reimbursement as part of its taxable services for the purpose of Levy of Service Tax. The Company is aware that Service Tax Department is frequently raising demand on assessees rendering the said class of Service for the Service Tax Component on reimbursement and the chances of the X Ltd coming under assessment is more likely than not. The total amount of levy in case the assessment is opened would be to the tune of Rs 6 Lakhs. X Ltd can also recover the amount of such service tax paid to the department from its customers and it is estimated that 90% of the amount of tax paid on assessment can be certainly recovered from its customers. Considering the situation X Ltd asks your opinion on the disclosure requirements in the financials of the company. You may Advise X Ltd considering the provisions outlined in AS 29 and AS 9.

Answer:

1. Recognition of Provision [2 Marks]

- (a) **AS Provisions:** Provision should be recognized, when all of the below conditions are satisfied –
 - an enterprise has a present obligation as a result of a past event,
 - It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation;
 - A reliable estimate can be made of the amount of the obligation.
- (b) **Analysis and Conclusion:** In the instant case, it is probable that service tax assessment will be made on the company for the non charging of service tax on reimbursement. Therefore the estimated outflow to settle the obligation i.e. Rs. 6 Lakhs should be recognized as the gross amount of liability

2. Treatment of Reimbursement of Expenses [2 Marks]:

- (a) **AS Provisions:**
 - When some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized only when it is virtually certain such reimbursement will be received if the enterprise settles the obligation.
 - The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the provision.
 - Expense relating to a provision may be recognized net off the amount of reimbursement recognized. **(Para 47)**
- (b) **Analysis and Conclusion:**
 - Since 90% of estimated obligation can certainly be recovered, to the extent of 90% of Provision can be recognized as an asset, and provision may be recognized in Profit and Loss Account for the net amount i.e. 6 Lakhs **Less 90% = 0.6 Lakhs.**
 - In the Balance Sheet, amount of provision should be recognized on a Gross basis i.e 6 Lakhs and the amount of expected inflow i.e Rs 5.4 Lakhs should be recognized on as a separate asset.

Question 6(d) – AS 18 – Related Party – 4 Marks

Mr. A, is the Managing Director of PQR Ltd. His purchases from the company amount to Rs. 2,00,000 every month for the year ended 31.03.2009. His term of managing director of the company came to end on 31.12.2008, and he was not re appointed on the expiry of the term. Now considering the facts of the case, state the transactions that are required to be disclosed as Related Party Transactions during the year ended 31.03.2009.

Answer:

1. **Related Party:** Key Management Personnel and relatives of such key management personnel are treated as Related Party under AS 18 [1 Mark]
2. **Disclosure:** As per AS 18, following are to be disclosed – [1 Mark]
 - (a) Name of the Related Party
 - (b) Nature of Related Party Relationships
 - (c) Transactions with the Related Party during the existence of Related Party Relationships
 - (d) The above are to be disclosed irrespective of whether such relationship exists as at Balance Sheet date.
3. **Analysis and Conclusion:** [2 Marks]
 - (a) Mr. A is a Related Party, since he was a Key Managerial Personnel of PQR Ltd.
 - (b) Transactions with Mr. A during his existence as Managing Director should be disclosed in the Financial Statements.
 - (c) Therefore, the amount of purchases for the period upto 31.12.2008 should be disclosed in the Financial Statements.

Question 6(e) – Environmental Accounting – Basics – 4 Marks

Describe the major issues in Environmental Accounting.

Answer: Major Accounting Issues in Environmental Accounting are –

1. **Environmental Expenditure vs. Normal Business Expenditure:** Many machines may have state-of-the-art environmental technology. Hence, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. There should be proper guidelines for allocating the capital and revenue expenditures between Environmental Expenditure and Normal Business Expenditure.
2. **Capitalisation vs. Charging Off of Environmental Expenditure:** Environmental protection costs relating to prior periods and current period are generally very high. If these are expensed off in one year, EPS may be adversely affected. Some Companies may capitalise such expenditure and amortise the same over say 10 years. Uniformity is required for comparative analysis of Financial Statements.
3. **Recognition of Environment related Contingent Liabilities:** Environmental Contingent Liabilities are a matter of increasing concern. Recognizing a liability for hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably. Developing a reliable estimate requires evaluation of technological, regulatory and legal factors, each of which calls for exercise of management judgement to reach a supportable accounting conclusions.