

PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.

Working Notes should form part of the answer.

Wherever necessary, suitable assumption(s) should be made by the candidates.

Question 1

The Balance Sheets of Aqua Ltd. and Baqa Ltd. as on the dates of last closing of accounts are as under:

	Aqua Ltd. as on 31.03.2009 Rs.	Baqa Ltd. as on 31.12.2008 Rs.
Liabilities		
Share capital (equity shares of Rs.10 each)	11,00,000	5,00,000
Accumulated Profits & Reserves	4,50,000	2,05,000
15% Rs.100 non-convertible debentures	-	3,00,000
Accounts Payable	4,80,000	2,80,000
Other liabilities	1,00,000	40,000
Tax Provision	1,50,000	2,50,000
Total	22,80,000	15,75,000
Assets		
Fixed Assets at Cost	8,45,000	5,26,500
Less: Depreciation	1,95,000	1,21,500
	6,50,000	4,05,000
Investments:		
40,000 shares in Baqa Ltd.	8,00,000	—
1,000 debentures in Baqa Ltd.	1,50,000	—
Current Assets:		
Inventories	2,00,000	3,50,000
Accounts Receivable	2,50,000	4,65,000
Cash & Bank	2,30,000	3,55,000
Total	22,80,000	15,75,000

The following information is also available:

1. On 8th February, 2009 there was a fire at the factory of Baqa Ltd., resulting in inventory worth Rs.20,000 being destroyed. Baqa received 75 per cent of the loss as insurance.

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2. The same fire resulted in destruction of a machine having a written down value of Rs.1,00,000. The Insurance company admitted the Company's claim to the extent of 80 per cent. The machine was insured at its fair value of Rs.1,50,000.
3. On 13th March, 2009, Aqua sold goods costing Rs.1,50,000 to Baqa at a mark-up of 20 per cent. Half of these goods were resold to Aqua who in turn was able to liquidate the entire stock of such goods before closure of accounts on 31st March, 2009. As on 31st March, 2009 Baqa's accounts payable show Rs.60,000 due to Aqua on the two transactions.
4. Aqua acquired the holdings in Baqa on 1st January, 2007 when the reserves and accumulated profits of Baqa Ltd. stood at Rs.75,000.
5. Both Companies have not provided for tax on current year profits. The current year taxable profits are Rs.33,000 and Rs.66,000 for Aqua Ltd. and Baqa Ltd. respectively. The tax rate is 33%.
6. The incremental profits earned by Baqa Ltd. for the period January, 2009 to March 2009 over that earned in the corresponding period in 2008 was Rs.56,000. Except for the profits that resulted from the transactions with Aqua in the aforesaid period, the entire profits have been realised in cash before 31st March, 2009.

You are requested to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Aqua Limited and its subsidiary as at 31st March, 2009.

(20 Marks)

Answer

Consolidated Balance Sheet of Aqua Ltd. and its Subsidiary Baqa Ltd. as on 31.03.2009

Liabilities	Rs.
Share Capital (equity shares of Rs.10 each)	11,00,000
Minority Interest (W.N. 4)	1,50,844
Accumulated Profits & Reserves (W.N. 5)	5,67,486
15% Rs.100 Non-Convertible Debentures (Rs.3,00,000 – Rs.1,00,000)	2,00,000
Accounts Payable (W.N. 6)	7,60,000
Other Liabilities (Rs.1,00,000 + Rs.40,000)	1,40,000
Tax Provision (1,50,000 + 2,50,000+21,780+10,890)	<u>4,32,670</u>
Total	<u>33,51,000</u>
Assets	
Fixed Assets at Cost (W.N. 7)	12,41,500
Less: Depreciation (W.N. 7)	<u>2,86,500</u>

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	9,55,000
Goodwill (W.N. 3)	3,90,000
Current Assets:	
Inventories (W.N. 8)	6,05,000
Accounts Receivable (W.N. 6)	6,55,000
Insurance claim Receivable	1,20,000
Cash & Bank (2,30,000 + 3,96,000)	<u>6,26,000</u>
Total	<u>33,51,000</u>

Working Notes:

1. Adjustments to Balance sheet of Baqa Ltd. and its Adjusted balance Sheet

	Rs.
(i) Inventories as on 31.12.2008	3,50,000
Add: Unsold Stock = $\frac{(\text{Rs.}1,50,000 \times 120\%)}{2}$	<u>90,000</u>
	4,40,000
Less: Cost of inventory destroyed in fire	<u>20,000</u>
Inventories as on 31.3.2009	<u>4,20,000</u>
(ii) Incremental profits earned in January, 2009 to March, 2009 over corresponding period in 2008	
Total incremental profit earned in January 2009 – March, 2009	56,000*
Less: Earned on transaction with Aqua Ltd. [W.N(viii)]	<u>30,000</u>
Balance profits realised in cash	<u>26,000</u>
(iii) Cash and Bank Balance as on 31.12.2008	3,55,000
Add: Insurance Claim received	15,000
Incremental profits realised [W.N(ii)]	<u>26,000</u>
Cash and Bank Balance as on 31.3.2009	<u>3,96,000</u>
(iv) Fixed assets as on 31.12.2008	4,05,000
Less: Written down value of machine destroyed	<u>1,00,000</u>
Fixed assets as on 31.3.2009	<u>3,05,000</u>
(v) Insurance Claim Receivable = 80% of Rs.1,50,000	1,20,000

* Before adjustments of profit/loss on destruction by fire but after including profit on sale of goods to Aqua Ltd.

