Guideline Answers to Nov 2010 Financial Reporting Exams (New Syllabus)

Question No.1 is compulsory **(4 X 5 = 20 Marks).**
Answer **any five** questions from the **remaining six** questions **(16 X 5 = 80 Marks).**

Question 1(a): AS–2 – EAC Opinion — N 10 (5 Marks)

Night Ltd sells beer to customers. Some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the Consumers leave the empty bottles in the bars and the Company takes possession of these empty bottles. The Company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the Company by calling for tenders. Keeping this in view –

(a) Decide whether the Stock of Empty Bottles is an Asset of the Company.

(b) If so, whether the Stock of Empty Bottles existing as on the date of Balance Sheet is to be considered as Inventories of the Company and valued as per AS–2, or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

Solution: **Stock of Empty Bottles – Nov 2007 – CA Journal Page 776**

1. **Asset:** Where the enterprise takes possession of the empty bottles left behind by the customers at its bar, it constitutes an **asset** for the enterprise, being a resource controlled by the Company as a result of past events from which future economic benefits are expected to flow to it.
2. **Inventory:** It is in the nature of **Inventory** as it is consumed in the production process (i.e. primary packing of beer).
3. **Conclusion:** Since the bottles are acquired by the Company without incurring any cost, they (the total inventory) should be recorded at a Nominal Value of Re.1, which is the value at which they should figure in the Balance Sheet, and should not be recognized as Income.

Question 1(b): AS 4 and Sch VI – Proposed Dividend — N 10 (5 Marks)

AS–4 prescribes that adjustments to Assets and Liabilities are required for events occurring after the Balance Sheet date that provide additional information materially affecting the determination of the amount relating to conditions existing at the Balance Sheet date, generally called Adjusting Events. "Proposed Dividend" is shown and adjusted in the Balance Sheet even if it is not an Adjusting Event as per AS–4 because it is proposed by the Board of Directors of the Company after the Balance Sheet date. Keeping this in view, is it not violation of AS–4 to show Proposed Dividends as Current Liabilities and Provisions? Comment.

Solution:

1. **Schedule VI Requirements:** Schedule VI Part I Balance Sheet and Part II Paragraph 3(xiv) P&L Account require specific disclosure of Proposed Dividend.
2. **AS – 4 Requirements:** Para 14 states that Dividends stated to be in respect of the period covered by the Financial Statements, which are proposed or declared by the enterprise after the Balance Sheet date, but before the approval of Financial Statements, should be **adjusted**.
3. **Auditors' Duties:** As per **ICAI's Guidance Note** on Provision for Proposed Dividend, if no provision is made for Proposed Dividend, the Shareholders' attention should be drawn to such fact and the amount should be quantified.
4. **Conclusion:** Disclosure of Proposed Dividend, as part of Current Liabilities and Provisions, does not violate AS–4.

Question 1(c): AS 23 and AS 13 – Investment in Associates — N 10 (5 Marks)

Bright Ltd acquired 30% of East India Ltd Shares for Rs.2,00,000 on 01–06–09. By such an acquisition, Bright can exercise significant influence over East India Ltd. During the financial year ending on 31–03–09, East India Ltd earned profits Rs.80,000 and declared a dividend of Rs.50,000 on 12–08–09. East India reported earnings of Rs.3,00,000 for the financial year ending on 31–3–10 and declared dividends of Rs.60,000 on 12–06–2010.

(a) Calculate the carrying amount of investment in –
Separate Financial Statement of Bright Ltd as on 31–03–10,
Consolidated Financial Statement of Bright Ltd as on 31–03–10,

(b) What will be the Carrying Amount as on 30–06–2010 in Consolidated Financial Statements?

Solution:

1. **Separate Financial Statements of Bright Ltd as at 31.03.2010:** To be disclosed in accordance with AS 13 – Accounting for Investments, i.e. at Cost as follows —

	Particulars	Rs.
	Cost of Acquisition	2,00,000
Less:	Pre Acquisition Period Dividend (Rs.50,000 × Bright Ltd's Share 30%)	(15,000)
	Net Cost = To be disclosed in Separate Financial Statements	**1,85,000**

2. **Consolidated Financial Statements of Bright Ltd as at 31.03.2010:** To be disclosed in accordance with AS 23 Accounting for Investment in Associates, i.e. as per Equity Method as follows —

	Particulars	Rs.
	Net Cost as per Separate Financial Statements	1,85,000
Less:	Pre Acquisition Period Reserves (Rs. 30,000 × Bright Ltd's Share 30%)	(9,000)
Add:	Share of Post Acquisition Period Reserves (Rs.3,00,000 × Bright Ltd's Share 30%)	90,000
	Carrying Amount in Consolidated Balance Sheet	**2,66,000**

Note: Dividends actually received before the date of Balance Sheet should be considered. Dividends after the Balance Sheet date, 31.03.2010 should not be considered.

3. **Consolidated Financial Statements of Bright Ltd as at 30.06.2010:** To be disclosed in accordance with AS 23 Accounting for Investment in Associates, i.e. as per Equity Method as follows —

	Particulars	Rs.
	Net Cost as per Separate Financial Statements	1,85,000
Less:	Pre Acquisition Period Reserves (Rs.30,000 × Bright Ltd's Share 30%)	(9,000)
Add:	Share of Post Acquisition Period Reserves (Rs.2,40,000 × Bright Ltd's Share 30%)	72,000
	Carrying Amount in Consolidated Balance Sheet	**2,48,000**

Note: Dividends actually received is accounted as per AS 13 – Accounting for Investments. It is assumed that the Dividend Declared on 30.06.2010 is out of profits for the year ended 31.03.2010. Hence the same will be credited to the Profit and Loss Account.

Common Note to Point 2 and Point 3 above:

It is assumed that East India Ltd did not have any other Reserves other than those earned during Financial Year 2008–09 and 2009–10.

The amount of Goodwill / Capital Reserve on Consolidation is not ascertainable, since the Amount of Net Assets attributable to Bright Ltd is not given.

Question 1(d): AS 10 and AS 29 — N 10 (5 Marks)

An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at Rs.6,00,000. The estimated cost of destroying the asset is Rs.70,000. How is the asset to be accounted for?

Solution:

1. **Carrying Amount of Fixed Asset (AS 10 – Para 25):**
   (a) Fixed Assets should be eliminated from the Financial Statements on disposal, or when no further benefit is expected from its use or disposal.
   (b) So, the Fixed Asset should be eliminated from the Financial Statements, as it is proposed to be destroyed as per law.
2. **Cost of Destroying Asset:** Cost of destroying the asset of Rs.70,000 should be accounted for as and when incurred. A provision for the same should not be created since it is an obligation from a future event (i.e. destruction of the asset).

Question 2: Accounting for Stock Appreciation Rights — N 10 (16 Marks)

Softex Ltd announced a Stock Appreciation Right (SAR) on 01–04–07 for each of its employees. The scheme gives the employees the right to claim cash payment equivalent to an excess of Market Price of Company's Shares on the Exercise Date over the Exercise Price of Rs.125 per Share in respect of 100 Shares, subject to a condition of continuous employment of 3 years. The SAR is exercisable after 31–03–2010 but before 30–06–10. The Fair Value of SAR was Rs.21 in 2007–08, Rs.23 in 2008–09 and Rs.24 in 2009–10. In 2007–08, the Company estimated that 2% of its employees shall leave the Company annually. This was revised to 3% in 2008–09. Actually 15 employees left the Company in 2007–08, 10 left in 2008–09 and 8 left in 2009–10. The SAR therefore actually vested in 492 employees on 30–06–2010, when SAR was exercised, the intrinsic value was Rs.25 per Share. Show the Provision for SAR Account by Fair Value Method. Is this provision a Liability or Equity?

Solution: **1. Computation of Expense to be recognized under Stock Appreciation Rights (SAR)**

(a) Year 2007–08

Total Number of Employees as on 01.04.2007 = 492 + 15 + 10 + 8 =	525
Number of Employees expected to be eligible (525 –15) × 0.98 × 0.98	498.82
Number of SAR expected to vest = (498.82 Employees × 100 Shares)	49,882
Total Fair Value of Options Expected to Vest = 49,882 Shares × Fair Value of SAR Rs.21 per Share	Rs.10,47,522
Vesting Period	3 Years
Value of SAR recognized as Expense in the Year 2007–08 = Rs.10,47,522 ÷ 3 Years	**Rs.3,49,174**

(b) Year 2008–09

Number of SAR expected to vest = [525 – 15 – 10] × 0.97 × 100 Shares		48,500
Total Fair Value of SAR expected to be exercised = 48,500 × Fair Value of SAR Rs.23 per Share		Rs.11,15,500
Vesting Period		3 Years
No. of years expired		2 Years
Cumulative Value of SAR to be recognized as Expense in 2007–08 and 2008–09 (Rs.11,15,500 × 2 Years ÷ 3)		7,43,667
Less:	Value of SAR already recognized in FY 2007–08	(3,49,174)
	Value of SAR recognized as Expense in 2008–09	**Rs.3,94,493**

(c) Year 2009–10

No. of SAR actually vested = [525 – 15 – 10 – 8] Employees × 100 Shares per Employee		49,200
Total Fair Value of SAR to be recognized as Expense = 49,200 Shares × Fair Value of SAR Rs.24 per Share		11,80,800
Less:	Value of SAR already recognized earlier in FY 07–08 and 08–09	7,43,667
	Value of SAR recognized as Expense in 2009–10	**Rs.4,37,133**

(d) Year 2010–11

	Cash Payment (49,200 Shares × Intrinsic Value of SAR per Share Rs.25)	12,30,000
Less:	Value of SAR recognized as expense in books	11,80,800
	Value of SAR recognized as expense in 2010–11	**49,200**

2. Provision for Stock Appreciation Right A/c

Year	Particulars	Rs.	Particulars	Rs.
2007–08	To Balance c/d	3,49,174	By Employees' Compensation A/c	3,49,174
	Total	**3,49,174**	**Total**	**3,49,174**
2008–09	To Balance c/d	7,43,667	By Balance b/d	3,49,174
			By Employees' Compensation A/c	**3,94,493**
	Total	**7,43,667**	**Total**	**7,43,667**
2009–10	To Balance c/d	11,80,800	By Balance b/d	7,43,667
			By Employees' Compensation A/c	4,37,133
	Total	**11,80,800**	**Total**	**11,80,800**
2010–11	To Bank (49,200 X 25)	12,30,000	By Balance b/d (49,200 × 24)	11,80,800
			By Employees' Compensation A/c	49,200
	Total	**12,30,000**	**Total**	**12,30,000**

3. Provision vs. Equity:

"Provision for Stock Appreciation Right by Fair Value A/c" is a Provision, and not a Liability. It should be disclosed under Current Liabilities, and not under Share Capital / Reserves.

