Chapter – 1

AMALGAMATION

Illustration 1

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

The following information is supplied to you:

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

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

1. The profits of the respective companies would be adjusted for half the value of contingent liabilities as on 31st March, 2009.

2. Debtors of Small Ltd. include an irrecoverable amount of Rs.2 lakh against which Rs.1 lakh was recovered but kept in Advance account.

3. Little Ltd. had omitted to provide for increased FOREX liability of US$10,000 on loan availed in financial year 2005-06 for purchase of Machinery. The machinery was acquired on 1^{st} January, 2006 and put to use in Financial year 2006-07. The additional liability arose due to change in exchange rates and is arrived at in conformity with prevailing provisions of AS 11. The exchange rate is US $ 1 = INR 50.

4. Small Ltd. has omitted to invoice a sale that took place on 31st March, 2009 of goods costing Rs.2,50,000 at a mark up of 15 per cent instead the goods were considered as part of closing inventory.

5. Closing Inventory of Rs.45 lakhs of Little Ltd. as on 31st March, 2009 stands undervalued by 10 per cent.

6. Contingent liabilities of Small Ltd. and Little Ltd. as on 31st March, 2009 stands at Rs.5 lakhs and Rs.10 lakhs respectively.

The terms of the share issue are as under:

(i) Shares in Big Ltd. will be issued at a premium of Rs.13 per share for all external shareholders of Small Ltd. The Premium will be Rs.15 per share for shares in Big Ltd. issued to all external shareholders of Little Ltd.

(ii) No shares in Big Ltd. will be issued in lieu of the investments (intercompany holdings) of both companies. Instead the shares so held shall be transferred to Big Ltd. at the close of the financial year ended 31st March, 2010 at Par Value consideration payable on date of transfer.

(iii) Big Ltd. would in addition to the issue of shares to outside shareholders of Small Ltd. and Little Ltd. make a preferential allotment on 31st March, 2010 of 2 lakhs ordinary shares at a premium of Rs.28 per share to Virgin Capital Ltd. (VCL). These shares will not be eligible for any dividends declared or paid till that date.

(iv) Big Ltd. will go in for a 18 per cent unsecured Bank overdraft facility to meet incorporation costs of Rs.16 lakhs and towards management expenses till 31st March, 2010 estimated at Rs.14 lakhs. The overdraft is expected to be availed on 1st February, 2010 and closed on 31st March, 2010 out of the proceeds of the preferential allotment.

(v) It is agreed that interim dividends will be paid on 31.03.2010 for the period January, 2010 to March, 2010 by Big Ltd. at 2 per cent; Small Ltd. at 3 per cent and Little Ltd. at 2.5 per cent. Ignore Dividend Distribution tax.

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

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

Solution:

Computation of number of shares issued

Calculation of Rectified Profits and Purchase consideration

	Rs.	Rs.
Small Ltd.		
Given profits		50,00,000
Less: Irrecoverable Debtors	1,00,000	
50% Contingent Liability	2,50,000	3,50,000
		46,50,000
Add: Profit on omitted sale (15% of Rs.2,50,000)		37,500
		46,87,500

Less: Debenture interest		2,00,000
		44,87,500
Less: Income Tax @ 25%		11,21,875
Profits after Tax (PAT)		33,65,625
Less: Preference Dividend (10% of Rs.2,00,00,000)		20,00,000
Rectified Profits		13,65,625
Average PE ratio = 10		
Total consideration for all equity shareholders (Average PE ratio × Profit)		136,56,250
Less:10% thereof for shareholders of Little Ltd.		13,65,625
Balance available for other shareholders of Small Ltd.		122,90,625
Little Ltd.		
Given profits		25,00,000
Less: Increase in FOREX liability (US$10,000 × 50)	5,00,000	
50% Contingent Liability	5,00,000	10,00,000
		15,00,000
Add: Undervaluation of inventory (45,00,000×10/90)		5,00,000
		20,00,000
Less: Debenture interest		2,00,000
		18,00,000
Less: Income Tax @ 25%		4,50,000
Profits after Tax (PAT)		13,50,000
Less: Preference Dividend (10% of Rs.20,00,000)		2,00,000
Rectified Profits		11,50,000
Average PE ratio = 8		
Total consideration for all equity shareholders (Average PE ratio × Profit)		92,00,000
Less:10% thereof for shareholders of Small Ltd.		9,20,000
Balance available for other shareholders of Little Ltd.		82,80,000