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(vi)	Accounts Payable as on 31.12.2008	2,80,000
	Add: Amount payable to Aqua Ltd.	<u>60,000</u>
	Accounts Payable as on 31.3.2009	<u>3,40,000</u>
(vii)	Accumulated profits and Reserves as on 31.12.2008	2,05,000
	Less: Tax Provision = 33% of Rs.66,000	21,780
	Less: Goods destroyed in Fire after adjusting claim received	5,000
	Add: Profit on sale of goods [W.N.(viii)]	30,000
	Incremental profits realised in cash in Jan-March 2009 over prior period	26,000
	Additional amount receivable from Insurance Company over written down value for machine destroyed [1,20,000 – 1,00,000]	<u>20,000</u>
	Accumulated profits and Reserves as on 31.3.2009	<u>2,54,220</u>
(viii)	Profit made by Baqa Ltd. on transaction with Aqua Ltd.	
	Cost of goods sold from Aqua to Baqa Ltd.	1,50,000
	Add: Mark up of 20% (profit of Aqua Ltd.)	<u>30,000</u>
	Purchases by Baqa payable to Aqua Ltd. (A)	1,80,000
	Less: 50% unsold	<u>90,000</u>
	Cost of goods sold back to Aqua Ltd.	<u>90,000</u>
	Balance payable to Aqua Ltd. after 50% goods were sold back (B)	60,000
	Sales price charged by Baqa Ltd. for selling 50% of the goods (A-B)	1,20,000
	Less: Cost of these goods to Baqa Ltd.	<u>90,000</u>
	Profit on sale of 50% goods to Aqua Ltd.	<u>30,000</u>
(ix)	Balance Sheet of Baqa Ltd.	
	as at 31.3.2009	

Rs.

Liabilities	
Share Capital (equity shares of Rs. 10 each)	5,00,000
Accumulated Profits and Reserves	2,54,220
15% Non-convertible debentures	3,00,000
Accounts Payable	3,40,000
Other Liabilities	40,000
Tax provision (Rs.2,50,000 + Rs.21,780)	<u>2,71,780</u>
	<u>17,06,000</u>

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Assets	
Fixed assets at cost	3,96,500
Less: Depreciation $\left(\frac{1,21,500}{4,05,000} \times 3,05,000 \right)$	<u>91,500</u>
	3,05,000
Inventories	4,20,000
Accounts Receivable	4,65,000
Insurance Claim receivable	1,20,000
Cash and Bank	<u>3,96,000</u>
	<u>17,06,000</u>

2. Analysis of Accumulated Profits and Reserves of Baqa Ltd.

	Pre- acquisition Rs.	Post acquisition Rs.
Profits and Reserves	<u>75,000</u>	<u>1,79,220</u>
Share of Aqua Ltd. (80%)	60,000	1,43,376
Minority Interest (20%)	15,000	35,844

3. Calculation of Goodwill/ Cost of Control

	Rs.
Amount paid for shares in Baqa Ltd.	8,00,000
Amount paid for 1,000 debentures	<u>1,50,000</u>
	9,50,000
Less: Nominal Value of shares acquired	4,00,000
Nominal Value of debentures acquired	1,00,000
80% share in pre-acquisition profits	<u>60,000</u>
Goodwill	<u>3,90,000</u>

4. Minority Interest

Share Capital (20%)	1,00,000
20% of Profits and Reserves of Baqa Ltd. (15,000 + 35,844)	<u>50,844</u>
	<u>1,50,844</u>

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5. Accumulated Profits and Reserves in the Consolidated Balance Sheet

Balance as on 31.03.2009	4,50,000
Add: 80% Share in revenue reserves(2,54,220-75,000) of Baqa Ltd.	1,43,376
Less: Unrealised profits on inventory Rs. $\left(1,50,000 \times 20\% \times \frac{1}{2}\right)$	15,000
Less: Provision for taxation 33% on Rs.33,000	<u>10,890</u>
	<u>5,67,486</u>

6. Accounts Payable and Accounts Receivable in Consolidated Balance Sheet

Accounts payable as per Balance Sheet of Aqua Ltd.	4,80,000
Accounts payable as per Balance Sheet of Baqa Ltd [W.N. 1(vi)]	<u>3,40,000</u>
	8,20,000
Less: Inter company dues set off	<u>60,000</u>
Balance of Accounts Payable for Consolidated Balance Sheet	<u>7,60,000</u>
Accounts Receivable as per Balance Sheet of Aqua Ltd.	2,50,000
Accounts Receivable as per Balance Sheet of Baqa Ltd. [W.N. 1(ix)]	<u>4,65,000</u>
	7,15,000
Less: Inter company dues	<u>60,000</u>
Balance of Accounts Receivable for Consolidated Balance Sheet	<u>6,55,000</u>

7. Fixed Assets and accumulated Depreciation in Consolidated Balance Sheet

WDV of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)	4,05,000
Accumulated depreciation	1,21,500
% of Depreciation (1,21,500/ 4,05,000)	30
Original Cost of Destroyed Asset (W.D.V. of Rs.1,00,000)	1,30,000
Original Cost of Fixed Assets of Aqua Ltd. as per Balance sheet (given in question)	8,45,000
Original Cost of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)	<u>5,26,500</u>
	13,71,500
Less: Original Cost of Destroyed Asset of Baqa Ltd.	<u>1,30,000</u>
Original Cost of Fixed Assets for Consolidated Balance Sheet	<u>12,41,500</u>