Question 3: Consolidated Financial Statements – Wholly Owned Subsidiary and Joint Venture N 10 (16 Marks)

Air Ltd, a Listed Company, entered into an expansion programme on 1st October 2009. On that date, the Company purchased from Bag Ltd, its investments in two Private Limited Companies. The purchase was of – (a) the entire Share Capital of Cold Ltd, and (b) 50% of the Share Capital of Dry Ltd.

Both the investments were previously owned by Bag Ltd. After acquisition by Air Limited, Dry Ltd was to be run by Air Ltd and Bag Ltd, as a Jointly Controlled Entity. Air Ltd makes its Financial Statements upto 30th September each year. The terms of acquisition were:

Cold Ltd: The total consideration was based on Price Earnings Ratio (P/E) of 12, applied to the reported Profit of Rs.20 Lakhs of Cold Ltd, for the year 30th September 2009. The consideration was settled by Air Ltd, issuing 8% Debentures for Rs.140 Lakhs (at par) and the balance by a new issue of Re.1 Equity Shares, based on its Market Value of Rs.2.50 each.

Dry Ltd: The Market Value of Dry Ltd on 1st October 2009 was mutually agreed as Rs.375 Lakhs. Air Ltd satisfied its share of 50% of this amount by issuing 75 Lakhs Re.1 Equity Shares (Market Value Rs.2.50 each) to Bag Ltd.

Air Ltd has not recorded in its books the acquisition of the above investments or the discharge of the consideration.

The summarized statements of financial position of the three entities at 30th September 2010 are: (Rs. Thousands)

Particulars	Air Ltd	Cold Ltd	Dry Ltd
Tangible Assets	34,260	27,000	21,060
Inventories	9,640	7,200	18,640
Debtors	11,200	5,060	4,620
Cash	–	3,410	40
Total Assets	55,100	42,670	44,360
Equity Capital Re.1 each	10,000	20,000	25,000
Retained Earnings	20,800	15,000	4,500
Trade and other Payables	17,120	5,270	14,100
Overdraft	1,540	–	–
Provision for Taxes	5,640	2,400	760
Total Liabilities	55,100	42,670	44,360

1. The Book Values of the Net Assets of Cold Ltd and Dry Ltd on the date of acquisition, were considered to be a reasonable approximation to their Fair Values.
2. The current profits of Cold Ltd and Dry Ltd for the year ended 30th September 2010 were Rs.80 Lakhs and Rs.20 Lakhs respectively. No dividends were paid by any of the Companies during the year.
3. Dry Ltd, the Jointly Controlled Entity, is to be accounted for using proportional consolidation, in accordance with AS–27 "Interest in Joint Venture".
4. Goodwill in respect of the acquisition of Dry Ltd has been impaired by Rs.10 Lakhs at 30th September 2010. Gain on acquisition, if any, will be separately accounted.

Prepare the Consolidated Balance Sheet of Air Ltd and its Subsidiaries as at 30th September 2010.

Solution:

1. Basic Information

Company	**Cold Ltd**	**Dry Ltd**
Nature	Subsidiary	Jointly Controlled Entity
Nature of Consolidation	Total Consolidation	Proportionate Consolidation
Group Interest	100%	50%
Minority Interest	NIL	Not Applicable

2. Cost of Investments

Company	**Consideration**	**Mode of Discharge**
Cold Ltd	Profits Rs.20 Lakhs × PE Multiple 12 = Rs.240 Lakhs	• In 8% Debentures Rs.140 Lakhs issued at Par • In Equity Shares of Re.1 each issued at Rs.2.50 = Rs.100 Lakhs, i.e. 40 Lakhs Equity Shares of Re.1 each issued at Rs.2.50
Dry Ltd	50% of Total Market Value Rs.375 Lakhs = Rs.187.50 Lakhs	75 Lakhs Equity Shares of Re.1 each issued at Rs.2.50

3. Analysis of Reserves (Rs.000's)

Cold Ltd		**Dry Ltd**	
As on DOC 15,000		As on DOC 4,500	
DOA (Bal.Fig)	From DOA to DOC	DOA (Bal.Fig)	From DOA to DOC
7,000 (Pre)	8,000 (Post)	2,500 (Pre)	2,000 (Post)

4. Consolidation of Balances (Note: Credit Balances in Positive. Debit Balances in Negative**)**

Particulars	**Invt. in Cold Ltd (Pre Acqn.)**	**Invt. in Dry Ltd (Pre Acqn.)**	**Retained Profits**
Balance as per Balance Sheet (Cost of Investment and Balance in Reserves)	(24,000)	(18,750)	20,800
Share in Equity Capital	20,000	50% × 25000 = 12,500	NA.
Share in Pre Acquisition Profits	7000 × 100% = 7,000	2500 × 50% = 1,250	—
Capital Reserve / Goodwill / Total	**3,000**	**(5,000)**	20,800
Share in Post Acquisition Reserves			
From Cold Ltd			8,000
From Dry Ltd [2000 × 50%]			1,000
Goodwill Adjusted Earlier		1,000	(1,000)
For Consolidated Balance Sheet	**3,000**	**(4,000)**	**28,800**
	Capital Reserve	**Goodwill**	**Retained Earnings**

5. Consolidated Balance Sheet

Liabilities	Rs. 000s	Assets	Rs. 000s
Equity Share Capital (Re.1 each) [10,000 + 4,000 + 7,500]	21,500	Goodwill on Consolidation (WN 4)	4,000
Retained Earnings	28,800	Tangible Assets	
Capital Reserve on Consolidation	3,000	[34,260 + 27,000 + (50% × 21,060)]	71,790
Securities Premium [6,000 + 11,250]	17,250	Inventories	
8% Debentures	14,000	[9,640 + 7,200 + (18640 × 50%)]	26,160
Trade & Other Payables (17,120 + 5,270 + (14,100×50%)]	29,440	Sundry Debtors	
Overdraft	1,540	[11,200 + 5,060 + (4620 × 50%)]	18,570
Provision for Taxes [5,640 + 2,400 + 50% × 760]	8,420	Cash [3410 + (40× 50%)]	3,430
Total	**1,23,950**	**Total**	**1,23,950**

Note: Since this is a 100% Holding, there is no Minority Interest of Cold Ltd.

Question 4: Amalgamations – Cross Holdings N 10 (16 Marks)

The following are the Balance Sheets of X Ltd and Y Ltd as on 31st December 2009. (Amount in Rs.)

Liabilities	X Ltd	Y Ltd	Assets	X Ltd	Y Ltd
Equity Shares of Rs.10 each	6,00,000	3,00,000	Fixed Assets	7,00,000	2,50,000
10% Preference Shares of Rs.10 each	2,00,000	1,00,000	Stock	2,40,000	3,20,000
Reserve and Surplus	3,00,000	2,00,000	Debtors	3,60,000	1,90,000
12% Debentures	2,00,000	1,50,000	Bills Receivable	60,000	20,000
Sundry Creditors	2,20,000	1,25,000	Cash at Bank	1,10,000	40,000
Bills Payable	30,000	25,000	Investment in:		
			6,000 Shares of Y Ltd.	80,000	
			5,000 Shares of X Ltd.		80,000
Total	15,50,000	9,00,000	Total	15,50,000	9,00,000

Fixed Assets of both the Companies are to be revalued at 15% above Book Values and Stock and Debtors are to be taken over at 5% less than their Book Values. Both the Companies are to pay 10% Equity Dividends, Preference Dividends having been paid already. After the above transactions are given effect to, X Ltd will absorb Y Ltd on the following terms –

(a) 8 Equity Shares of Rs.10 each will be issued by X Ltd, at par against 6 Shares of Y Ltd.

(b) 10% Preference Share of Y Ltd will be paid off at 10% Discount, by issue of 10% Preference Shares of Rs.100 each of X Ltd at par.

(c) 12% Debenture Holders of Y Ltd are to be paid off at a 8% Premium by 12% Debentures in X Ltd, issued at a discount of 10%.

(d) Rs.30,000 to be paid by X Ltd. to Y Ltd. for Liquidation Expenses.

(e) Sundry Creditors of Y Ltd, include Rs.10,000 due to X Ltd.

Prepare: (a) A Statement of Purchase Consideration payable by X Ltd, (b) A Balance Sheet of X Ltd after its absorption of Y Ltd.