Statement showing Disposal of Purchase Consideration

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

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

		Rs.
Dividends received from Subsidiaries (12,00,000 + 5,00,000)		17,00,000
Less: Management expenses	14,00,000	
Interest on Bank O/D	90,000	14,90,000
Net profit for the period		2,10,000
Less: Proposed Dividend (2% of Rs.86,55,750)		1,73,115
Balance of Profit and Loss Account carried forward		36,885

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

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

Working Notes:

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

Number of shares issued 2,00,000

	Rs.
Face Value of Share Capital @ Rs.10 each	20,00,000
Securities Premium @ Rs.28 each	56,00,000
Total cash received from VCL	76,00,000

2. **Overdraft of Big Ltd. as on 31.3.2010**

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

3. **Bank balance of Big Ltd. as on 31.3.2010**

Bank Account of Big Ltd.

		Rs.			Rs.
01.02.2010	To Overdraft	30,00,000	01.02.2010	By Incorporation Expenses	16,00,000
31.03.2010	To VCL	76,00,000	31.03.2010	By Management Expenses	14,00,000
31.03.2010	To Dividend		31.03.2010	By Interest on Overdraft	90,000
	Small	12,00,000[1]	31.03.2010	By Overdraft	30,00,000
	Little	5,00,000[2]	31.03.2010	By Dividend paid	1,73,1153
			31.03.2010	By Shares in Small Ltd. bought from	

					Little Ltd.	40,00,000
			31.03.2010	By	Shares in Little Ltd. bought from Small Ltd.	20,00,000
				By	Balance c/d (Bal. fig.)	36,885
		123,00,000				123,00,000

4. Investments of Big Ltd. in Projected Balance Sheet

	Rs.
Purchase consideration paid for acquiring shares of outside holders of -	
Small Ltd	122,90,625
Little Ltd.	82,80,000
Consideration paid in cash for acquiring cross holdings	
From Small Ltd. (shares of Little Ltd.)	20,00,000
From Little Ltd. (shares of Small Ltd.)	40,00,000
	2,65,70,625

Chapter – 2

CONSOLIDATION

Illustration 1

(Combined application of subsidiary, associate and Joint venture)

P Ltd. owns 80% of S and 40% of J and 40% of A. J is jointly controlled entity and A is an associate. Balance Sheet of four companies as on 31.03.09 are:

	P Ltd.	S	J	A (Rs. in lakhs)
Investment in S	800	-	-	-
Investment in J	600	-	-	-
Investment in A	600	-	-	-
Fixed assets	1000	800	1400	1000
Current assets	2200	3300	3250	3650
Total	5200	4100	4650	4650
Liabilities:				
Share capital Re. 1				
Equity share	1000	400	800	800
Retained earnings	4000	3400	3600	3600
Creditors	200	300	250	250
Total	5200	4100	4650	4650

P Ltd. acquired shares in ‘S’ many years ago when ‘S’ retained earnings were Rs. 520 lakhs. P Ltd. acquired its shares in ‘J’ at the beginning of the year when ‘J’ retained earnings were Rs. 400 lakhs. P Ltd. acquired its shares in ‘A’ on 01.04.08 when ‘A’ retained earnings were Rs. 400 lakhs.

The balance of goodwill relating to S had been written off three years ago. The value of goodwill in ‘J’ remains unchanged.

Prepare the Consolidated Balance Sheet of P Ltd. as on 31.03.09 as per AS 21, 23, and 27. (16 Marks)

Solution:

Consolidated Balance Sheet of P Ltd.

