

PAPER – 1: ADVANCED ACCOUNTING

Question No.1 is compulsory

Answer any **five** from the remaining **six** questions.

Question 1

(a) Albert Finance Ltd. has made the following investments.

(i) Purchased the following equity shares from stock exchange on 1st June, 2009.

	Cost
	,
Scrip X	1,80,000
Scrip Y	50,000
Scrip Z	<u>1,70,000</u>
	<u>4,00,000</u>

(ii) Purchased gold of ` 3,00,000 on 1st April, 2006.

(iii) Invested in mutual funds at a cost of ` 6,00,000 on 31st March, 2009.

(iv) Purchased government securities at a cost of ` 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		,
Scrip X	1,90,000	
Scrip Y	40,000	
Scrip Z	<u>70,000</u>	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?

(b) A Ltd. purchased fixed assets costing ` 2,544 lakhs on 1<sup>st</sup> 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 ` 42.40. The first instalment was paid on 31st March, 2009 when 1 US Dollar fetched ` 45.40. The entire loss on exchange was included in cost of goods sold of normal business operations. A Ltd. provides depreciation on their fixed assets at 20% on WDV basis.

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

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- (c) State the treatment of the following items with reference to Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS):
- (i) Impairment of assets
- (ii) Business combinations
- (d) The Chief Accountant of ANZ Ltd., gives the following data regarding its six segments:

(` in lakhs)

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment 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.
(4 x 5 = 20 Marks)

Answer

- (a) As per AS 13 'Accounting for Investments', current investments should be carried in the financial statements at lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis and long-term investments are carried at cost except when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognize the decline.
- (i) If the investment in shares is intended to be held for not more than one year from the date on which such investment is made: Scrip X should be valued at cost i.e. ` 1,80,000 (lower of cost and fair value); Scrip Y should be valued at fair value i.e. ` 40,000 (lower of cost and fair value) and scrip Z should be valued at fair value i.e. ` 70,000 (lower of cost and fair value). The total loss of ` 1,00,000 (` 4,00,000 – ` 3,00,000) on scrips purchased on 1st June, 2009, is to be charged to profit and loss account for the year ended 31st March, 2010.
- If investment is intended to be held for long term period: Investment will continue to be shown at cost in the balance sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually.
- (ii) Investment in gold (purchased in April, 2006) shall continue to be shown at cost of ` 3,00,000 in the balance sheet as on 31.3.2010.
- (iii) If mutual funds are intended to be held for short term period it will be valued at ` 4,50,000 as on 31<sup>st</sup> March, 2010 and if it is intended to be held for long term, then it should be valued at its cost i.e. ` 6,00,000.
- (iv) Value of government securities (purchased on 1st April, 2009) is to be shown at cost of ` 5,00,000 in the balance sheet as on 31.3.2010.

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Inter category adjustments of appreciation and depreciation in value of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation in value of investment in government securities.

- (b) As per AS 11 'The Effects of Changes in Foreign Exchange Rates', foreign currency non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction and exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expense in the period in which they arise. Foreign Currency loss will be computed as ₹ 180 lakhs { \$ 60 lakhs $\left[\frac{2544 \text{ lakhs}}{42.40} \right] \times (\text{₹ } 45.40 - \text{₹ } 42.40)$ }. The

entire loss on exchange difference of ₹ 180 lakhs should be recognized as an expense for the year ended 31st March 2010 and should not be included in the cost of goods sold. Depreciation on fixed assets amounting ₹ 508.80 lakhs* (20% of ₹ 2,544 lakhs) should be provided for in the financial statements for the year ended 31st March 2010.

PS: In the third sentence of the question, the date 31st March, 2009 should be read as 31st March, 2010.

- (c) **Treatment under Indian Accounting Standards (AS) and International Financial Reporting Standards (IFRS)**

	AS	IFRS
(i) Impairment of Assets	Assets are impaired if recoverable amount is less than the carrying amount. Recoverable amount will be calculated as higher of net selling price and value in use based on discounted cashflows. Impairment test is to be conducted every year and if	Similar to Indian Accounting Standard.