Solution: **Also Refer Q No.39, Page 2.86 (May 1988 Exam)**

1. Basic Information

Buying Company: **X Ltd**	Balance Sheet Date: 31st December	**Nature of Amalgamation**
Selling Company: **Y Ltd**	Amalgamation Date: 31st December	Purchase

2. Computation of Purchase Consideration

	Equity Shares held by outsiders in Y Ltd = Total Shares 30000 Less Shares held by X Ltd 6,000	24,000 Shares
	Equity Shares to be issued by X Ltd to Outside Shareholders in Y Ltd = 24,000 × 8/6	32,000 Shares
Less:	Shares already held by Y Ltd	5,000 Shares
	Hence, Balance additional Equity Shares to be issued now by X Ltd	27,000 Shares
	To Equity Shareholders of X Ltd i.e. Value of Equity Shares = 27,000 Shares × Rs.10 To 10% Preference Shareholders of Y Ltd (Rs.1,00,000 Less 10% Discount) [9000 10% Preference Shares of X Ltd of Rs.10 each at Par)	Rs.2,70,000 Rs.90,000
	Total Purchase Consideration	**Rs.3,60,000**

3. Journal Entries in the books of X Ltd

	Particulars	Debit	Credit
1.	Business Purchase Dr. To Liquidator of Y Ltd. (Being business of Y Ltd purchased as a going concern)	3,60,000	 3,60,000

	Particulars		Debit	Credit
2.	Fixed Assets (2,50,000 + 15% upward revaluation)	Dr.	2,87,500	
	Stock (3,20,000 – 5%)	Dr.	3,04,000	
	Debtors (1,90,000 – 5%)	Dr.	1,80,500	
	Bills Receivable	Dr.	20,000	
	Cash and Bank (40,000 – 30,000 Dividend Paid + 5,000 Dividend received)	Dr.	15,000	
	To Debentureholders A/c (including 8% Premium Payable) (1,50,000 + 8%)			1,62,000
	To Sundry Creditors			1,25,000
	To Bills Payable			25,000
	To Business Purchase			3,60,000
	To Investments in Y Ltd. (cancellation of own invt. on absorption)			80,000
	To Capital Reserve			55,000
	(Being Sundry Assets & Liabilities of Y Ltd taken over)			
3.	12% Debentureholders A/c	Dr.	1,62,000	
	Discount on Issue of Debentures	Dr.	18,000	
	To 12% Debentures (1,62,000 ÷ 90%)			1,80,000
	(Being 12% debentures of Y Ltd taken over at 8% premium, now settled by 13% own debentures at 10% discount) **Note:** Alternatively, the Discount may be adjusted against Capital Reserve, since it arises only on account of Amalgamation.			
4.	Capital Reserve A/c	Dr.	30,000	
	To Y Ltd			30,000
	(Being Y Ltd's Expenses met and adjusted out of Capital Reserve)			
5.	Y Ltd A/c	Dr.	30,000	
	To Cash / Bank A/c			30,000
	(Being amount due to Y Ltd's for realisation expenses settled)			
6.	Liquidator of Y Ltd A/c	Dr.	3,60,000	
	To Equity Share Capital			2,70,000
	To 10% Preference Share Capital			90,000
	(Being the settlement of Purcharse Consideration to Y Ltd)			
7.	Sundry Creditors A/c	Dr.	10,000	
	To Sundry Debtors A /c			10,000
	(Being elimination of Inter–Company Owings / Balances)			

4. Balance Sheet of X Ltd (after absorption)

Liabilities	Rs.	Assets	Rs.
Share Capital		**Fixed Assets** (8,05,000 + 2,87,500)	10,92,500
87,000 Equity Shares of (Rs.10 each fully paid) (of these 27,000 Shares issued for non–cash consideration under a scheme of amalgamation)	8,70,000	**Current Assets**	
		Stock in Trade (2,40,000+ 3,04,000)	5,44,000
11% Preference Share Capital (non–cash)	90,000	Sundry Debtors	
10% Preference Share Capital	2,00,000	(3,60,000 + 1,80,500 –10,000)	5,30,500
Reserves & Surplus		Bills Receivable (60,000 + 20,000)	80,000
Capital Reserve (55,000 – 30,000)	25,000	Cash and Bank	
Revaluation Reserve (own assets revalued)	1,05,000	(1,10,000+15,000– 60,000 + 6,000 – 30,000)	41,000
Other Reserves (2,00,000 – 60,000 + 6,000)	1,46,000	**Misc. Expenditure (not written off):**	
Secured Loans		Discount on Issue of Debentures	18,000
12% Debentures (2,00,000 + 1,80,000)	3,80,000		
Current Liabilities			
Sundry Creditors (2,20,000 + 1,25,000–10,000)	4,35,000		
Bills Payable (30,000 + 25,000)	55,000		
Total	**23,06,000**	**Total**	**23,06,000**

Note: Discount on issue of Debentures can also be written off against Capital Reserve.

Question 5(a): Valuation of Shares – Yield Based Valuation N 10 (8 Marks)

From the following information, calculate the value of a Share if you want to – (i) Buy a small lot of shares, (ii) Buy a controlling interest in the Company. [The market expectation is 12%].

Year	Profit (Rs.)	Capital Employed (Rs.)	Dividend
2007	55,00,000	3,43,75,000	12
2008	1,60,00,000	8,00,00,000	15
2009	2,20,00,000	10,00,00,000	18
2010	2,50,00,000	10,00,00,000	20

Solution: **Note:** Face Value per Share or Number of Shares is not given.
So, Value has been determined based on assumed Face Value of Rs.100.

1. Computation of Weighted Average Return on Capital Employed

Year	Profit (Rs.)	Capital Employed (Rs.)	Return on Capital Employed	Weights	Product
2007	55,00,000	3,43,75,000	16%	1	16
2008	1,60,00,000	8,00,00,000	20%	2	40
2009	2,20,00,000	10,00,00,000	22%	3	66
2010	2,50,00,000	10,00,00,000	25%	4	100
				10	**222**

Therefore, Weighted Average Return on Capital Employed = 222 ÷ 10 = 22.20%

2. Computation of Weighted Average Rate of Dividend

Year	Dividend	Weights	Product
2007	12%	1	12
2008	15%	2	30
2009	18%	3	54
2010	20%	4	80
		10	**176**

Therefore, Weighted Average Dividend Rate = 176 ÷ 10 = 17.60%

3. Value Per Share

Nature of Buy	Decision Factor	Value Per Share
Small Lot of Shares	Dividend	Face Value Rs.100 × Weighted Average Dividend Rate 17.60% ÷ Expectation 12% = **Rs.146.67**
Controlling Interest	Return on Capital Employed	Face Value Rs.100 × Weighted Average ROCE 22.20% ÷ Expectation 12% = **Rs.185.00**

Question 5(b): Accounting for Financial Instruments – Forward Contracts N 10 (8 Marks)

On 1st February 2009, Future Ltd entered into a contract with Son Ltd, to receive the Fair Value of 1000 Future Ltd's Own Equity Shares Outstanding as on 31–01–2010 in exchange for payment of Rs.1,04,000 in cash, i.e. Rs.104 per Share. The contract will be settled in net cash on 31–01–2010.

The Fair Values of this forward contract on the different dates were:

Fair Value of forward on 01–02–2009 Nil
Fair Value of forward on 31–12–2009 Rs.6,300
Fair Value of forward on 31–01–2010 Rs.2,000

Presuming that Future Ltd, closes its books on 31st December each year, pass entries –
If net settled in cash.
If net is settled by Son Ltd, by delivering Shares of Future Ltd.

Solution: **1. Journal Entries (Cash Settlement)**

Date	Particulars	Dr. Rs.	Cr. Rs.
01.02.2009	Entering into Forward Contract – No Journal Entry since fair value of the derivative instrument is "Rs. NIL" and no cash is paid or received.		
31.12.2009	Year end Value of Forward Contract is Rs.6,300. Therefore, value of Forward Contract has increased to Rs.6,300 from Rs. NIL. Forward Contract Receivable A/c Dr. To Profit and Loss A/c (Being Increase in Fair Value of Forward Contract)	6,300	6,300

Date	Particulars	Dr. Rs.	Cr. Rs.
31.1.2010	Value of Forward Contract on the date of settlement is Rs.2,000. Therefore, value has decreased from Rs.6,300 by Rs.4,300. Profit and Loss A/c Dr. To Forward Contract Receivable A/c (Being Decrease in value of Forward Contract recorded)	 4,300	 4,300
31.1.2010	Settlement of Net Receivable by Cash Bank A/c Dr. To Forward Contract Receivable A/c (Being Settlement of Forward Contract by Cash)	 2,000	 2,000

2. Journal Entries (Settlement of "net" amount by shares)

First three journal entries are the same as above for Cash Settlement. The final entry will be as follows —

Date	Particulars	Dr. Rs.	Cr. Rs.
31.1.2010	Settlement of Net Receivable by delivery of Shares of Future Ltd. Equity Shares of Future Ltd (Own Shares) A/c Dr. To Forward Contract Receivable A/c (Settlement of Forward Contract by receipt of Shares of Son Ltd. No. of Shares received = Rs.2000 ÷ Rs.106 (18.87 based on closing share price)	 2,000	 2,000

Note: Only the "Net Amount" is settled by delivering shares of Future Ltd, and not the gross amount. If Gross Amount were to be settled, Future Ltd would receive Rs.1,04,000, and allot 1000 Equity Shares to Son Ltd at Rs.104 per share. Only the entry for allotment will be passed on 31.1.2010. No other journal entry should be passed. When Net Settlement is done, equity shares valued at Rs.2,000 should be delivered by Son Ltd to Future Ltd i.e. value on 31.1.2010. Since Fair Value as on 31.1.2010 is Rs.2,000, total value of the contract on that date is Rs.1,06,000 (Rs.1,04,000 Original Contract Value + Fair Value Rs.2,000), for 1,000 shares. Therefore, value per share is Rs.106.

Question 6(a): Compound Financial Instruments — N 10 (8 Marks)

On 1st April 2008, Sigma Ltd issued 6% Convertible Debentures of Face Value of Rs.100 per Debenture at par. The Debentures are redeemable at a premium of 10% on 31–03–2012, or these may be converted into Ordinary Shares at the option of the Holder, the interest rate for equivalent debentures without conversion rights would have been 10%. Being a compound financial instrument, you are required to separate Equity and Debt portions as on 01–04–08. If Equity Portion is Rs.1,85,400, find out the Debt Portion (Debenture Amount). The Present Value of Rs.1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of year	1	2	3	4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

Solution: **1. Valuation of Debt Component (Based on Expectation of 10% p.a.)**

Nature	Period	Cash Flow	DF @ 10%	DCF
Annual Interest Payments (Rs.100 × 6%)	1 – 4	6.00	(0.91+ 0.83 + 0.75+0.68)=3.17	19.02
Maturity Proceeds: Face Value Rs.100 + Premium 10%	4	110.00	0.68	74.80
Value of Host (Liability Component)				**93.82**

2. Valuation of Embedded Derivative

	Particulars	
	Capital Raised: Rs.100 Debenture at Par	100.00
Less:	Value of Host (Liability Component)	93.82
	Value of Embedded Derivative (Equity Component)	6.18
	Total Value of Equity Portion (given)	1,85,400
	Number of Debentures [Total Value Rs.1,85,400 ÷ Rs.6.18]	30,000
	Therefore, Total Value of Debt Portion = 30,000 Debentures × Rs.93.82	Rs.28,14,600

Question 6(b): Valuation of Liability — N 10 (8 Marks)

(i) What is the meaning of 'Valuation of Liabilities'?