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Accumulated Depreciation	
As per Balance Sheet of Aqua Ltd. (given in question)	1,95,000
As per Balance Sheet of Baqa Ltd. (given in question)	<u>1,21,500</u>
	3,16,500
Less: Accumulated Depreciation on Destroyed asset	<u>30,000</u>
Accumulated Depreciation for Consolidated Balance Sheet	<u>2,86,500</u>
8. Inventories	
As per Balance Sheet of Aqua Ltd.	2,00,000
Balance in Baqa Ltd. Balance Sheet [W.N. 1(i)]	<u>4,20,000</u>
	6,20,000
Less: Unrealised Profits on closing inventory	<u>15,000</u>
Balance in Consolidated Balance Sheet	<u>6,05,000</u>

Question 2

Small Ltd. and Little Ltd., two Companies in the field of speciality chemicals, decided to go in for a follow on Public Offer after completion of an amalgamation of their businesses. As per agreed terms initially a new company Big Ltd. will be incorporated on 1st January, 2010 with an authorized capital of Rs.2 crore comprised of 20 lakh equity shares of Rs.10 each. The holding company would acquire the entire shareholding of Small Ltd. & Little Ltd. and in turn would issue its shares to the outside holders of these shares. It is also agreed that the consideration would be a multiple of the average P/E ratio for the period 1st January, 2009 to 31st March, 2009 times the rectified profits of each company, subject to necessary adjustments for complying with the terms of the share issue.

The following information is supplied to you:

	Small Ltd.	Little Ltd.
Ordinary Shares of Rs.10 each (Nos.)	40 lakhs	20 lakhs
10% Preference shares of Rs.100 each (Nos.)	2 lakh	Nil
10% Preference shares of Rs.10 each (Nos.)	Nil	2 lakh
5% debentures of Rs.10 each (Nos.)	4 lakh	4 lakh
Investments Held		
(a) 4 lakh ordinary shares in Small Ltd.	-	Rs.40 lakhs
(b) 2 lakh ordinary shares in Little Ltd.	Rs.20 lakhs	-
Profit before Interest & Tax (PBIT) after considering impact of Inter-company Transactions and Holdings.	Rs.50 lakhs	Rs.25 lakhs
Average P/E ratio January, 2009 to March, 2009	10	8

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The following additional information is also furnished to you in respect of adjustments required to the profit figure as given above:

1. The profits of the respective companies would be adjusted for half the value of contingent liabilities as on 31st March, 2009.
2. Debtors of Small Ltd. include an irrecoverable amount of Rs.2 lakh against which Rs.1 lakh was recovered but kept in Advance account.
3. Little Ltd. had omitted to provide for increased FOREX liability of US\$10,000 on loan availed in financial year 2005-06 for purchase of Machinery. The machinery was acquired on 1st January, 2006 and put to use in Financial year 2006-07. The additional liability arose due to change in exchange rates and is arrived at in conformity with prevailing provisions of AS 11. The exchange rate is US \$ 1 = INR 50.
4. Small Ltd. has omitted to invoice a sale that took place on 31st March, 2009 of goods costing Rs.2,50,000 at a mark up of 15 per cent instead the goods were considered as part of closing inventory.
5. Closing Inventory of Rs.45 lakhs of Little Ltd. as on 31st March, 2009 stands undervalued by 10 per cent.
6. Contingent liabilities of Small Ltd. and Little Ltd. as on 31st March, 2009 stands at Rs.5 lakhs and Rs.10 lakhs respectively.

The terms of the share issue are as under:

- (i) Shares in Big Ltd. will be issued at a premium of Rs.13 per share for all external shareholders of Small Ltd. The Premium will be Rs.15 per share for shares in Big Ltd. issued to all external shareholders of Little Ltd.
- (ii) No shares in Big Ltd. will be issued in lieu of the investments (intercompany holdings) of both companies. Instead the shares so held shall be transferred to Big Ltd. at the close of the financial year ended 31st March, 2010 at Par Value consideration payable on date of transfer.
- (iii) Big Ltd. would in addition to the issue of shares to outside shareholders of Small Ltd. and Little Ltd. make a preferential allotment on 31st March, 2010 of 2 lakhs ordinary shares at a premium of Rs.28 per share to Virgin Capital Ltd. (VCL). These shares will not be eligible for any dividends declared or paid till that date.
- (iv) Big Ltd. will go in for a 18 per cent unsecured Bank overdraft facility to meet incorporation costs of Rs.16 lakhs and towards management expenses till 31st March, 2010 estimated at Rs.14 lakhs. The overdraft is expected to be availed on 1st February, 2010 and closed on 31st March, 2010 out of the proceeds of the preferential allotment.
- (v) It is agreed that interim dividends will be paid on 31.03.2010 for the period January, 2010 to March, 2010 by Big Ltd. at 2 per cent; Small Ltd. at 3 per cent and Little Ltd. at 2.5 per cent. Ignore Dividend Distribution tax.

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(vi) The prevailing Income Tax Rate is 25 per cent.