Liabilities	Rs. in lakhs	Assets	Rs. in lakhs
Share Capital	1,000	Goodwill (W.N.1)	120
Retained Earnings(W.N.2)	8,800	Fixed Assets	2,360
Creditors (200+ 300 + 40% of 250)	600	[1,000 + 800 + 560 (1400 x 40%)]	
Minority Interest (W.N.3)	760	Current Assets	6,800
		[2,200+3,300+1,300(3,250x 40%)]	
		Investment in Associates (W.N.4)	1,880
	11,160		11,160

Working Notes:

1. Computation of Goodwill

S (subsidiary)		**Rs. in lakhs**
Cost of investment		800
Less: Paid up value of shares acquired	320	
Share in pre- acquisition profits of S Ltd. (520 × 80%)	416	736
Goodwill		64

J (Jointly Controlled Entity)		**Rs. in lakhs**
Cost of Investment		600
Less: Paid up value of shares acquired (40% of 800)	320	
Share in pre-acquisition profits (40% of 400)	160	480
Goodwill		120

Note: Jointly controlled entity 'J' to be consolidated on proportionate basis i.e. 40% as per AS 27

Associate A (AS 23)		**Rs. in lakhs**
Cost of investment		600
Less: Paid up value of shares acquired (800 x 40%)	320	
Share in pre-acquisition profits (400 x 40%)	160	480
Goodwill		120

Goodwill shown in the Consolidated Balance Sheet	**Rs. in lakhs**
Goodwill of 'J'	120
Goodwill of 'S'	64
Less: Goodwill written off of 'S'	64
Goodwill	120

2. Consolidated Retained Earnings

	Rs. in lakhs
P Ltd.	4,000
Share in post acquisition profits of S - 80% (3,400 – 520)	2,304
Share in post acquisition profits of J - 40% (3,600 – 400)	1,280
Share in post acquisition profits of A - 40% (3,600 – 400)	1,280
Less: Goodwill written off	(64)
	8,800

3. Minority Interest 'S'

	Rs. in lakhs
Share Capital (20% of 400)	80
Share in Retained Earnings (20% of 3,400)	680
	760

4. Investment in Associates

	Rs. in lakhs
Cost of Investments (including goodwill Rs. 120 lakhs)	600
Share of post acquisition profits	1,280
Carrying amount of Investment (including goodwill Rs. 120 lakhs)	1,880

Illustration 2

The draft Balance Sheet of three companies, W, H, O, as at 31.3.2010 is as under:

			Rs. in thousands
Assets	W	H	O
Fixed assets	697	648	349
Investments			
1,60,000 shares in H	562	---	---
80,000 shares in O	184	---	---
Cash at bank	101	95	80
Trade receivables	386	321	251
Inventory	495	389	287
Total	2,425	1,453	967
Liabilities			
Share capital (Nominal value Re.1 per share)	600	200	200
Reserves	1,050	850	478
Trade payables	375	253	189
Debentures	400	150	100
Total	2,425	1,453	967

You are given the following information:

(a) W purchased the shares in H on 13.10.2005 when the balance in reserves was Rs.500 thousands.

(b) The shares in O were purchased on 11.5.2005 when the balance in reserves was Rs.242 thousands.

(c) The following dividend have been declared but not accounted for before the accounting year end.

W -	Rs.65 thousands
H -	Rs.30 thousands
O -	Rs.15 thousands

(d) Included in inventory figure of O is inventory valued at Rs.20 thousands which had been purchased from W at cost plus 25%.

(e) Goodwill in respect of the acquisition of H has been fully written off.

(f) On 31.3.2010 H made bonus issue of one share for every share held. This had not been accounted in the balance sheet as on 31.3.2010.

(g) Included in trade payables of W is Rs.18 thousands to O, which is included in trade receivables of O.

Prepare Consolidated Balance Sheet of W as at 31.3.2010.