(ii) State the purpose of valuation of liabilities in Financial Accounting and Reporting.

(iii) How is the Liability determined in the case of a Finance Lease?

Solution:

Valuation of Liabilities	It refers the process of ascertaining the amount to be disclosed in the Financial Statements i.e. in Balance Sheet. It involves use of either of the following methods — Discounted Cash Flow Method Market Price / Value method (Relative Price Method)
Purpose of Valuation	To determine correct value of a Company in a scheme of amalgamation / takeover. To disclose the fair value of liabilities in the Financial Statements.
Finance Lease Liability	Liability in case of a Finance Lease is determined as follows — Equivalent to Fair Value of the Asset taken on Finance Lease, or Present Value of Minimum Lease Payments (Discounted Cash Flow), whichever is **lower**.

Question 7(a) to (e): Various Topics – Answer any four of the following – N 10 (4 X 4 = 16 Marks)

Question 7(a): N 10 (4 Marks)

M/s TS Ltd has entered into a contract by which it has the option to sell its specified asset to NB Ltd for Rs.100 Lakhs after 3 years whereas the current market price is Rs.150 Lakhs. Company always settles account by delivery. What type of option is this? Is it a Financial Instrument? Explain with reference to the relevant Accounting Standard.

Solution:

1. **Type of Option:** TS Ltd has an "Option to Sell" the underlying asset. Hence, it is a Put Option Contract.
2. **Nature of Instrument:** Option Contracts are accounted for as Financial Instruments.
3. **Accounting:** The premium paid for buying the "Put Options" contract will be accounted for as an Asset, based on fair value principles.

Question 7(b): N 10 (4 Marks)

Assam Ltd purchased an Oil Well for $ 100 million. It estimates that the well contains 250 Million Barrels of oil. The oil well has no salvage value. If the Company extracted and sells 10,000 barrels of oil during the first year, how much Depletion Expense should be recognized as per IFRS 6?

Solution:

Particulars	Value
Gross Block of the Cost Centre (Depreciation Base) (Rs. Millions)	USD 100.00
Proven Oil Reserves (in Millions of Barrels of Oil)	250.00
Therefore, Depreciation Rate (Unit of Production Rate) [Depreciation Base Rs.100.00 Millions ÷ Oil Reserves 250.00 Million Barrels)	USD 0.40/Barrel
No. of Barrel Extracted	10,000
Therefore Depletion Expense for the First Year = 10,000 Barrels × USD 0.40	**USD 4,000**

Question 7(c): N 10 (4 Marks)

X Ltd sold its building to Mini Ltd for Rs.60 Lakhs on 30–09–2009 and gave possession of the property to Mini Ltd. However, documentation and legal formalities are pending. Due to this, the Company has not recorded the sale and has shown the amount received as an advance. The Book Value of the building is Rs.25 Lakhs as on 31st March 2010. Do you agree with this treatment? If you do not agree, explain the reasons with reference to the Accounting Standard.

Solution:

1. X Ltd has sold its property and handed over the possession against consideration on 30.09.2009, i.e. before the end of the financial year.
2. Therefore, significant risks and rewards associated with the property has been transferred to the buyer before the Balance Sheet. Where consideration is paid to the Seller and possession of the property is handed over to the Buyer, even if the Sale Deed has not been registered, Sec 53A of the Transfer of Property Act will be applicable.
3. Hence, necessary adjustment should be made to the assets and liabilities at the Balance Sheet Date. The sale and the gain of Rs.35 Lakhs thereon (Sale Price Rs.60 Lakhs Less Cost Rs.25 Lakhs) should be recognized in the accounts for the year ended 31st March 2010.

Question 7(d): N 10 (4 Marks)

Southern Tower Ltd purchased a plant from M/s. Tatamaco Ltd. on 30–09–2008 with a quoted price of Rs.180 Lakhs. Tatamaco offer 3 months credit with a condition that discount of 1.25% will be allowed if the payment were made within one month. VAT is 12.5% on the quoted price. Company incurred 2% on Transportation Costs and 3% on Erection Costs of the quoted price. Pre–operative Cost amounted to Rs.1.50 Lakhs. To finance the purchase of the machinery, the Company took a Term Bank Loan of Rs.125 Lakhs at an interest rate of 14.50% per annum. The machine was ready for use on 30–12–2008, however, it was put to use only on 01–04–2009.

Find out the Original Cost.

Suggest the accounting treatment for the cost incurred during the period between the date the machine was ready for use and the actual date the machine was put to use.

Solution:

	Particulars	Rs. Lakhs
	Quoted Price of Plant	180.00
	VAT at 12.50% of Quoted Price of 180.00 [Assuming the Company is not claiming any VAT Credit]	22.50
	Transportation Cost (Cost of bringing the asset to present location = 180.00 × 2%)	3.60
	Erection Cost (Cost of bring the asset to present condition = 180.00 × 3%)	5.40
	Pre–Operative Cost (assuming directly relatable to the Machinery)	1.50
	Total Original Cost	**213.00**
Less:	Discount (assuming Company avails the discount by prepaying the amount = 1.25% of Quoted Price)	(2.25)
	Net Cost	**210.75**
Add:	Interest Cost for 3 Months from 30th Sept. to 31st Dec. (Rs.125 Lakhs × 14.50% × 3/12)	**4.53**
	Total Capitalized Cost of the Asset	**215.28**

Note: 1. It is assumed that 3 months constitutes "substantial period of time" for Southern Tower Ltd, for the purpose of capitalizing interest cost in accordance with AS–16.

2. Interest Cost for the period from 30.12.2008 to 01.04.2009 should not be capitalized, since interest cost is to be capitalized only till the date where the Plant is substantially ready for its intended use (30.12.2008).

Question 7(e): N 10 (4 Marks)

S Square Private Limited has taken machinery on lease from S.K. Ltd. The information is as under:

Lease Term	4 years
Fair Value at inception of lease	Rs.20,00,000
Lease Rent	Rs.6,25,000 p.a. at the end of year
Guaranteed Residual Value	Rs.1,25,000
Expected Residual Value	Rs.3,75,000
Implicit Interest Rate	15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively. Calculate the Value of the Lease Liability as per AS–19.

Solution:

Value of Liability = Fair Value of the Asset or Present Value of Minimum Lease Payments, **whichever is lower.**

(a) Fair Value = Rs.20,00,000

(b) Present Value of Minimum Lease Payments from "Lessee":

Year	Nature	Cash Flow	PV Factor	Disc. Cash Flow
1 – 4	Annual Lease Rental	6,25,000	2.8550 (0.8696 + 0.7561 + 0.6575 + 0.5718)	17,84,375
4	Guaranteed Residual Value	1,25,000	0.5718	71,475
	Total			**18,55,850**

Therefore, Liability to be recognized = Lower of Rs.20,00,000 vs. Rs.18,55,850 = **Rs.18,55,850**. The Expected Residual Value given is not relevant in ascertaining the Liability of the Lessee.

Guideline Answers to Nov 2010 Advanced Accounting Exams (Old Syllabus)

Question No.1 is compulsory **(4 X 5 = 20 Marks).**
Answer **any five** questions from the **remaining six** questions **(16 X 5 = 80 Marks).**

Question No.1(a) AS 13 – Valuation – Short Term Vs Long Term — 5 Marks

Albert Finance Ltd has made the following investments.
Purchased the following Equity Shares from Stock Exchange on 1st June 2009.

Particulars	Cost (Rs.)
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	1,70,000
	4,00,000

Purchased gold of Rs.3,00,000 on 1st April, 2006.
Invested in Mutual Funds at a cost of Rs.6,00,000 on 31st March 2009.
Purchased Government Securities at a cost of Rs.5,00,000 on 1st April 2009.

How will you treat these investments as per applicable AS in the books of the Company for the year ended on 31st March 2010, if the values of these investments are as follows:

Shares	Rs.	Rs.
Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	70,000	3,00,000
Gold		5,00,000
Mutual Funds		4,50,000
Government Securities		7,00,000

Also explain is it possible to off-set depreciation in investment in Mutual Funds against appreciation of the value of investment in Government Securities?

Solution: Similar to Q.No.1, Page No.7.68

1. **Relevant Provision:** Since the Company is a NBFC, both AS–13 "Accounting for Investments" and RBI Guidelines shall be applicable. In case of conflict between AS and RBI Guidelines, RBI Guidelines shall prevail.

2. **Valuation:**
   (a) **Current Investments** are to be valued at Cost or Fair Value, whichever is lower. Such Valuation can be done category–wise or on individual basis. Hence, the net depreciation can be computed after comparing the Aggregate Market Value with the aggregate cost. *(As per both AS–13 and RBI Guidelines).*

   (b) **Long–Term Investments** are to be valued at Cost, unless there is a permanent diminution in value of such investments. *(As per both AS–13 and RBI Guidelines)*

3. **Calculation of Value of Investments:**

Type of Investment	Valuation Principle	Value of Investments
Equity Shares (aggregate)	Lower of Cost or Market Value / Fair Value	3,00,000
Mutual Funds	NAV (assumed as Market Value) (Refer Note)	4,50,000
Government Securities	Cost (assumed as fair value)	5,00,000
Gold	Cost (Assumed as Long Term Investment since the asset is held for about 3 years)	3,00,000
Total		**15,50,000**

Note: As per AS–13, Mutual Funds (Current Investments) are to be valued at the lower of Cost (Rs.6,00,000) and Market Value (Rs.4,50,000). Hence, Value as per AS–13 shall be Rs.4,50,000. But, Value as per RBI Guidelines will override the value as per AS–13.