* Alternatively, A Ltd. may opt for capitalizing the difference of foreign exchange to fixed assets account on the basis of the notification no G.S.R.225(E) issued by the Central Government dated 31.3.2009. According to the notification, the new cost of the fixed asset will be ₹ 2,724 lakhs { ₹ 2,544 lakhs + Difference in foreign exchange currency translation as on 31.3.2010 ₹ 180 lakhs [\$ 60 lakhs $\times (\text{₹ } 45.40 - \text{₹ } 42.40)$] }. Depreciation on fixed assets will be ₹ 598.80 lakhs (₹ 508.80 lakhs + ₹ 90 lakhs). Difference in foreign exchange capitalised due to the said notification amounting ₹ 180 lakhs, should be amortised till 31st March 2011 i.e. in 2 years.

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there is upward increase in the value of asset, then reversal of impairment losses is required in certain circumstances.

Assets are not separately classified or disclosed as held for sale on the face of the balance sheet. However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.

- | | | |
|----------------------------|---|--|
| (ii) Business Combinations | No particular standard has been issued by ICAI till date. However, all business acquisitions are business combinations except pooling of interest method for certain amalgamations. | All business acquisitions are business combinations as per IFRS 3. |
|----------------------------|---|--|

(d) As per para 27 of AS 17 "Segment Reporting", a business segment or geographical segment should be identified as a reportable segment, if

- (i) Its 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; or
- (ii) Its segment result whether profit or loss is 10% or more of
 - (1) The combined result of all segments in profit; or
 - (2) The combined result of all segments in loss, whichever is greater in absolute amount; or
- (iii) Its segment assets are 10% or more of the total assets of all segments.

Further, if the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% threshold until atleast 75% of total enterprise revenue is included in reportable segments.

- (a) On the basis of 'Revenue' criteria, segments M and N are reportable segments.
- (b) On the basis of 'Result' criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of ` 200 lakhs)
- (c) On the basis of 'Asset' criteria, all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria, all segments have to be reported upon in accordance with AS 17. Hence the opinion of chief accountant that segments 'M' and 'N' alone should be reported is wrong.

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Question 2

The summarised Balance Sheets of the following three companies are given below:

	(` in lakhs)		
	A. Ltd.	B. Ltd.	C. Ltd
<i>Liabilities:</i>	<i>As on 31st March, 2009</i>		
Equity shares (` 10 each fully paid up)	60	48	40
7½ % Cumulative preference shares (` 100 each fully paid up)	15	12	10
Capital reserve on revaluation of land, buildings and machinery	120	-	-
General reserve	25	15	10
2,500, 8% Mortgage debenture bonds of ` 1,000 each	25	-	-
Secured loans and advances from banks	153	71	52
Unsecured loans:			
(i) From B Ltd.	-	-	12
(ii) From C Ltd.	15	-	-
(iii) Deposits from public	18	12	3
Current liabilities and provisions			
(i) Inter-company balances	9	-	-
(ii) Other liabilities and provisions	<u>314</u>	<u>125</u>	<u>72</u>
Total	<u>754</u>	<u>283</u>	<u>199</u>
<i>Assets :</i>			
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 preference shares of A Ltd.	-	-	10
1,500 Mortgage debentures of A Ltd.	-	-	14
Current assets	353	123	112
Profit and loss account	<u>96</u>	<u>36</u>	<u>21</u>
Total	<u>754</u>	<u>283</u>	<u>199</u>

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- (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 latter acquired by purchase in the market 80,000 shares of C Ltd. at ₹ 15 each when reserves and surplus of C Ltd. stood at ₹ 5 lakhs.
- (iii) Current assets of B Ltd. & C Ltd. included ₹ 4 lakhs and ₹ 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. (16 Marks)

Answer

Consolidated Balance Sheet* of A Ltd.

as on 31st March, 2009

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
Share capital :		Goodwill (W.N.5)	1.00
6,00,000 Equity shares of ₹ 10 each fully paid	60.00	Fixed assets (Net) (272+104+42)	418.00
5,000, 7½% Cumulative preference shares of ₹ 100 each (15-10)	5.00	Current assets [(353+123+112)-(12+15)-9]	552.00
Minority interest (W.N.3)	44.07	Profit & loss account (W.N.4)	122.92
Reserves & surplus:			
Capital reserve	120.00		
General reserve (W.N.4)	34.85		
Secured loans:			
8% Mortgage debenture bonds of ₹ 1,000 each (25-15)	10.00		
Loans & Advances from banks (153+71+52)	276.00		
Unsecured Loans:			
Public Deposits (18+12+3)	33.00		

* In accordance with para 15 of AS 21 "Consolidated Financial Statements", the balance sheet has been presented from the date on which holding subsidiary relationship comes into existence.