You are required to compute the number of shares to be issued to the shareholders of each of the companies and prepare the projected Profit and Loss Account for the period from 1st January, 2010 to 31.03.2010 of Big Ltd. and its Balance Sheet as on 31st March, 2010. (20 Marks)

Answer

Computation of number of shares issued

Calculation of Rectified Profits and Purchase consideration

	Rs.	Rs.
Small Ltd.		
Given profits		50,00,000
Less: Irrecoverable Debtors	1,00,000	
50% Contingent Liability	<u>2,50,000</u>	<u>3,50,000</u>
		46,50,000
Add: Profit on omitted sale (15% of Rs.2,50,000)		<u>37,500</u>
		46,87,500
Less: Debenture interest		<u>2,00,000</u>
		44,87,500
Less: Income Tax @ 25%		<u>11,21,875</u>
Profits after Tax (PAT)		33,65,625
Less: Preference Dividend (10% of Rs.2,00,00,000)		<u>20,00,000</u>
Rectified Profits		<u>13,65,625</u>
Average PE ratio = 10		
Total consideration for all equity shareholders (Average PE ratio × Profit)		136,56,250
Less: 10% thereof for shareholders of Little Ltd.		<u>13,65,625</u>
Balance available for other shareholders of Small Ltd.		<u>122,90,625</u>
Little Ltd.		
Given profits		25,00,000
Less: Increase in FOREX liability (US\$10,000 × 50)	5,00,000	
50% Contingent Liability	<u>5,00,000</u>	<u>10,00,000</u>
		15,00,000
Add: Undervaluation of inventory (45,00,000 × 10/90)		<u>5,00,000</u>
		20,00,000

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Less:Debenture interest	<u>2,00,000</u>
	18,00,000
Less:Income Tax @ 25%	<u>4,50,000</u>
Profits after Tax (PAT)	13,50,000
Less:Preference Dividend (10% of Rs.20,00,000)	<u>2,00,000</u>
Rectified Profis	<u>11,50,000</u>
Average PE ratio = 8	
Total consideration for all equity shareholders (Average PE ratio × Profit)	92,00,000
Less:10% thereof for shareholders of Small Ltd.	<u>9,20,000</u>
Balance available for other shareholders of Little Ltd.	<u>82,80,000</u>

Statement showing Disposal of Purchase Consideration

	Small Ltd. Rs.	Little Ltd. Rs.	Total Rs.
Number of shares [Purchase consideration/(Face Value + Securities Premium)]	<u>5,34,375</u>	<u>3,31,200</u>	<u>8,65,575</u>
Share Capital	53,43,750	33,12,000	86,55,750
Securities Premium	<u>69,46,875</u>	<u>49,68,000</u>	<u>1,19,14,875</u>
Purchase Consideration	<u>122,90,625</u>	<u>82,80,000</u>	<u>2,05,70,625</u>

Projected Profit and Loss Account of Big Ltd.
for the period 1st January, 2010 to 31st March, 2010

	Rs.
Dividends received from Subsidiaries (12,00,000 + 5,00,000)	17,00,000
Less:Management expenses	14,00,000
Interest on Bank O/D	<u>90,000</u>
Net profit for the period	<u>14,90,000</u>
Less:Proposed Dividend (2% of Rs.86,55,750)	<u>1,73,115</u>
Balance of Profit and Loss Account carried forward	<u>36,885</u>

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Projected Balance Sheet of Big Ltd. as on 31st March, 2010

Liabilities	Rs.	Assets	Rs.
Equity Share Capital		Investments	
Authorised		Shares in Subsidiaries (W.N. 4)	2,65,70,625
20 lakhs shares of Rs.10 each	<u>2,00,00,000</u>	Current Assets	
Issued & Paid up		Cash at Bank (W.N. 3)	36,885
10,65,575 shares of Rs.10 each	1,06,55,750	Miscellaneous Expenditure	
(out of the above 8,65,575 shares have been issued for consideration other than cash)		Preliminary expenses	16,00,000
Reserves & Surplus			
Securities Premium	1,75,14,875		
(1,19,14,875 + 56,00,000)			
Profit and loss Account	<u>36,885</u>		
	<u>2,82,07,510</u>		<u>282,07,510</u>

Working Notes:

- Shares issued by Big Ltd. to Virgin capital Ltd. (VCL)

Number of shares issued	2,00,000
	Rs.
Face Value of Share Capital @ Rs.10 each	20,00,000
Securities Premium @ Rs.28 each	<u>56,00,000</u>
Total cash received from VCL	<u>76,00,000</u>
- Overdraft of Big Ltd. as on 31.3.2010

	Rs.
Towards Incorporation expenses i.e. preliminary expenses	16,00,000
Towards Management expenses	<u>14,00,000</u>
Total Bank Overdraft availed	<u>30,00,000</u>
Interest @ 18% p.a. for 2 months	<u>90,000</u>

- Bank balance of Big Ltd. as on 31.3.2010
Bank Account of Big Ltd.