4. **Inter–Category Adjustment:** Depreciation in value of investments in one category cannot be set off against the appreciation in the value of investments falling under other category. Hence, it is not possible to offset depreciation in Investment in Mutual Funds against appreciation of value of investments in Equity Shares and Government Securities.

Question No.1(b) AS 11 – Foreign Currency Loan & AS 6 — 5 Marks

A Ltd purchased Fixed Assets costing Rs.2,544 Lakhs on 1st April 2009 and the same was fully financed by foreign currency loan in U.S. Dollars, repayable in four equal annual instalments. Exchange Rate at the time of purchase was 1 US Dollar = Rs.42.40. The first instalment was paid on 31st March 2010 when 1 US Dollar fetched Rs.45.40. The entire loss on exchange was included in cost of goods sold of normal business operation. A Ltd provides depreciation on their Fixed Assets at 20% on WDV basis.

Show the correct accounting treatment with reference to relevant accounting standards.

Solution: Similar to Q.No.18, Page No.11.9 of Padhuka's Accounting Standards Book

1. **Accounting Treatment:**

Amount of Foreign Currency Loan	= Rs.2,544 lakhs ÷ Rs.42.40	= USD 60,00,000
Amount of First Instalment paid on 31st March 2010	= USD 60,00,000 ÷ 4 years	= USD 15,00,000
Amount of loan outstanding to be reported at Balance Sheet Date	=USD 45,00,000 × Rs.45.40	= Rs.2,043 Lakhs

Exchange Differences to be accounted for the year ending 31st March are –

Due to **Settlement:**	First Instalment	(Rs.42.40 – Rs.45.40) × 15,00,000	= Rs.45,00,000 (Loss)
Due to **Reporting:**	Balance Due	(Rs.42.40 – Rs.45.40) × 45,00,000	= Rs.1,35,00,000 (Loss)
Total Amount Debited to P&L Account			= Rs.1,80,00,000 (Loss)

(a) **Exchange Differences:** As per AS–11, the Exchange Rate differences shall not be adjusted in the Carrying Amounts of Fixed Assets. It shall be written off in Profit and Loss Account.

(b) **Depreciation on Fixed Assets :** Depreciation on Fixed Assets will be provided on the Original Cost of Rs.2,544 Lakhs in accordance with AS – 6 requirements.

2. **AS – 11 vis-à-vis Companies Act, 1956:**

(a) The Ministry of Corporate Affairs has issued the Companies (Accounting Standards) Rules, 2006 by way of Notification GSR 739(E), dated 7-12-2006.

(b) AS – 11 published in the above Notification requires the Exchange Rate differences to be treated according to this Standard **irrespective** of the relevant provisions of the Companies Act, 1956.

(c) So, Exchange Rate differences should not be adjusted to the cost of Fixed Assets. Such differences should be debited/ credited to P&L Account, in accordance with AS – 11 requirements.

Question No.1(c) AS vs IFRS — 5 Marks

State the treatment of the following items with reference to Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS) – (a) Impairment of assets, and (b) Business combinations.

Solution: **Refer Page 11 & 14 of Appendix in Padhuka's Students' Referencer on Accounting Standards**

Question No.1(d) AS 17 – Segment Reporting — 5 Marks

The Chief Accountant of ANZ Ltd., gives the following data regarding its six segments: (Rs. In Lakhs)

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segments Results	50	–190	10	10	–10	30	–100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that segments 'M' and 'N' alone should be reported. Is he justified in his view? Discuss.

Solution:

Reportable Segment [Para 27]: A Business or Geographical Segment should be identified as a Reportable Segment if any one of the following criteria is satisfied –

Criteria	Condition
Segment Revenue	• The Revenue from Sales to external customers and from transactions with other segments is **10% or more** of the total revenue, external and internal, of all segments. • 10% of the Total Revenue of All Segments = 10 % × 1200 = 120. • **So, Reportable Segments are M and N**

Segment Result	1. The Segment Result, whether Profit or Loss, is **10% or more** of – (a) the combined result of all segments in Profit, or (b) the combined result of all segments in Loss, **whichever is greater** in absolute amount. 2. **Computation:** (a) Total of the Segments Profits = 100 (50+10+10+30) (b) Total of the Segment Losses = 200 (190+10) (c) Higher of (a) and (b) = 200. (d) 10% of (c) = 10% of 200 = 20. 3. **So, Reportable Segments are M, N, and R**
Segment Assets	1. Segment Assets are **10% or more** of the Total Assets of all segments. 2. 10% of the Total Segment Assets = 10% of 200 = 20 3. **So, Reportable Segments are M, N, O, P, and Q**

Conclusion: Therefore, the Reportable Segments are M,N,O,P,Q,R i.e all the given segments.

Question No.2: Consolidation – Triangle Holding – Abnormal Loss, Dividends etc. 16 Marks

The summarized Balance Sheet of the following three Companies as on 31st March 2009 are given below: (Rs. in Lakhs)

Particulars	A Ltd	B Ltd	C Ltd
<u>Liabilities:</u>			
Equity Shares (Rs.10 each fully paid up)	60	48	40
7½% Cum. Pref. Shares (Rs.100 each fully paid)	15	12	10
Capital Reserve on revaluation of Land, Buildings and Machinery	120	–	–
General Reserve	25	15	10
8% 2,500 Mortgage Debenture Bonds of Rs.1,000 each	25	–	–
Secured Loans and Advances from Banks	153	71	52
Unsecured Loans:			
From B Ltd.	–	–	12
From C Ltd.	15	–	–
Deposits from Public	18	12	3
Current Liabilities and Provisions			
Inter-Company balances	9	–	–
Other Liabilities and Provisions	314	125	72
Total	754	283	199
<u>Assets;</u>			
Fixed Assets (Net)	272	104	42
Investments (at cost)			
2,50,000 Equity Shares of B Ltd.	25	–	–
80,000 Equity Shares of C Ltd.	8	–	–
1,60,000 Equity Shares of C Ltd.	–	20	–
10,000 Cumulative Pref. Shares of A Ltd.	–	–	10
1,500 Mortgage Debentures of A Ltd.	–	–	14
Current Assets	353	123	112
Profit and Loss Account	96	36	21
Total	754	283	199

(i) A Ltd subscribed for the Shares of B Ltd & C Ltd at par at the time of first issue of Shares by the latter Companies.

(ii) B Ltd subscribed for 80,000 Shares of C Ltd at par at the time of first issue, and later acquired by purchase in the market 80,000 Shares of C Ltd at Rs.15 each, when Reserves and Surplus of C Ltd stood at Rs.5 Lakhs.

(iii) Current Assets of B Ltd & C Ltd included Rs.4 Lakhs and Rs.6 Lakhs respectively being the Current Accounts balance against A Ltd. These accounts remained unreconciled.

(iv) Preference dividends were in arrears for –

(a) 8 years in the case of A Ltd and

(b) 4 years in the case of other two Companies.

Prepare the Consolidated Balance Sheet for the year as on 31st March 2009.

Solution:

1. Basic Information

Company Status	Dates	Holding Status		
			B. Ltd	**C. Ltd. Ltd**
Holding Company = A. Ltd. Subsidiary = B. Ltd Sub–Subsidiary = C. Ltd.	Date of Consolidation 31.03.09 B. Ltd in C. Ltd.: DOA 1 80,000 DOA 2 80,000 A. Ltd. in B. Ltd and C. Ltd. DOA 1	(a) Holding Co.	80% —	(A) 20% (B) 40%
		(b) Minority Int.	20%	40%

Date of Controlling Acquisition in C. Ltd. Ltd is DOA 2, since as on DOA 1 the controlling interest is not yet acquired.

Note: The Shareholding Pattern is as under –

Co.	held by A Ltd	Held by B Ltd	Total Holdings	Minority Interest	Total No of Shares
B Ltd	2,50,000 (52.08%)	N.A.	2,50,000 (52.08%)	2,30,000 (47.92%)	4,80,000 (100%)
C Ltd	80,000 (20%)	1,60,000 (40%)	2,40,000 (60%)	1,60,000 (40%)	4,00,000 (100%)

2. Analysis of Reserves and Surplus of Subsidiary Companies

(a) B Ltd

Reserves		Profit and Loss Account	
as on 31.3.2009 15		as on 31.3.2009 (36)	
DOA 1	Tfr between DOA and DOC	DOA 1	Tfr between DOA and DOC
NIL	**15 (Revenue)**	**NIL**	**Debit (36) Revenue**

(b) C Ltd

Reserves		Profit and Loss Account	
31.3.2009 – 10		31.3.2009 (21)	
DOA 2	DOA 2 to DOC	DO2	Tfr between DOA2 and DOC
10	**NIL**	**(5)**	**Debit (16)**
Pre	**Post**	**Pre**	**Post**

Note: Aggregate Reserves and Surplus on the second date of acquisition (i.e. Date of Controlling Acquisition) is Rs.5 Lakhs. Assuming Balance in "Other Reserves" to be Rs.10 Lakhs from that date itself, balance in P&L A/c on the date of controlling acquisition is debit balance of Rs.5 Lakhs.