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Current Liabilities and Provisions:

Other Liabilities and Provisions

(314+125+72)

511.00

1,093.92

1,093.92

Note: Preference dividends are in arrears for 8 years in A Ltd. and 4 years in subsidiaries B Ltd. and C Ltd.

Working Notes:

1. Analysis of profits of C Ltd.

(` in lakhs)

	Pre acquisition (capital) profit	Post acquisition (Revenue) gains	
		General Reserve	Profit and Loss Account
	(` in lakhs)	(` in lakhs)	(` in lakhs)
General reserve	5	5	
Profit and loss account (21-1)	<u> </u>	<u> </u>	<u>(20)</u>
	<u>5</u>	<u>5</u>	<u>(20)</u>
A Ltd. (20%)	1	1	(4)
B Ltd. (40%)	2	2	(8)
Minority interest (40%)	2	2	(8)

2. Analysis of Profits of B Ltd.

	Pre acquisition (capital) profit	Post acquisition (revenue) gains	
		General Reserve	Profit and Loss Account
	(` in lakhs)	(` in lakhs)	(` in lakhs)
General reserve		15	
Profit and loss account			(36)
Share in post acquisition gains of C Ltd.		<u>2</u>	<u>(8)</u>
		<u>17</u>	<u>(44)</u>
A Ltd. (25/48)		8.85	(22.92)
Minority interest (23/48)		8.15	(21.08)

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3. Minority interest

	B Ltd.	C Ltd.
	(` in lakhs)	(` in lakhs)
Equity share capital	23	16
Preference share capital	12	10
Pre acquisition profit		2
Post acquisition gains:		
General reserve	8.15	2
Profit and Loss Account	<u>(21.08)</u>	<u>(8)</u>
	<u>22.07</u>	<u>22.00</u>
Total = 22.07 + 22.00 = ` 44.07 lakhs		

4. Consolidated General Reserve and Profit and Loss Account of A Ltd.

	General Reserve	Profit and Loss Account
	(` in lakhs)	(` in lakhs)
Balance as per the Balance Sheet of A Ltd.	25	(96.00)
B Ltd.	8.85	(22.92)
C Ltd.	<u>1</u>	<u>(4.00)</u>
	<u>34.85</u>	<u>(122.92)</u>

5. Cost of Control

		(` in lakhs)
Cost of investments in B Ltd. by A Ltd.		25.00
Add: Cost of investments in C Ltd.:		
By A Ltd.	8	
By B Ltd.	<u>20</u>	<u>28.00</u>
		53.00
Less: Paid up value of equity shares in		
B Ltd.	25.00	
C Ltd.	<u>24.00</u>	49.00
Capital Profit in C Ltd.	<u>3.00</u>	<u>(52.00)</u>
Goodwill		<u>1.00</u>

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Question 3

Libra Ltd. has two divisions A and B and their respective shares of various assets and liabilities in the company's Balance Sheet as on 31st March, 2009 are given below:

	(` in lakhs)	
	A division	B division Total
Fixed assets:		
Cost	650	340
Less: Depreciation	<u>225</u>	<u>160</u>
Written down value	<u>425</u>	<u>180</u>
Investments		605
Current Assets	350	430
Less: Current Liabilities	<u>185</u>	<u>210</u>
Net Current Assets	<u>165</u>	<u>220</u>
		<u>385</u>
		<u>1,105</u>
Financed by:		
Loan Funds		400
Own Funds:		
Equity share capital- shares of ` 10 each		300
Reserves and Surplus		<u>405</u>
		<u>1,105</u>

Division B has been invariably suffering losses. The company sold this division B along with its assets and liabilities to a newly formed company, Zee Ltd. which was incorporated with an authorized capital of ` 800 lakhs divided into shares of ` 10 each. Zee Ltd. allotted to Libra Ltd's shareholders its two fully paid equity shares of ` 10 each at par for every fully paid equity shares of ` 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 ` 280 lakhs, current assets at ` 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 ` 135 lakhs and redeemed debentures liability of ` 150 lakhs at par, which was included in loan funds. The cash transaction 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.

(16 Marks)

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Answer

(i) Journal Entries* in the books of Libra Ltd.