	Rs.		Rs.
01.02.2010 To Overdraft	30,00,000	01.02.2010 By Incorporation expenses	16,00,000
31.03.2010 To VCL	76,00,000	31.03.2010 By Management expenses	14,00,000

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31.03.2010	To	Dividend		31.03.2010	By	Interest on Overdraft	90,000
		Small	12,00,000 ¹	31.03.2010	By	Overdraft	30,00,000
		Little	5,00,000 ²	31.03.2010	By	Dividend paid	1,73,115 ³
				31.03.2010	By	Shares in Small Ltd. bought from Little Ltd.	40,00,000
				31.03.2010	By	Shares in Little Ltd. bought from Small Ltd.	20,00,000
					By	Balance c/d (Balancing figure)	
							<u>36,885</u>
			<u>123,00,000</u>				<u>123,00,000</u>

4.	Investments of Big Ltd. in Projected Balance Sheet	Rs.
	Purchase consideration paid for acquiring shares of outside holders of -	
	Small Ltd	122,90,625
	Little Ltd.	82,80,000
	Consideration paid in cash for acquiring cross holdings	
	From Small Ltd. (shares of Little Ltd.)	20,00,000
	From Little Ltd. (shares of Small Ltd.)	<u>40,00,000</u>
		<u>2,65,70,625</u>

Question 3

- (a) Timby Ltd. is in the business of making sports equipment. The Company operates from Thailand. To globalise its operations Timby has identified Fine Toys Ltd. an Indian Company, as a potential take over candidate. After due diligence of Fine Toys Ltd. the following information is available:

- (a) Cash Flow Forecasts (Rs. in crore):

Year	10	9	8	7	6	5	4	3	2	1
Fine Toys Ltd.	24	21	15	16	15	12	10	8	6	3
Timby Ltd.	108	70	55	60	52	44	32	30	20	16

¹ (40,00,000 x 10) x 3% = 12,00,000.

² (20,00,000 x 10) x 2.5% = 5,00,000.

³ [(5,34,375 + 3,31,200) x 10] x 2% = 1,73,115.

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- (b) The net worth of Fine Toys Ltd. (in lakh Rs.) after considering certain adjustments suggested by the due diligence team reads as under:

Tangible		750
Inventories		145
Receivables		<u>75</u>
		970
Less:		
Creditors	165	
Bank Loans	<u>250</u>	<u>(415)</u>
Represented by equity shares of Rs. 1000 each		<u>555</u>

Talks for take over have crystalized on the following:

1. Timby Ltd. will not be able to use Machinery worth Rs.75 lakhs which will be disposed of by them subsequent to take over. The expected realization will be Rs.50 lakhs.
2. The inventories and receivables are agreed for takeover at values of Rs.100 and Rs.50 lakhs respectively which is the price they will realize on disposal.
3. The liabilities of Fine Toys Ltd. will be discharged in full on take over alongwith an employee settlement of Rs.90 lakhs for the employees who are not interested in continuing under the new management.
4. Timby Ltd. will invest a sum of Rs.150 lakhs for upgrading the Plant of Fine Toys Ltd. on takeover. A further sum of Rs.50 lakhs will also be incurred in the second year to revamp the machine shop floor of Fine Toys Ltd.
5. The Anticipated Cash Flows (in Rs. crore) post takeover are as follows:

Year	1	2	3	4	5	6	7	8	9	10
	18	24	36	44	60	80	96	100	140	200

You are required to advise the management the maximum price which they can pay per share of Fine Toys Ltd. if a discount factor of 20 per cent is considered appropriate.

- (b) Investors Mutual Fund is registered with SEBI and having its registered office at Pune. The fund is in the process of finalising the annual statement of accounts of one of its open ended mutual fund schemes. From the information furnished below you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31st March, 2009.

	Rs.'000
Opening Balance of net assets	12,00,000
Net Income for the year (Audited)	85,000

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8,50,200 units issued during 2008-09	96,500
7,52,300 units redeemed during 2008-09	71,320
The par value per unit is Rs100	

(10+4 = 14 Marks)

Answer

(a) Calculation of Maximum Price that can be quoted for take over of Fine Toys Ltd.

	Rs. in lakhs	Rs. in lakhs
Present (Discounted) value of incremental cash flows (Refer Working Note)		7,845.02
Add: Proceeds from disposal of fixed assets	50.00	
Proceeds from disposal of inventories	100.00	
Receipts from debtors	<u>50.00</u>	<u>200.00</u>
		8,045.02
Less: Settlement of creditors	165.00	
Bank Loans	250.00	
Employee settlement	90.00	
Renovation of Plant	150.00	
Revamp of machine shop floor (Rs. 50 lakhs × 0.6944)*	<u>34.72</u>	<u>689.72</u>
Maximum value that can be offered		<u>7,355.30</u>
Maximum price per share of Fine Toys Ltd. (Rs. 7,355.30 lakhs / 55,500 shares) = Rs. 13,252.79		

Working Note:

Present Value of Incremental Cash Flows				(Rs. in lakhs)	
Year	Cash flow after takeover	Cash flows before takeover	Incremental Cash flows	Discount factor@20%	Discounted Cash flows
1	1,800	1600	200	0.8333	166.66
2	2,400	2000	400	0.6944	277.76
3	3,600	3000	600	0.5787	347.22
4	4,400	3200	1200	0.4823	578.76
5	6,000	4400	1600	0.4019	643.04
6	8,000	5200	2800	0.3349	937.72
7	9,600	6000	3600	0.2791	1,004.76

* Discount factor of year 2 @20% .