3. Consolidation of Balances (Direct Method)

Particulars	Total	Minority Interest	Pre Acqn.	Post Acquisition	
				Gen.Res.	P&L A/c
C Ltd (A Ltd – 20%, B Ltd– 40% Minority – 40%)					
Equity Capital	40.00	16.00	24.00	—	—
7 ½% Preference Capital	10.00	10.00			
General Reserve	10.00	4.00 (10 × 40%)	6.00 (10 × 60%)	—	—
P&L A/c	(21.00)	(8.40) (21 × 40%)	(3.00) (5 × 60%)	–	(9.60) (16× 60%)
Sub Total (1)		**21.60**	**27.00**	**—**	**(9.60)**
B Ltd (A Ltd–52.083%, Minority–47.917%)					
Equity Capital	48.00	23.00	25.00	—	—
7 ½% Preference Capital	12.00	12.00			
General Reserve	15.00	7.19 (15×47.917%)	—	7.81 (15×52.083 %)	—
P&L A/c	(36.00)	(17.25) (36×47.917%)	—	—	(18.75) (36×52.083%)
Share of B Ltd in Post Acquisition Reserves of C Ltd • P&L A/c (16 × B. Ltd in C Ltd 40% × 47.9167%)		(2.68)			2.68
Sub Total (2)		**22.26**	**25.00**	**7.81**	**(16.07)**

Particulars	Total	Minority Interest	Pre Acqn.	Post Acquisition	
				Gen.Res.	P&L A/c
Total of 1 & 2 above		**43.86**	**52.00**	**7.81**	
Cost of Investment[Dr.] (25 + 8+ 20)			(53.00)		
Parent's Balances				25.00	(96.00)
Gain on Cancellation of Mutual Debentures (Face Value Cr. Rs.15 Lakhs – Cost Dr. Rs.14 Lakhs)				1.00	—
Gain on Cancellation of Mutual Preference Capital (Face Value Cr. Rs.10 Lakhs – Cost Dr. Rs.10 Lakhs)			—	—	—
For Consolidated Balance Sheet		**43.86**	**(1.00) Goodwill**	**33.81**	**(121.67) P&L A/c**

4. Consolidated Balance Sheet of A Ltd and its subsidiaries B Ltd and C Ltd. as at 31.03.2009

Liabilities	Rs. Lakhs	Assets	Rs. Lakhs
Share Capital		**Fixed Assets**	
Equity Share Capital (Rs.10 each fully paid up)	60.00	Goodwill on Consolidation	1.00
7½ % Cum. Pref. Share Capital (Rs.100 each fully paid up)	5.00	Fixed Assets (Net) (272 + 104 + 42)	418.00
[15 – Mutual 10]		**Current Asset** (353 + 123 + 112 – Inter Company Loans 15 – 12 – Inter Company Liabilities 9)	552.00
Reserves and Surpluses:			
Capital Reserve (Revaluation of Fixed Assets)	120.00		
General Reserve	33.81	**Profit and Loss Account**	121.67
Minority Interest	43.86		
Secured Loans:			
7,500 8% Mortgage Debentures Bonds of Rs.100 each [25 – Mutual 15]	10.00		
Secured Loans & Advances from Bank (171 + 83 + 55)	309.00		
Current Liabilities & Provisions – Other Liabilities (314 + 125 + 72)	511.00		
Total	**1092.67**	**Total**	**1092.67**

Note:

- Preference Dividends have not been declared and are in arrears for 8 years in A Ltd & 4 Years in case of B Ltd & C Ltd
- Total receivables from A Ltd as per B Ltd and C Ltd is Rs.10 Lakhs (6 + 4). However, amount shown as payable is Rs.9 Lakhs only. The remaining Rs.1 Lakh may represent remittance in transit, and is part of Current Assets itself. Hence, only Rs.9 Lakhs has been adjusted in Current Assets.

Question No.3: Demerger 16 Marks

Libra Ltd has two divisions A and B and their respective shares of various Assets and Liabilities in the Company's Balance Sheet as in 31st March 2009 are given below: (Rs. in lakhs)

Particulars	A Division	B Division	Total
Fixed Assets: Cost	650	340	
Less: Depreciation	225	160	
Written down value	425	180	605
Investments			115
Current Assets	350	430	
Less: Current Liabilities	185	210	
Net Current Assets	165	220	385
Total			1,105
Financed by:			
Loan Funds			400
Own Funds:			
Equity Share Capital – Shares of Rs.10 each			300
Reserve and Surplus			405
Total			1,105

Division B has been invariably suffering losses. The Company sold this division B along with its Assets and Liabilities to a new COMPANY, Zee Ltd, which was incorporated with an Authorized Capital of Rs.800 Lakhs divided into Shares of Rs.10 each. Zee Ltd allotted to Libra Ltd's Shareholders, its two fully paid Equity Shares of Rs.10 each at par for every fully paid Equity Shares of Rs.10 each held in Libra Ltd, as discharge of consideration for the division taken over.

Zee Ltd recorded in its books the Fixed Assets at Rs.280 Lakhs, Current Assets at Rs.320 Lakhs and liabilities at the same value at which they appeared in the books of Libra Ltd.

On 1st April 2009 Libra Ltd sold all its investments for Rs.135 Lakhs and redeemed Debentures liability of Rs.150 Lakhs at par, which was included in Loan Funds. The cash transactions being recorded in the Bank Account pertaining to A Division.

You are required to:

(i) Show Journal Entries in the Books of Libra Ltd,

(ii) Prepare Libra Ltd's Balance Sheet immediately after the Demerger, and

(iii) Initial Balance Sheet of Zee Ltd.

Solution:

1. Journal of Libra Ltd (Rs. Lakhs)

Date	Particulars		Debit	Credit
1.	Realisation A/c	Dr.	770	
	To Fixed Assets			340
	To Current Assets			430
	(Assets of Division B transferred to Zee Ltd)			
2.	Provision for Depreciation A/c	Dr.	160	
	Current Liabilities	Dr.	210	
	To Realisation A/c			370
	(Being liabilities of division B of Libra Ltd. transferred to Zee Ltd)			
3.	Zee Ltd A/c	Dr.	600	
	To Realisation A/c			600
	(Being consideration due from Zee Ltd for the transfer of assets and liabilities of Division B) (No. of Shares in Libra Ltd 30 Lakhs × Swap Ratio 2 × Issue Price at Par Rs.10)			
4.	Realisation A/c	Dr.	200	
	To Capital Reserve A/c			200
	(Gain on Realisation transferred to Capital Reserve being non–distributable profits)			
5.	Members A/c	Dr.	600	
	To Zee Ltd A/c			600
	(Discharge of purchase consideration of 60 Lakhs equity shares of Zee Ltd to shareholders of Libra Ltd)			
6.	Capital Reserve A/c	Dr.	200	
	Reserves A/c	Dr.	400	
	To Members A/c			600
	(Balance in Members A/c representing distribution of assets of the Company to members, adjusted against reserves including Capital Reserve created on such a transfer)			
7.	Bank A/c	Dr.	135	
	To Investment A/c			115
	To Profit on Sale of Investment A/c			20
	(Being all the Investment sold for a consideration of Rs.135 Lakhs)			
8.	Debentures A/c	Dr.	150	
	To Bank A/c			150
	(Being Debentures Redeemed at par for Rs.150 Lakhs)			

2. Books of Zee Ltd (Rs. Lakhs)

	Particulars		Debit	Credit
1.	Fixed Assets A/c	Dr.	440	
	Current Assets A/c	Dr.	320	
	Goodwill A/c (balancing figure)		210	
	To Current Liabilities A/c			210
	To Provision for Depreciation			160
	To Equity Share Capital			600
	(Being the Assets and Liabilities of B division of Libra Ltd taken over by Zee Ltd, and allotment of Rs.600 Lakhs Equity Shares (of Rs.10) each at par as fully paid up to the members of Zee Ltd)			

3. Balance Sheet of Libra Ltd as at 1st April 2009 before and after Demerger (Rs.Lakhs)

Liabilities	Before Demerger	After Demerger	Assets	Before Demerger	After Demerger
Share Capital Rs.10 Shares	300	300	**Fixed Assets** Gross Block	990	(990-340) 650
Reserves	405	(405+20-400) 25	**Less:** Depreciation	385	(385-160) 225
			Net Block	605	425
Loan Funds Secured Loan	400	(400-150) 250	Investments	115	NIL
Current Liabilities	395	(395-210) 185	**Current Assets**	780	(780-430-150+135) 335
Total	**1500**	**760**	**Total**	**1500**	**760**

4. Balance Sheet of Zee Ltd as at 1st April 2009 after takeover of B division

Liabilities		Rs. Lakhs	Assets		Rs. Lakhs
Share Capital	Rs.10 Shares	600	**Goodwill**		210
Reserves:	Capital Reserve		**Fixed Assets**	Gross Block	440
			Less:	Depreciation	160
				Net Block	280
Current Liabilities		210	**Current Assets**		320
Total		**810**	**Total**		**810**

Question No.4: Valuation of Shares – Different Types of Shares & Different Paid Up Values — 16 marks

The Balance Sheet of Bird Ltd as on 31st March 2009 is given below:

Liabilities		Rs.	Assets	Rs.
Share Capital:			Fixed Assets:	
Equity Shares of Rs.10 each	6,00,000		Goodwill	40,000
Less: Call in Arrears (Rs.2 for Final Call)	20,000	5,80,000	Machinery	3,00,000
7% Preference Shares of Rs.10 each fully paid		3,00,000	Freehold Properties	4,50,000
Reserve and Surplus:			Vehicles	1,00,000
General Reserve		3,50,000	Furniture	50,000
Profit and Loss Account		1,50,000	Investments	2,00,000
Current Liabilities:			Current Assets:	
Sundry Creditors		3,00,000	Stock–in–Trade	2,50,000
Bank Loan		2,00,000	Sundry Debtors	4,00,000
			Cash at Bank	60,000
			Preliminary Expenses	30,000
		18,80,000		18,80,000

Additional Information:

(i) On 1-4-2006, a new Furniture costing Rs.20,000 was purchased and wrongly charged to revenue. No rectification has yet been made for above. Depreciation charged on Furniture is at 10% on reducing system.

(ii) Fixed Assets are worth 15% above their actual Book Value.

(iii) Stock is overvalued by Rs.50,000 and 10% Debtors are doubtful.
(iv) Of the Investments, 10% is in Trade and the balance Non-Trade. Trade Investments are to be valued at 10% below cost. A uniform rate of dividend of 10% is earned on all investments.
(v) For the purpose of Valuation of Shares, Goodwill is to be considered on the basis of 2 years' purchase of super profits based on average profit of last 3 years. Profits are as follows:

Year	Rs.
2006-07	2,50,000
2007-08	2,80,000
3,30,000	

(vi) In a similar business Normal Return on Capital Employed is 20%.
You are required to value each fully paid and partly-paid Equity Share, assuming tax rate of 50%.