		(` in lakhs)	
		Dr.	Cr.
(a)	Bank account (Current assets) Dr.	135	
	To Investments		115
	To Profit and loss account (Reserves & surplus)		20
	(Being sales of investments at a profit of ` 20 lakhs)		
(b)	Debentures account (Loan funds) Dr.	150	
	To Bank account (Current assets)		150
	(Being redemption of debentures at par)		
(c)	Current liabilities account Dr.	210	
	Provision for depreciation account Dr.	160	
	Reserves and surplus Dr.	400	
	To Fixed assets account		340
	To Current assets account		430
	(Being assets and liabilities pertaining to B division taken out of the books on transfer of the division to Zee Ltd.)		

**(ii) Libra Ltd.'s Balance Sheet (After Demerger)
as on 1.4.2009**

	` in lakhs	` in lakhs
Fixed assets		
Gross block	650	
Less: Depreciation	<u>225</u>	425
Net current assets		
Current assets (W.N.3)	335	
Less: Current liabilities	<u>185</u>	<u>150</u>
		<u>575</u>
Financed by		
Shareholders' funds		
Equity share capital	300	

* Any other alternative set of entries, with the same net effect on various accounts may be given.

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Reserve and surplus (W.N.1)	<u>25</u>	325
Loan funds (W.N.2)		<u>250</u>
		<u>575</u>

(iii) **Initial Balance Sheet of Zee Ltd.**
as on 1.4.2009

	` in lakhs	` in lakhs
Fixed assets		280
Goodwill (W.N.4)		210
Net current assets:		
Current assets	320	
Less: Current liabilities	<u>210</u>	<u>110</u>
		<u>600</u>
Financed by		
Shareholders' funds: (Authorised share capital ` 800)		
Equity share capital (issued for acquisition of business)		<u>600</u>
		<u>600</u>

Working Notes:

1. Reserves and surplus of Libra Ltd.	` in lakhs
Balance as on 31 st March, 2009	405
Add: Profit on sale of investments	<u>20</u>
	425
Less: Adjustment for difference on demerger	<u>400</u>
Balance shown in balance sheet after demerger	<u>25</u>
2. Loan funds of Libra Ltd.	
Balance as on 31 st March, 2009	400
Less: Debentures redeemed	<u>150</u>
Balance shown in balance sheet after demerger	<u>250</u>
3. Current assets of Libra Ltd.	
Balance as on 31 st March, 2009	350
Add: Cash received from sale of investments	<u>135</u>
	485
Less: Cash paid for redemption of debentures	<u>150</u>
Balance shown in balance sheet after demerger	<u>335</u>

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4. Calculation of goodwill for Zee Ltd.	₹ in lakhs
Purchase consideration (300 x 2)	600
Less: Assets sold	
Fixed assets	280
Current assets	<u>320</u>
	600
Less: Current liabilities	<u>210</u> <u>390</u>
Goodwill	<u>210</u>

Question 4

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

Liabilities		Assets	
<i>Share capital:</i>		<i>Fixed assets:</i>	
Equity shares of ₹ 10 each 6,00,000		Goodwill	40,000
Less: Calls in arrear (₹ 2 for final call) <u>20,000</u>	5,80,000	Machinery	3,00,000
7% Preference shares of ₹ 10 each fully paid 3,00,000		Freehold properties	4,50,000
<i>Reserve and surplus:</i>		Vehicles	1,00,000
General reserve 3,50,000		Furniture	50,000
Profit and loss account 1,50,000		Investments	2,00,000
<i>Current liabilities:</i>		<i>Current assets:</i>	
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	<u>30,000</u>
	<u>18,80,000</u>		<u>18,80,000</u>

Additional information:

- On 1-4-2006 a new furniture costing ₹ 20,000 was purchased and wrongly charged to revenue. No rectification has yet been made for above. Depreciation charged on furniture is @ 10% on reducing balance system.
- Fixed assets are worth 15% above their actual book value.
- Stock is overvalued by ₹ 50,000 and 10% debtors are doubtful.

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- (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:

2006-07	2,50,000
2007-08	2,80,000
2008-09	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%.
(16 Marks)

Answer

Valuation of shares of Bird Ltd.