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8	10,000	5500	4500	0.2326	1,046.70
9	14,000	7000	7000	0.1938	1,356.60
10	20,000	10800	9200	0.1615	<u>1,485.80</u>
					<u>7,845.02</u>

- (b) Statement showing the Movement of Unit Holders' Funds for the year ended 31st March, 2009

	(Rs.'000)
Opening balance of net assets	12,00,000
Add: Par value of units issued (8,50,200 × Rs.100)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working Note)	<u>15,390</u>
	13,85,410
Less: Par value of units redeemed (7,52,300 × Rs.100)	<u>75,230</u>
Closing balance of net assets (as on 31 st March, 2009)	<u>13,10,180</u>

Working Note:

Particulars	Issued	Redeemed
Units	8,50,200	7,52,300
	Rs.'000	Rs.'000
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve /Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund		15,390

Question 4

- (a) Pankaj Ltd. is a company engaged in manufacture of Nuclear Power Stations. The Company usually resorts to long term Foreign Currency borrowings for its fund requirements. The Company had on 1st April, 2005 borrowed U.S. \$100 million from Global Fund Consortium based in Washington, USA. The funds were used by Pankaj Ltd. for purposes OTHER THAN acquiring 'Depreciable Capital Assets'. The loan carries an interest rate of 3 per cent on reducing balance and is repayable in two instalments, the first one due on 1st April, 2010 and the next on 1st April, 2012. The interest due on the loan has been paid in full on 31st March of each year. The exchange rate on the date of borrowing was 1 U.S. \$ = INR 40.

The accounting treatment followed by the Company for the subsequent three years with exchange rates prevailing on those dates were as under:

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Year ended	Exchange Rate	Accounting Treatment
31 st March, 2006	1 US \$ = 41	Forex Loss of Rs.10 crore charged to Profit and Loss account;
31 st March, 2007	1 US \$ = 39	Forex gain of Rs.20 crore recognised in Profit and Loss Account;
31 st March, 2008	1 US \$ = 48	Forex Loss of Rs.90 crore charged to Profit and Loss account;

Note: Interest payment were charged to Profit and Loss account of each year at transaction value on payment dates.

Pankaj Ltd. is in the process of finalising its accounts for the year ended 31st March, 2009 and understands that AS 11 has been amended and opts to follow the Companies (Accounting Standards) Amendment Rules, 2009.

- (i) You are required to show treatment of the Forex Losses/gains in the light of the above amendment to AS 11 for the years 2005-06; 06-07; 07-08 & 08-09. The exchange rate to 1 US Dollar on 31st March, 2009 is Rs.50. Assuming that the rates of Exchange on 31st March, 2010 and 31st March, 2011 will be Rs.51 and Rs.52 respectively the accounting for the Forex Losses/gains may also be shown for these years also.
 - (ii) What are the disclosure requirements to be complied with by Pankaj Ltd. as a result of having opted to follow the amendment in the Companies (Accounting Standard) Rules, 2006.
 - (iii) Would your answer to (i) above be different if Pankaj Ltd. was not a Company and were a Co-operative Society.
- (b) As on 1st April, 2008 the fair value of plan assets was Rs.1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2008 the plan paid out benefits of Rs.19,000 and received inward contributions of Rs.49,000. On 31st March, 2009 the fair value of plan assets was Rs.1,50,000 and present value of the defined benefit obligation was Rs.1,47,920. Acturial losses on the obligations for the year 2008-09 were Rs.600.

On 1st April, 2008 the company made the following estimates, based on its market studies, understanding and prevailing prices.

	%
Interest & dividend income, after tax payable by the fund	9.25
Realised and unrealised gains on plan assets (after tax)	2.00
Fund administrative costs	<u>(1.00)</u>
Expected Rate of Return	<u>10.25</u>

You are required to find the expected and actual returns on plan assets.(10+4= 14 Marks)

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Answer

- (a) Central Govt. in consultation with National advisory Committee on Accounting Standards made an amendment to AS 11 "The Effects of Changes in Foreign Exchange Rates" vide Notification No. G.S.R.225(E), dated 31st March, 09 in the form of Companies (Accounting Standards) Amendment Rules, 2009. According to the Notification, any exchange gain or loss resulting from the translation of foreign currency monetary items not attributable to a depreciable asset should be accumulated in the Foreign Currency Monetary Item Translation Difference (FCMITD) Account and should be written off over the useful life of the assets but not beyond 31st March, 2011. The treatment availed at the option of the company shall be irrevocable and shall be exercised till 31st March, 2011. Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, previously, recognised in the profit and loss account before the exercise of the option shall be reversed in case of non-depreciable asset by transfer to Foreign Currency Monetary Item Translation Difference (FCMITD) Account, and by debit or credit, as the case may be, to the general reserve.

- (i) Table showing the Treatment of Forex Losses/gains as per amendment to AS 11

Year ended	Opening Balance in FCMITD A/c (Rs. in crores)	Exchange Gain/ (Loss) (Rs. in crores)	Total (Rs. in crores)	Amount Recognised in P&L A/c (Rs. in crores)	Closing Balance in FCMITD A/c (Rs. in crores)
31 st March, 06	Nil	(10)	(10)	(10)	NIL
31 st March, 07	NIL	20		20	NIL
31 st March, 08	NIL	(90)		(22.50) ¹	(67.50)
31 st March, 09	(67.50)	(20)	(87.50)	(29.17) ²	(58.33)
31 st March, 10	(58.33)	(10)	(68.33)	(34.17) ³	(34.16)
31 st March, 11	(34.16)	(10)	(44.16)	(44.16) ⁴	NIL

- (ii) Disclosure Requirements:

- The company has chosen to avail the option provided by way of amendment in the Companies (AS) Amendment Rules, 2009.
- According to AS 1 "Disclosure of Accounting Policies", Exercise of option due to amendment in AS 11 is a change in accounting policy.
- The amount amortized to profit and loss account and the amount carried forwarded in each year till 31st March, 2011 should be disclosed.