Solution: Similar to Q.No.27, Page No.1.101

1. Calculation of Value per Share:

Particulars	Rs.
Capital Employed **(W.N.1)**	11,47,477
Add:	
(a) Calls in arrears	20,000
(b) Non Trade Investments (1,80,000 X 90%)	1,62,000
(c) Goodwill **(W.N.2)**	41,600
	13,71,077
Less: Preference Share Capital	(3,00,000)
Net Capital Employed belonging to Equity Share Holders	10,71,077
No. of Shares (6,00,000/10)	60,000
Value of Rs.10 Paid–up Share (Face Value:Rs.10 per Share)	**17.85**
Value of Rs.8 Paid–up Share (Face Value:Rs.10 per Share) (Rs.17.85 – Rs.2.00)	**15.85**

Working Notes:

1. Computation of Closing Capital Employed

Particulars	Computation	Rs
(A) Assets		
1. Machinery	3,00,000 x 115%	3,45,000
2. Freehold Properties	4,50,000 x 115%	5,17,500
3. Vehicles	1,00,000 x 115%	1,15,000
4. Furniture (See Note 3 below)	(50,000+14,580) x 115%	74,267
5. Investments (Trade only)	(2,00,000 X 10% x 90%)	18,000
6. Stock in Trade	(2,50,000 – 50,000)	2,00,000
7. Sundry Debtors Less Provision for Bad Debts	(4,00,000 – 10% Doubtful)	3,60,000
Sub Total (A)		**16,29,767**
(B) Liabilites		
1. Sundry Creditors		3,00,000
2. Bank Loan		2,00,000
3. Provision for Tax	**(W.N.3)**	(17,710)
Sub Total (B)		**4,82,290**
Capital Employed [(A) – (B)]		**11,47,477**

2. Computation of Future Maintainable Profits:

Particulars	2006-07	2007-08	2008-09
(a) Profit after Tax before adjustment	2,50,000	2,80,000	3,30,000
(b) **Add:** Furniture wrongly recorded as revenue (after tax effect)	10,000	-	-
(c) **Less:** Adjustment for Depreciation (after tax effect)	(1,000)	(900)	(810)
(d) **Less:** Income from Non-Trade Investments – assumed tax free dividends	(18,000)	(18,000)	(18,000)
(e) **Less:** Reduction in Stock (after tax effect)			(25,000)
(f) Provision for Debts **(refer note)**			(40,000)
(g) Future Maintainable Profits	2,41,000	2,61,100	2,46,190
(h) Average Profits		Rs.2,49,430	
(i) Normal Rate of Return x Capital Employed (11,47,477 x 20%)		Rs.2,29,495	

Particulars	2006-07	2007-08	2008-09
(j) Super Profits (h) – (i)	Rs.19,935		
(k) Goodwill (19,935 x 2)	**Rs.39,870**		

Note: Assumed that the Provision for Doubtful Debts in **not** allowable as deduction under the Income Tax Act, 1961.

3. Computation of Provision for Tax:

Adjustment	Gross Amount (Rs.)	Tax Effect @ 50% (Rs.) (Note)
Furniture Wrongly expensed – rectified	20,000	10,000
Depreciation on Furniture now capitalised (a) FY 2006 – 07 (b) FY 2007 – 08 (c) FY 2008 – 09	 (Rs.20,000 x 10%) 2,000 (Rs.18,000 x 10%) 1,800 (Rs.16,200 x 10%) 1,620	 (1,000) (900) (810)
Income from Non–Trade Investments	18,000	Nil(assumed tax free dividends)
Reduction in Stock overvalued	50,000	(25,000)
Total (Savings in Income Tax)		**(17,710)**

Note: Numbers in brackets indicate savings in income–tax.
Net WDV of Furniture on 31.03.2009 = 20,000 – 2,000 – 1,800 – 1,620 = 14,580.

Question No.5(a): Valuation of Business – Cash Flow Approach 10 Marks

S Ltd is considering buying the business of R Ltd the final accounts of which for the last 3 years were as follows:

Profit and Loss Accounts for the 3 years ended 31st Dec. (Figures in Rs.)

	2007	2008	2009
Sales	2,00,000	1,90,000	2,24,000
Material Consumed	1,00,000	95,000	1,12,000
Business Expenses	80,000	80,000	82,000
Depreciation	12,000	13,000	14,000
Net Profit	8,000	2,000	16,000

Balance Sheet as at 31st Dec. (Figures in Rs.)

	2006	2007	2008	2009
Fixed Assets (at Cost)	1,00,000	1,20,000	1,40,000	1,80,000
less Depreciation	70,000	82,000	95,000	1,09,000
	30,000	38,000	45,000	71,000
Stock in Trade	16,000	17,000	18,500	21,000
Sundry Debtors	21,000	24,000	26,000	28,000
Cash in hand and at Bank	32,000	11,000	28,000	13,200
Prepaid Expenses	1,000	500	2,000	1,000
Total Assets	1,00,000	90,500	1,19,500	1,34,200`
Equity Capital	50,000	50,000	70,000	70,000
Share premium	–	–	5,000	5,000
General Reserve	16,000	24,000	26,000	42,000
Debentures	20,000	–	–	–
Sundry Creditors	11,000	13,000	14,000	14,000
Accrued Expenses	3,000	3,500	4,500	3,200
Total Liabilities	1,00,000	90,500	1,19,500	1,34,200

S Ltd wishes the offer to be based upon trading cash flows rather than book profits. By Trading Cash Flow is meant Cash received from Debtors less Cash Paid to Creditors and for Business Expenses (excluding Depreciation), together with an allowance for average annual expenditure on Fixed Assets of Rs.15,000 per year.

The actual expenditure on Fixed Assets is to be ignored, as is any cash received or paid out on the issue or redemption of Shares or Debentures.

S Ltd wishes the Trading Cash Flow to be calculated for each of the years 2007, 2008 and 2009 and for these to be combined using weighting of 20% for 2007, 30% for 2008 and 50% for 2009 to give an Average Annual Trading Cash Flow.

S Ltd considers that the Average Annual Trading Cash Flow should show a return of 10% on its investment.

You are required to calculate:
Trading Cash Flow for each of the years 2007, 2008 & 2009.
Weighted Average Annual Trading Cash Flow.
Price which S Ltd should offer for the business.

Solution:

Particulars	2007	2008	2009
Net Profits as per P&L	8,000	2,000	16,000
Add: Depreciation	12,000	13,000	14,000
Operating Cash Flows before Working Capital Changes	20,000	15,000	30,000
Adjustment for Working Capital Changes			
(a) Change in Stock	(1,000)	(1,500)	(2,500)
(b) Change in Debtors	(3,000)	(2,000)	(2,000)
(c) Prepaid Expenses	500	(1,500)	1,000
(d) Sundry Creditors	2,000	1,000	-
(e) Accrued Expenses	500	1,000	(1,300)
Cash Generated from Operations	**19,000**	**12,000**	**25,200**
Less: Allowance for Expenditure on Fixed Assets	(15,000)	(15,000)	(15,000)
Trading Cash Flow	4,000	(3,000)	10,200
Weights	20%	30%	50%
Weighted Trading Cash Flow	1,000	(900)	5,100
Weighted Average Cash Flow	5,500		
Capitalisation Rate	10%		
Value of Business	**55,000**		

Question No.5(b) Corporate Social Reporting — 6 Marks

From the following information of Steel India Limited for the year ended 31st March 2010, prepare their Social Balance Sheet as on that date –

1. A Specialist has valued their Human Assets at Rs.828 Lakhs.
2. Their Investments were classified as – (Rs. in Lakhs)

Asset	Residential	Hospital	School	Welfare
Building	17.00	1.00	1.40	0.80
Equipments	2.80	1.00	1.00	–

3. Water, Electricity and Gas Supply Systems totalled Rs.1 Lakh.
4. Their Net Owned Funds were Rs.26 lakhs.

Solution:

Social Balance Sheet of Steel India Ltd as on 31st March 2010 (Rs.Lakhs)

Particulars	Current Year	Previous Year
(A) Social Liabilities		
(b) Organisation Equity	26.00	
(c) Social Equity – Contribution by Staff	828.00	
Total	**854.00**	
(B) Social Assets		
1. Social Capital Investment in Building of –		
(a) Employee Housing	17.00	
(b) Hospital	1.00	
(c) Schools	1.40	
(d) Community Halls for Social Welfare Activities	0.80	
2. Social Capital Investment in Equipment in –		
(a) Employee Housing	2.80	
(b) Hospital	1.00	

Particulars	Current Year	Previous Year
(c) Schools	1.00	
(d) Community Halls for Social Welfare Activities	NIL	
3. Electricity, Gas and Water Supply to Employees	1.00	
4. Human Assets	828.00	
Total	**854.00**	

Question No.6(a) GVA Statement – Calculation of Excise Duty 10 Marks

The following is the Profit and Loss Account of Murali Ltd for the year ended 31st March. Prepare a GVA Statement of Murali Ltd.

Profit and Loss Account for the year ended 31st March

	Particulars	Rs. Lakhs	Rs. Lakhs
Income:	Sales	890	
	Other Income	55	945
Expenditure:	Production and Operational Expenses	641	
	Administration Expenses (Factory)	33	
	Interest	29	
	Depreciation	17	720
	Profit Before Taxes		225
Less:	Provision for Taxes		30
	Profit After Tax		195
Add:	Balance as per Balance Sheet		10
			205
Less:	Transferred to General Reserve	45	
	Dividend Paid	95	140
	Surplus carried to Balance Sheet		65

1. Production and Operational Expenses consists of Consumption of Raw Materials 293 Consumption of Stores 59 Salaries, Wages, Gratuities etc. (Admn.) 82 Cess and Local Taxes 98 Other Manufacturing Expenses 109	2. Interest Charges Consists of Int. on loan from ICICI Bank for Working Capital 9 Interest on loan from ICICI Bank for Fixed Loan 10 Interest on loan from IFCI for Fixed Loan 8 Interest on Debentures 2 Total 29
3. Administration Expenses include Salaries to Directors Rs. 9 Lakhs. Provision for Doubtful Debts Rs. 6.30 Lakhs.	4. The charges for taxation include a transfer of Rs. 3 Lakhs to the credit of Deferred Tax Account.
5. Cess and Local Taxes include Excise Duty, which is equal to 10% of cost of bought–in material.	