Capital employed (net tangible assets) as on 31.3.2009 (W.N.1)	12,07,477
Add: Value of goodwill (W.N.3)	<u>33,870</u>
	12,41,347
Add: Non-Trade investments	1,80,000
Add : Calls in arrear	<u>20,000</u>
	14,41,347
Less : Preference share capital	<u>3,00,000</u>
Equity available for equity shareholders	<u>11,41,347</u>
No. of shares	60,000
Value of a fully paid equity share	$\frac{11,41,347}{60,000 \text{ shares}}$
	₹ 19.02
Values of a partly paid equity share (₹ 19.02- ₹ 2)	₹ 17.02

Workings Notes:

1. Capital employed as on 31.3.2009

Machinery	3,00,000
Freehold properties	4,50,000
Vehicles	1,00,000

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Furniture (W.N.4)		<u>64,580</u>
		9,14,580
Add: 15%		<u>1,37,187</u>
		10,51,767
Trade investment		18,000
Stock in trade		2,00,000
Sundry debtors		3,60,000
Cash at bank		60,000
Tax recoverable (W.N.5)		<u>17,710</u>
		17,07,477
Less : Outside liabilities:		
Sundry creditors	3,00,000	
Bank loan	<u>2,00,000</u>	<u>5,00,000</u>
		<u>12,07,477</u>

2. Average profits for last three years

	2006-07	2007-08	2008-09
Reported profits	2,50,000	2,80,000	3,30,000
Add: Furniture purchased wrongly charged to revenue (net of tax)	<u>10,000</u>	<u>-</u>	<u>-</u>
	2,60,000	2,80,000	3,30,000
Less: Depreciation on furniture purchased (net of tax)	<u>1,000</u>	<u>900</u>	<u>810</u>
	2,59,000	2,79,100	3,29,190
Less: Dividend on non trading investments (net of tax)	<u>9,000</u>	<u>9,000</u>	<u>9,000</u>
	2,50,000	2,70,100	3,20,190
Less: Adjustment for stock overvaluation (net of tax)			(25,000)
Less: Provision for doubtful debts (not tax deductible)			<u>(40,000)</u>
	<u>2,50,000</u>	<u>2,70,100</u>	<u>2,55,190</u>
Average profit	7,75,290/3 = 2,58,430		

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3. Computation of goodwill

Capital employed	<u>12,07,477</u>
Average Profit (W.N.2)	2,58,430
Normal profit @ 20% on capital employed	<u>2,41,495</u>
Super profit	<u>16,935</u>
Goodwill at 2 years' purchase	33,870

4. Value of furniture as on 31.3.2009

Furniture (Given in balance sheet) as on 31.3.2009		50,000
Add: Purchased on 1.4.2006	20,000	
Less: Depreciation @10% on WDV	<u>2,000</u>	
WDV as on 31.3.2007	18,000	
Less: Depreciation @10% on WDV	<u>1,800</u>	
WDV as on 31.3.2008	16,200	
Less: Depreciation @10% on WDV	<u>1,620</u>	
WDV as on 31.3.2009	<u>14,580</u>	<u>14,580</u>
Total		<u>64,580</u>

5. Tax recoverable

Tax recoverable:

Due to additional depreciation on furniture [(2,000 + 1,800 + 1,620) x 50%]	2,710	
Due to overvaluation of stock (50,000 x 50%)	<u>25,000</u>	27,710
Less: Tax liability of furniture wrongly charged to profit and loss account (20,000 x 50%)		<u>10,000</u>
		<u>17,710</u>

Assumptions:

1. Profit given in the question is assumed as post tax profit.

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2. Terminal capital employed has been considered for valuation of goodwill and shares. It is also possible to adjust half of the profits earned in 2008-09 for calculation of average capital employed.
3. Dividend from non-trade investment is assumed to be subject to tax.
4. Provision for doubtful debts is not allowed in the Income Tax Act. Hence, it is not tax deductible

Question 5

- (a) S Ltd. is considering buying the business of R Ltd.; the final accounts of which for the last 3 years were as follow:

Profit and Loss Accounts for the 3 years ended December 31st

(Figures in `)

	2007	2008	2009
Sales	<u>2,00,000</u>	<u>1,90,000</u>	<u>2,24,000</u>
Material consumed	<u>1,00,000</u>	<u>95,000</u>	<u>1,12,000</u>
Business expenses	<u>80,000</u>	<u>80,000</u>	<u>82,000</u>
Depreciation	<u>12,000</u>	<u>13,000</u>	<u>14,000</u>
Net profit	<u>8,000</u>	<u>2,000</u>	<u>16,000</u>