Solution:

Consolidated Balance Sheet of W and its subsidiary H
As at 31st March, 2010

		(Rs. in thousands)
Assets		
Fixed assets (697+ 648)		1,345.00
Investment in Associate (W.N.5) (including goodwill Rs.7.20 thousand)	184.00	
Add: Accumulated reserves	86.80	270.80
Cash at bank (101+ 95)		196.00
Trade receivables (386+ 321)		707.00
Inventory (495+ 389)		884.00
Dividend receivable from O		6.00
Total		3,408.80
Liabilities		
Share capital (Nominal value Re.1 per share)		600.00
Minority Interest (W.N.3)		204.00
Reserves (W.N.4)		1,355.80
Trade payables (375+ 253)		628.00
Debentures (400+ 150)		550.00
Proposed Dividend (W.N.6)		71.00
Total		3,408.80

Working Notes:

1. **Analysis of profits of H**

		(Rs. in '000)
	Pre acquisition profits	**Post acquisition profits**
Reserves on the date of acquisition	500	350
Less: Bonus issue*	200	-
	300	350
Less: Dividend declared on 31.3.2010		30
	300	320
Minority interest (20%)	60	64
W's share (80%)	240	256

2. **Cost of control/Goodwill**

		(Rs. in '000)
Amount paid for investment		562
Less: Paid up value of shares including bonus (80% of 400)	320	
Share in pre-acquisition profits of H	240	560
Goodwill		2

3. **Minority Interest**

	(Rs. in '000)
Paid up value of share including bonus issue (400 × 20%)	80
Share in pre acquisition profits of H	60
Share in post acquisition profits of H	64
	204

4. **Consolidated Reserves**

			(Rs. in '000)
Balance as per W's Balance Sheet			1,050.00
Add:	Share in post acquisition profits of H		256.00
	Dividend from H		24.00
	Share of profit from Associate O	86.80	
	Add: Dividend from O	6.00	92.80
			1,422.80
Less:	Dividend payable	65.00	
	Goodwill written off	2.00	67.00
			1,355.80

5. **Investment in Associate O as on 31.03.2010 (As per AS 23)**

		(Rs. in '000)
Amount paid for investment		184.00
Less: Paid up value of shares	80.00	
Share in pre acquisition reserves (40% of 242)	96.8	176.80
Goodwill (Identified at the time of purchase)		7.20
Initial cost		184.00
Add: Increase in equity reserves [40% of (478 – 15 – 242)]	88.40	
Less: Unrealised profit (20 x $^{25}/_{125}$) x 40%	(1.60)	86.80
Investment in Associate O as on 31.03.10		270.80
Share of profit from Associate O (270.80 – 184 + 6)		92.80

6. **Proposed Dividend**

	(Rs. in '000)
W	65
Minority Interest (30 – 24)	6
	71

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* It is assumed that bonus issue had been made out of pre-acquisition reserves.

Illustration 3

The summarized Balance Sheets of Kush Ltd. and Shuk Ltd. as at 31st March, 2010 are as follows.

Liabilities	Kush Ltd. Rs.	Shuk Ltd. Rs.	Assets	Kush Ltd. Rs.	Shuk Ltd. Rs.
Share capital:			Plant at cost less		
Equity shares of			depreciation	86.4	72.9
Rs. 10 each	216.0	108.0	Furniture, Fixtures &		
Securities			Fittings	23.4	7.2
premium	32.4	-	Stock at cost	18.0	13.5
Capital reserve			Debtors	73.8	47.6
on 1.04.09	-	72	Trade investment	-	2.7
General reserve			Goodwill at cost	45.0	13.6
on 1.04.09	13.5	9.0	Investment		
Profit & Loss A/c	70.2	21.6	8.64 lakhs shares of		
Creditors	29.7	19.7	Shuk Ltd. at cost	972	-
	-	-	Balance at bank	18.0	8.0
	361.8	165.5		361.8	165.5

Additional information:

(1) On 1st April, 2009 Kush Ltd. acquired from the shareholders of Shuk Ltd 8.64 lakhs shares of Rs. 10 each in Shuk Lid. and allotted in consideration thereof 6.48 lakhs of its own shares of Rs. 10 each at a premium of Rs. 5 per share.

(2) The consideration for the shares of Shuk Ltd. was arrived at inter-alia by valuing certain assets of Shuk Ltd. on 1st April, 2009 as under:

(i) Plant at Rs. 90 lakhs
(ii) Furniture, Fixtures & Fittings at Rs. 8 lakhs
(iii) No value on Trade Investment and Goodwill.