¹ Total loss of Rs.90 crores will be amortised over 4 years till 2011. The amount of Rs.67.50 crores would be credited to General reserve and debited to FCMITD Account in the year 2008-09.

² Amount written off in 2008-09 is 29.17 crores [1/4 of Rs. 90 crores + 1/3 of Rs. 20 crores]

³ Amount written off in 2009-10 is 34.17 crores [1/4 of Rs. 90 crores + 1/3 of Rs. 20 crores + 1/2 of Rs. 10 crores]

⁴ Entire balance including exchange loss of current year is fully amortized.

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- (iii) Notification No. G.S.R.225(E) is relevant only for companies. If Pankaj Ltd., is a co-operative society, then the said notification would not be applicable. In that case, option to amortise FOREX losses over the period till 31.03.2011 will not be available to it. The amounts charged to Profit and loss account would be same as shown in the column carrying the heading "Exchange gain/Loss" in the table given under (i).

(b) Computation of Expected and Actual Returns on Plan Assets

	Rs.
Return on Rs. 1,00,000 held for 12 months at 10.25%	10,250
Return on Rs. 30,000 (49,000-19,000) held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	<u>1,500</u>
Expected return on plan assets for 2008-09	<u>11,750</u>
Fair value of plan assets as on 31 March, 2009	1,50,000
Less: Fair value of plan assets as on 1 April, 2008	1,00,000
Contributions received	<u>49,000</u>
	<u>1,49,000</u>
	1,000
Add: Benefits paid	<u>19,000</u>
Actual return on plan assets	<u>20,000</u>

Question 5

- (a) Global Health Foundation furnishes the following information with regard to its Development Fund for the year 2009:

	Rs.
UN Grant received for building construction in Afganistan	50,00,000
Development Grant from Prize Foundation	40,00,000
Grants from private charities for acquiring land at Afganistan	30,00,000
Interest received on Fixed Deposits invested in Trust Bank @ 10 per cent per annum on 1 st July, 2009	2,00,000
Cost of land purchased for setting up Rehabilitation Centre at Afganistan	12,25,000
Transfers from unrestricted fund for purchasing moveable assets	45,00,000
Advance payment for acquiring balance land at Afganistan	7,00,000
Furniture purchased for Rehabilitation Project	3,00,000
Cost of 5 Desert Deuller Jeeps	35,00,000
Amount settled to builders for construction of Rehabilitation Centre Building at Afganistan based on percentage of work completed	12,50,000
Prepare a statement of Changes in Development Fund and a Balance Sheet of the Fund at the year end.	

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- (b) AS Ltd. Leased a machine to SB Ltd. on the following terms:

	(Rs. In lakhs)
Fair value of the machine	4.00
Lease term	5 years
Lease Rental Per annum	1.00
Guaranteed Residual value	0.20
Expected Residual value	0.40
Internal Rate of Return	15%

Depreciation is provided on straight line method at 10 per cent per annum. Ascertain Unearned Financial Income. Necessary Journal entries in the books of the Lessee in first year may be shown. (8+8= 16 Marks)

Answer

- (a) Statement of Changes in Development Fund for the year 2009

Particulars	Rs.	Rs.
Receipts/Transfers		
UN Grant	50,00,000	
Grant - Prize Foundation	40,00,000	
Private grants	30,00,000	
Fixed deposit Interest	2,00,000	
Transfer from unrestricted funds	<u>45,00,000</u>	1,67,00,000
Payments/Transfers		
Land purchase- Afganisthan	12,25,000	
Furniture purchased	3,00,000	
Vehicles purchased	<u>35,00,000</u>	<u>50,25,000</u>
Balance as on 31.12.09		<u>1,16,75,000</u>

Balance sheet of the Development Fund of Global Heath Foundation

as on 31st December, 2009

Liabilities	Amount Rs.	Assets	Amount Rs.
Fund balance	116,75,000	Capital work in progress	12,50,000
		Land advance- Afghanistan	7,00,000
		Fixed deposit at Trust Bank	

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	(2,00,000 x 100/10x 2)	40,00,000
	Bank balance	
	(Refer working note)	<u>57,25,000</u>
<u>116,75,000</u>		<u>116,75,000</u>

Working Note:

Bank Account			
	Rs.		Rs.
To UN Grants	50,00,000	By Fixed deposits	40,00,000
To Grant - Prize Foundation	40,00,000	By Land purchased	12,25,000
To Private grants	30,00,000	By Land advance	7,00,000
To Interest on fixed deposit	2,00,000	By Furniture purchased	3,00,000
To Transfers from		By Vehicles purchased	35,00,000
unrestricted funds	45,00,000	By Payment to builders	12,50,000
		By Balance c/d	<u>57,25,000</u>
	<u>167,00,000</u>		<u>167,00,000</u>

Note: Land costing Rs.12.25 lakhs, Furniture Rs.3 lakhs and Vehicles Rs.35 lakhs will be shown in the General balance sheet of Global Heath Foundation.