Balance Sheets as at 31st December

	2006	2007	2008	2009
Fixes assets	<u>1,00,000</u>	<u>1,20,000</u>	<u>1,40,000</u>	<u>1,80,000</u>
(at cost) less depreciation	<u>70,000</u>	<u>82,000</u>	<u>95,000</u>	<u>1,09,000</u>
	<u>30,000</u>	<u>38,000</u>	<u>45,000</u>	<u>71,000</u>
Stock in trade	<u>16,000</u>	<u>17,000</u>	<u>18,500</u>	<u>21,000</u>
Sundry debtors	<u>21,000</u>	<u>24,000</u>	<u>26,000</u>	<u>28,000</u>
Cash in hand and at bank	<u>32,000</u>	<u>11,000</u>	<u>28,000</u>	<u>13,200</u>
Prepaid expenses	<u>1,000</u>	<u>500</u>	<u>2,000</u>	<u>1,000</u>
	<u>1,00,000</u>	<u>90,500</u>	<u>1,19,500</u>	<u>1,34,200</u>
Equity capital	<u>50,000</u>	<u>50,000</u>	<u>70,000</u>	<u>70,000</u>
Securities premium			<u>5,000</u>	<u>5,000</u>
General reserve	<u>16,000</u>	<u>24,000</u>	<u>26,000</u>	<u>42,000</u>
Debentures	<u>20,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Sundry creditors	<u>11,000</u>	<u>13,000</u>	<u>14,000</u>	<u>14,000</u>
Accrued expenses	<u>3,000</u>	<u>3,500</u>	<u>4,500</u>	<u>3,200</u>
	<u>1,00,000</u>	<u>90,500</u>	<u>1,19,500</u>	<u>1,34,200</u>

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 `15,000 per year.

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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:

- (a) the trading cash flow for each of the years 2007, 2008 & 2009.
 - (b) the weighted average annual trading cash flow.
 - (c) the price which S Ltd. should offer for the business. (10 Marks)
- (b) From the following information of Steel India Ltd. for the year ended 31st March, 2010, prepare their Social Balance Sheet as on that date.

A specialist has valued their human assets at ` 828 lakhs.

Their investments were classified as:

	Residential	Hospital	School	Welfare
Buildings	17.00	1.00	1.40	0.80
Equipments	2.80	1.00	1.00	-
- Water, Electricity and gas supply systems totaled ` 1 lakh.				
- Their net owned funds were ` 26 lakhs				

(6 Marks)

Answer

(a) Trading cash flows of R Ltd.

	2007	2008	2009
(a) Profits earned during the year	8,000	2,000	16,000
Depreciation	12,000	13,000	14,000
Increase in creditors	2,000	1,000	-
Increase in accrued expenses	500	1,000	
Decrease in prepaid expenses	<u>500</u>	<u>—</u>	<u>1,000</u>
(A)	<u>23,000</u>	<u>17,000</u>	<u>31,000</u>
Less : Increase in stock	1,000	1,500	2,500
Increase in debtors	3,000	2,000	2,000
Decrease in accrued expenses			1,300

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Increase in prepaid expenses	<u> - </u>	<u>1,500</u>	<u> </u>
(B)	<u>4,000</u>	<u>5,000</u>	<u>5,800</u>
Gross trading cash flows (A-B)	19,000	12,000	25,200
Less: Adjustment for average annual expenditure on fixed assets	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>
	<u>4,000</u>	<u>(3,000)</u>	<u>10,200</u>

(b) Calculation of weighted average annual trading cash flows

Year	Trading cashflow	Weight	Weighted trading cash flow
2007	4,000	20%	800
2008	(3000)	30%	(900)
2009	10,200	50%	<u>5,100</u>
Weighted average annual trading cash flows			<u>5,000</u>

(c) Offer price by S Ltd. for the business of R Ltd.

$$\frac{\text{Weighted average annual trading cashflow}}{\text{Return on investment}} = \frac{5,000}{0.10} = ₹ 50,000$$

(b) Social Balance Sheet of Steel India Ltd. as at 31st March, 2010:

(` in lakhs)

Liabilities

Organisation Equity	26.00
Social Equity (Contribution by staff)	<u>828.00</u>
	<u>854.00</u>

Assets

Social Capital Investment		
Buildings		
(i) Residential	17.00	
(ii) Hospital	1.00	
(iii) School	1.40	
(iv) Welfare	<u>0.80</u>	20.20
Equipments		

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(i) Residential	2.80	
(ii) Hospital	1.00	
(iii) School	<u>1.00</u>	4.80
Water, Gas and Electricity supply systems		1.00
Human Assets (as valued by the specialist)		<u>828.00</u>
		<u>854.00</u>

Question 6

- (a) The following is the Profit and Loss Account of Murali Ltd.; for the year ended 31st March, 2010. Prepare a gross value added statement of Murali Ltd.