Solution:

Value Added Statement of Murali Ltd for year ending 31st March

	Particulars			Rs. Lakhs
	Sales			890.00
Less:	Cost of Bought in Materials & Services		(W.N.1)	461.00
	Administrative Expenses		(W.N.2)	17.70
	Interest on working capital		(W.N.3)	9.00
	Excise Duty	(Rs.461 × 10%)		46.10
	Value Added from Manufacturing and Trading Activities			356.20
Add:	Other Income			55.00
	TOTAL VALUE ADDED			**411.20**
Application of Value Added			**%**	**Rs. Lakhs**
	To Pay Employees	(W.N.4)	20%	82.00
	To Pay Directors	(W.N.5)	2%	9.00
	To Pay Government	(W.N.6)	20%	81.90
	To Pay Providers of Capital	(W.N.7)	28%	115.00
	To Provide for Maintenance & Expansion of the Company	(W.N.8)	30%	123.30
	TOTAL APPLICATION		**100%**	**411.20**

Working Notes:

1. **Cost of bought in Materials and Services** includes Raw materials, Stores and Other Manufacturing Expenses, i.e., 293 + 59 + 109 = Rs.461 Lakhs.
2. **Administrative Expenses** excludes Commission to Directors and Provision for Debts i.e., [Rs.33 – (Rs.9 + Rs.6.3)] which is Rs.17.70 Lakhs.
3. **Interest** on Working Capital – ICICI Bank is Rs. 9 Lakhs.
4. **Employees:** Salaries, Wages, Gratuities etc. is Rs. 82 Lakhs.
5. **Directors -** Salaries and Commission to Directors is Rs. 9 Lakhs.
6. Payment to **Government** includes Cess and Local Taxes (Rs.98 Lakhs **Less** Rs.461 Lakhs × 10%), Deferred Taxes and Provision for Taxation i.e.(Rs.51.9 + Rs.3 + Rs.27) = Rs. 81.9 Lakhs.
7. Payment to **Providers of Capital** includes interest on Fixed Loan (Rs. 10 Lakhs + Rs. 8 Lakhs), Interest on Debentures and Dividend, i.e. Rs. 18 + Rs. 2 + Rs. 95 = Rs. 115 Lakhs.
8. **Retained Earnings and Depreciation** includes Depreciation, Transfer to General Reserve, Retained Profit and Provision for Doubtful Debts i.e. (Rs.17 + Rs.45 + Rs.55 + Rs.6.3) = Rs. 123.30 Lakhs.

Question No.6(b) Statement of changes in Development Fund — 6 Marks

From the following in respect of Loan funds of M/s Cometogether Foundation for 2009-10, prepare a statement showing Changes in Fund Balance during the year.

Particulars	Rs.
Private and Government Grants	5,00,000
Loan Fund Matching Grant from Revenue Funds	10,000
Other transfer from Unrestricted Funds	1,00,000
Investment Income	15,000
Interest on Loans	25,000
Refunded to Grantors	20,000
Loan Cancellation and Written off	10,000
Administrative and Collection costs	15,000
Fund Balance at the beginning of the year	20,15,000

Solution:

Statement of Changes in Development Fund Balance of M/s Cometogether Foundation for 2009–10

	Particulars	
A.	**Fund Balance at the beginning of the year**	**20,15,000**
B.	**Additions during the year:**	
	Private and Government Grants	5,00,000
	Investment Income	15,000
	Interest on Loans	25,000
	Total Additions	**5,40,000**
C.	**Deductions and Application during the year:**	
	Refunded to Grantors	20,000
	Loan Cancellation and Written off	10,000
	Administrative and Collection Costs	15,000
	Total Applications (Transferred to Unrestricted Fund)	**45,000**
D.	**Transfer from Other Funds:**	
	Loan Fund Matching Grant from Revenue Funds	10,000
	Other Transfers from Unrestricted Funds	1,00,000
	Total Transfers	**1,10,000**
E.	**Net Additions to Loan Fund during the year (B – C + D)**	**6,05,000**
F.	**Fund Balance at the end of the year (A+E)**	**26,20,000**

Question No.7(a) AS 6 – Depreciation — 4 Marks

An airline is required by law to overhaul its aircraft once in every three years. A Company which operates aircrafts does not provide any provision as required by law in its final accounts. Discuss with reference to relevant Accounting Standard.

Solution:

1. **Relevant Provision:** As per AS–29, provision shall be created when there is a present obligation as a result of past events and it is probable that the outflow of resources may happen whose amount can be measured reliably.

2. **Analysis:**
   (a) In the given case, the Airline Company is required by law to overhaul its aircrafts once in every three years.
   (b) Hence, the Company shall create provision for repairs based on its past experience regarding the amount spent on repairs for each year.
   (c) In the year of overhaul, the actual overhaul expenses shall be compared with the provision and any difference shall be appropriately debited / reversed in Profit and Loss Account.

3. **Conclusion:** The Company has to create provision for repairs based on its past experience. If the provision is not created, then the profits shall be considered as over–stated to that extent. *(Note: It is assumed that the creation of provision for such repairs is not mandated by law).*

Question No.7(b) AS 12 – Accounting for Govt. Subsidy 4 Marks

A company purchased on 1st April, 2010 a special purpose machinery for Rs.1 Crore, and received Central Government Subsidy for 25% of the price. Effective life of Machinery is 8 years. Explain the accounting treatment and quote the relevant AS.

Solution:

1. **Methods of presentation:** As per AS–12 "Accounting for Government Grants", there are 2 methods of presentation of Grants related to **specific depreciable Fixed Assets** in Financial Statements. They are –

Asset Cost Reduction Method	Deferred Income Method
(a) The Grant is shown as a **deduction from Gross Value of related asset** in arriving at its Book Value. (b) If the same is followed in the above case, then the Capital Subsidy is to be adjusted towards the cost of the Special Purpose Machinery, and the same may be quoted at Rs.75 Lakhs. (c) The Grant is indirectly recognised in the Profit and Loss Statement **over the useful life** of a depreciable asset by way of a reduced depreciation charge.	(a) The Grant of Rs.25 Lakhs can be treated as Deferred Income and recognised in Profit & Loss Account on a systematic and rational basis over the useful life of asset. (b) The allocation to income is usually made **over the period** and in the **proportion of depreciation** charged on related assets. (c) The Deferred Income balance is disclosed in the Balance Sheet separately, e.g. in a Company Balance Sheet, it is shown after 'Reserves and Surplus' but before 'Secured Loans' as 'Deferred Government Grants' with description.

Question No.7(c) AS 26 & AS 5 4 Marks

An intangible item is appearing in the Balance Sheet of A Ltd at Rs.15 Lakhs on 1-4-2010. The item was acquired for Rs.25 Lakhs on 1-4-2008. The enterprise has been following a policy of amortizing the intangible item over a period of 5 years on straight line basis. Applying paragraph 63 of AS-26, the Enterprise determines the amortization period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use, i.e. 1st April, 2008. Comment.

Solution:

1. **Review Principle:** The Amortisation Period should be reviewed at least every year–end.
2. **Recognition Principle:** If the expected useful life of the asset is **significantly different** from previous estimates, the Amortisation Period should be changed accordingly.
3. **Disclosure Principle:** The change in Amortisation Period should be accounted for as per **AS – 5,** being a change in the Accounting Estimate. The treatment for the change in Amortisation Period is as follows:
   (a) **Effect on Profit:** The effect of a change in an accounting estimate should be included in the determination of Net Profit or Loss in both the period of the change and future periods, since the change affects future periods also.
   (b) **Classification:** The effect of a change in an accounting estimate should be classified using the same classification in the Statement of Profit and Loss as was used previously for the estimate.

Question No.7(d) AS 7 Revenue Recognition on Construction contracts 4 Marks

Certain Ltd has signed at 31st Dec 2009, the Balance Sheet date, a contract where the Total Revenue is estimated at Rs.15 Crores and Total Cost is estimated at Rs.20 Crores. No work began on the contract. Is the contractor required to give any accounting effect for the year ended 31st December 2009 in his accounts?

Solution:

1. **AS – 7 Revenue Recognition:** As per AS–7 "Construction Contracts":
   (a) When it is probable that the Total Contract costs will exceed Total Contract Revenue, the expected losses should be recognized as an **expense immediately**.
   (b) The amount of such loss should be recognized irrespective of –
      (i) Whether or not work is commenced on the Contract,
      (ii) The Stage of Completion of Contract activity, or
      (iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract.

2. **Analysis and Conclusion:** In the above question, there is an expected loss of Rs.5 Crores (Rs.20 Crores – 15 Crores). Such loss should be recognized in the Profit and Loss Statement as per AS–7, even though work has not commenced.

Question No.7(e) AS 2 & AS 16 4 Marks

Can PT Ltd a wire netting company, while valuing its Finished Stock at the year end include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing Current Assets like Inventory and for meeting day to day working expenses?

Solution:

1. **Nature of Interest:** As per AS–2, "Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and hence usually, excluded in the cost of inventories."
2. **Qualifying Assets: AS – 16 "Borrowing Costs"** identifies inventories which require a substantial period of time to bring them to a saleable condition as a Qualifying Asset and permits capitalization of borrowing costs directly attributable to the asset as part of the Cost of the Asset.
3. **Analysis and Conclusion:** In the given case, PT Ltd can capitalize the interest cost on Bank Overdraft, **only** if its Inventories are in the nature of a Qualifying Asset. Otherwise, the entire amount shall be treated as **expense**.