- (b) As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where :

- (a) Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

$$\begin{aligned}
 \text{Gross investment} &= \text{Minimum lease payments} + \text{Unguaranteed residual value} \\
 &= [\text{Total lease rent} + \text{Guaranteed residual value (GRV)}] + \text{Unguaranteed residual value (URV)} \\
 &= [(\text{Rs. } 1,00,000 \times 5 \text{ years}) + \text{Rs. } 20,000] + \text{Rs. } 20,000 \\
 &= \text{Rs. } 5,40,000 \text{ (a)}
 \end{aligned}$$

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- (b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	M.L.P. inclusive of URV Rs.	Internal rate of return (Discount factor @ 15%)	Present Value Rs.
1	1,00,000	0.8696	86,960
2	1,00,000	0.7561	75,610
3	1,00,000	0.6575	65,750
4	1,00,000	0.5718	57,180
5	1,00,000	0.4972	49,720
	<u>20,000</u> (GRV)	0.4972	<u>9,944</u>
	5,20,000		3,45,164 (i)
	<u>20,000</u> (URV)	0.4972	<u>9,944</u> (ii)
	<u>5,40,000</u>	(i) + (ii)	<u>3,55,108</u> (b)
Unearned Finance Income = (a) – (b)			
= Rs. 5,40,000 – Rs. 3,55,108			
= Rs. 1,84,892			

Journal Entries in the books of SB Ltd.

	Rs.	Rs.
At the inception of lease		
Machinery account	Dr. 3,45,164*	
To AS Ltd.'s account		3,45,164*
(Being lease of machinery recorded at present value of minimum lease payments)		
At the end of the first year of lease		
Finance charges account	Dr. 51,775	
(Refer Working Note)		

* As per para 11 of AS 19, the lessee should recognize the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payments from the standpoint of lessee, the amount recorded should be the present value of these minimum lease payments. Therefore, in this case, as the fair value of Rs. 4,00,000 is more than the present value amounting Rs. 3,45,164, the machinery has been recorded at Rs. 3,45,164 in the books of SB Ltd. (the lessee) at the inception of the lease. According to para 13 of the standard, at the inception of the lease, the asset and liability for the future lease payments are recognised in the balance sheet at the same amounts.

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To AS Ltd.'s account			51,775
(Being the finance charges for first year due)			
AS Ltd.'s account	Dr.	1,00,000	
To Bank account			1,00,000
(Being the lease rent paid to the lessor which includes outstanding liability of Rs. 48,225 and finance charge of Rs. 51,775)			
Depreciation account [£]	Dr.	34,516	
To Machinery account			34,516
(Being the depreciation provided @ 10% p.a. on straight line method)			
Profit and loss account	Dr.	86,291	
To Depreciation account			34,516
To Finance charges account			51,775
(Being the depreciation and finance charges transferred to profit and loss account)			

Working Note:

Table showing apportionment of lease payments by SB Ltd. between the finance charges and the reduction of outstanding liability

Year	Outstanding liability (opening balance)	Minimum lease payments	Finance charges	Reduction in principal amount	Outstanding liability (closing balance)
	Rs.	Rs.	Rs.	Rs.	Rs.
1	3,45,164	1,00,000	51,775	48,225	2,96,939
2	2,96,939	1,00,000	44,541	55,459	2,41,480
3	2,41,480	1,00,000	36,222	63,778	1,77,702
4	1,77,702	1,00,000	26,655	73,345	1,04,357
5	1,04,357	1,00,000	15,654	84,346	20,011*

[£] Depreciation has been provided on the basis that the machine has been leased at the beginning of the year.

* The difference between this figure and guaranteed residual value (Rs. 20,000) is due to approximation in computing the interest rate implicit in the lease.

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Question 6

In preparing the Financial Statements of Santhanam Ltd. for the year ended 31st March, 2009, you come across the following features. State with reasons, how you would deal with them in the Financial Statements:

- (i) An unquoted long term investment is carried in the books at its cost of Rs.5 lakhs. The Published Accounts of the unlisted company received in May, 2009 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs.80,000.
- (ii) The Company invested Rs.560 lakhs in April, 2009 in the acquisition of another company doing similar business, the negotiations for which had started during the current financial year.
- (iii) There was a major theft of stores valued at Rs.46 lakhs in the preceding year which was detected only during the current financial year. (5+5+6= 16 Marks)

Answer

As it is stated in the question that financial statements for the year ended 31.3.2009 are under preparation, the views given are on the basis that the financial statements are yet to be approved by the Board of Directors. Para 3.2 of AS 4 (Revised) "Contingencies and Events occurring after the Balance Sheet Date" defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company.

- (i) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On this basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 80,000 in the financial statements for the year ended 31st March, 2009.
- (ii) The acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2009. Applying Para 15 of AS 4 (Revised), which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 560

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lakhs in April, 2009 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

- (iii) Due to major theft of stores in the preceding year (2007-08) which was detected only during the current financial year (2008-09), there was overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". Accordingly, the adjustments relating to both opening stock of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. The disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e, year ended 31st March, 2009.