Profit and Loss Account for the year ended 31st March, 2010:

	Amount (₹ in lakhs)	
Income		890
Sale		<u>55</u>
Other Income		945
Expenditure		
Production and operational expenses (a)	641	
Administrative expenses (factory) (b)	33	
Interest	29	
Depreciation	<u>17</u>	<u>720</u>
Profit before tax		225
Provision for taxation		<u>30</u>
Profit after tax		195
Balance as per last Balance Sheet		<u>10</u>
		<u>205</u>
Transferred to General Reserve		45
Dividend Paid		<u>95</u>
		140
Surplus carried to Balance Sheet		<u>65</u>
		<u>205</u>

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Notes:

(a)		(` in lakhs)
	<i>Production and operational expenses</i>	
	<i>Consumption of raw Materials</i>	293
	<i>Consumption of stores</i>	59
	<i>Salaries, wages. Gratuities etc., (Admn)</i>	82
	<i>Cess and local</i>	98
	<i>Other manufacturing expenses</i>	<u>109</u>
		<u>641</u>
(b)	<i>Administration expenses include salaries, commission to Directors `9.00 lakhs, Provision for doubtful debts `6.30 lakhs</i>	
(c)	<i>Interest on loan from bank for working capital</i>	9
	<i>Interest on fixed loan from bank</i>	10
	<i>Interest on loan from financial institution for fixed loan</i>	8
	<i>Interest on Debentures</i>	<u>2</u>
		<u>29</u>
(d)	<i>The charges for taxation include a transfer of `3.00 lakhs to the credit of Deferred tax account.</i>	
(e)	<i>Cess and local taxes include excise duty, which is equal to 10% of cost of bought-in-materials.</i>	

(10 Marks)

- (b) 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.

<i>Private and Government grants</i>	5,00,000
<i>Loan fund matching grant from revenue funds</i>	10,000
<i>Other transfer from unrestricted funds</i>	1,00,000
<i>Investment income</i>	15,000
<i>Interest on loans</i>	25,000
<i>Refunded to grantors</i>	20,000
<i>Loan cancellation and written off</i>	10,000
<i>Administrative and collection costs</i>	15,000
<i>Fund balance at the beginning of the year</i>	20,15,000

(6 Marks)

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Answer

(a)

Murali Ltd.

Gross Valued Added Statement for the year ended 31st March, 2010

	(` in lakhs)	(` in lakhs)	
Sales		890	
Less: Cost of bought in materials and services:			
Production and operational expenses*			
(293 + 59 +109)	461		
Administration expenses (33 – 9)	24		
Interest on working capital loan	9		
Excise duty (Refer W.N)	<u>35.20</u>	<u>529.20</u>	
Value added by manufacturing and trading activities		360.80	
Add: Other income		<u>55</u>	
Total Value Added		<u>415.80</u>	
Application of Value Added			%
To Employees			
Salaries, Wages, Gratuities etc.		82	19.72
To Directors			
salaries and commission		9	2.16
To Government			
Cess and local taxes (98 - 35.20)	62.80		
Income-tax	<u>27</u>		
		89.80	21.60
To providers of capital			
Interest on Debentures	2		
Interest on Fixed loan (10+8)	18		
Dividend	<u>95</u>		
		115	27.66
To provide for maintenance and expansion of the			

* As no increase or decrease in stock is given in the question, therefore, it is assumed that whatever raw material and stores were bought, had been consumed.

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company

Depreciation	17		
General Reserve	45		
Deferred tax	3		
Retained profits (65-10)	<u>55</u>		
		<u>120</u>	<u>28.86</u>
		<u>415.80</u>	<u>100</u>

Working Note:

Calculation of Excise duty

Excise duty is 10% of ` 352 lakhs (i.e. 293+59) = ` 35.20 lakhs

(b) Statement of Changes in Loan Fund Balances

A	Fund balance at the beginning of 2009-10		<u>20,15,000</u>
B	Additions during 2009-10		
	Private and Government Grants	5,00,000	
	Investment income	15,000	
	Interest on loans	<u>25,000</u>	
			<u>5,40,000</u>
C	Deductions during the year 2009-10		
	Refunded to grantors	20,000	
	Administrative and collection costs	15,000	
	Loan cancellations and written offs	<u>10,000</u>	
			<u>45,000</u>
D	Transfer from other funds		
	Mandatory		
	Loan fund matching grant	10,000	
	Non mandatory		
	Others transfers from unrestricted revenue funds	<u>1,00,000</u>	
			<u>1,10,000</u>
E	Net additions (B-C+D)		6,05,000
F	Fund balance at the end of 2009-10 (A+E)		26,20,000

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Question 7

Attempt any **four**:

- (a) *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 account. Discuss with reference to relevant Accounting Standard.*
- (b) *A company purchased on April 1, 2010 a special purpose machinery for ` 1 crore, and received Central Government subsidy for 25% of the price. Effective life of the machinery is 8 years. Explain the accounting treatment and quote the relevant AS.*
- (c) *An intangible item is appearing in the Balance Sheet of A Ltd. at ` 15 lakhs on 1-4-2010. The item was acquired for ` 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., April, 1, 2008. Comment.*
- (d) *Certain Ltd., has signed at 31st Dec, 2009, the Balance Sheet date, a contract where the total revenue is estimated at ` 15 crores and total cost is estimated at ` 20 crores. No work began on the contract. Is contractor required to give any accounting effect for the year ended December, 31st 2009 in his accounts?*
- (e) *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?* (4 x 4 = 16 Marks)

Answer

- (a) A provision should be recognised only when an enterprise has a present obligation as a result of a past event. In the given case, there is no present obligation, therefore no provision is recognized as per AS 29 'Provisions, Contingent Liabilities and Contingent Assets'.
The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprises can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of three years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than three years.
- (b) As per para 8 of AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.

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According to the first alternative, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Therefore, on the basis of this alternative, the cost of special purpose machinery will be recorded in the books after reducing it by the amount of government subsidy of ₹ 25 lakhs. Thus the depreciable value of the machinery recorded in the books will be ₹ 75 lakhs (i.e. ₹ 1 crore – ₹ 25 lakhs). Depreciation of ₹ 9.375 lakhs (i.e. ₹ 75 lakhs / 8 years) will be charged on it every year on straight line method.

Under the second alternative, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, machinery will be recorded in the books by ₹ 1 crore and depreciation will be charged on it for ₹ 12.5 lakhs (i.e. ₹ 1 crore / 8 years) per year on straight line method. Government subsidy of ₹ 25 lakhs will be treated as deferred income which will be recognized as income in the statement of profit and loss every year by ₹ 3.125 lakhs (i.e. ₹ 25 lakhs / 8 years).

- (c) Since AS 26 'Intangible Assets' was mandatory for the period when the intangible asset was acquired i.e. 1st April 2008, the revision of amortization period from 5 years to 8 years is a change in Accounting estimate and accordingly, para 78 of AS 26 would apply in this case. According to this para, if the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. AS 5 provides that in case of change in estimate, the effect should be given prospectively over the remaining useful life of the intangible asset i.e. 6 years.

Note: It is assumed that since the date of purchase of intangible item, the enterprise has been following a policy of amortizing the intangible asset over a period of 5 years on straight line basis by applying paragraph 63 of AS 26 i.e. being the best estimate of its useful life. On 1.4.2010, the company again reviewed the useful life of the intangible asset.

- (d) As per para 35 of AS 7 'Construction Contracts, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. The amount of such loss is determined irrespective of whether or not work has commenced on the contract. Thus, Certain Ltd. should recognize loss amounting ₹ 5 crores for the year ended 31st December, 2009. The contract should be reviewed at the end of the each accounting period for additional losses to be incurred, if any.
- (e) As per AS 2 "Valuation of Inventories", cost of inventories comprise of all costs of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition. Interest and other borrowing costs are usually considered as overheads that don't contribute to bringing the inventories to their present location and condition. Therefore, the proposal of PT Ltd., to include interest on bank overdraft as an element of cost is not acceptable. Interest on bank overdraft will not form part of cost of production.