No adjustments were made in the books of accounts of Shuk Lid. in respect of the above valuation.

During 2009-10 there was no purchase or sale of these assets. It is desired that such adjustments should however be made in the Consolidated Accounts.

(3) The figures for Plant and Furniture, Fixtures and Fittings at 31.3.2010 shown in the Balance Sheet are after providing depreciation for 2009-10 at the rates of 10 per cent per annum and 20 per cent per annum respectively, on the book values as at 1.04.09.

(4) The Profit and Loss Account of Shuk Ltd. showed a Credit balance of Rs. 27 lakhs on 1.04.09. A dividend of 10% was paid in January, 2010 for the year 2008-09. This dividend was credited to Profit and Loss Account of Kush Ltd.

(5) The following point was not considered in making out the accounts.

During the year, expenses of Rs. 4,500 per month were incurred by Kush Ltd. on behalf of Shuk Ltd It was by mistake debited to Profit and Loss Account of Kush Ltd. and nothing has been done in the accounts of Shuk Ltd.

(6) The stock of Shuk Ltd included Rs. 4.5 lakhs of goods received from Kush Ltd. invoiced at cost plus 25 per cent.

(7) Debtors of Shuk Ltd. include Rs 3.5lakhs due from Kush Lid. whereas Creditors of kush Ltd. include Rs. 3. 1 lakhs due a Shuk Ltd., the difference being represented by a cheque in transit.

You are required to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Kush Ltd. and its subsidiary as at 31S1 March, 2010. (20 Marks)

Solution:

Consolidated Balance Sheet of Kush Ltd. and its subsidiary Shuk Ltd.
As on 3151 March, 2010

(Rs. in lakhs)

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital:		**Fixed Assets:**	
Equity shares of Rs. 10 each	216.000	Goodwill (W.N.2)	27.880
Minority Interest (WN.3)	27.252	Plant (W.N.8)	167.400
Reserves & Surplus:		Furniture, fixtures & fittings (WN.9)	29.800
Securities premium	32.400	**Current Assets:**	
General reserve	13.500	Stock (W.N.1O)	30.600
Profit and loss account (W.NA)	64.528	Debtors (W.N.11)	117.900
		Balance at bank	
Current Liabilities:		(Rs.18 lakhs + RS.8 lakhs)	26.000
Creditors (W. N .12)	46.300	Cash in transit	
	-	(Rs.3.5 lakhs - RS.3.1 lakhs)	0.400
	399.980		399.980

Working Notes:

1. Analysis of Profits & Reserves of Shuk Ltd.

		Pre-Acquisition		**(Rs. in lakhs) Post Acquisition**
[Profit and loss account balance as on 31.3.2010 is RS.21.60 lakhs]				
Profit and loss account balance on 1.4.2009	27.00			
Less Dividend for 2008-09	(10.80)	16.20	(21.60 -16.20)	5.40
Capital reserve on 1.4.2009		7.20		
General reserve on 1.4.2009		9.00		
Upward revaluation of plant (W.N.6)		9.00		
Downward revaluation of furniture, fixtures and fittings (W.N.7)		(1.00)		
Trade Investment written off		(2.70)		
Goodwill written off		(13.60)		
Additional depreciation on plant				(0.90)
Overcharged depreciation on furniture, fixtures and fittings				0.20
Expenses paid by Kush Ltd. on behalf of Shuk Ltd. (Rs. 4,500 x 12)		--		(0.54)

	24.10	4.16
Share of Kush Ltd. (80%)	19.28	3.328
Minority interest (20%)	4.82	0.832

2. Cost Control

		(Rs. in lakhs)
Amount paid for investment in Shuk Ltd.		97.20
Less: Dividend for the year 2008-09		(8.64)
		88.56
Less: Nominal value of shares acquired	86.40	
Share in pre-acquisition profit (80%)	19.28	(105.68)
Capital reserve		17.12
Goodwill to be shown in the consolidated balance sheet = (Rs. 45.00 lakhs - Rs. 17.121akhs)		Rs. 27.88 lakhs

3. Minority Interest

	(Rs. in lakhs)
Share Capital (20%)	21.600
Share in pre-acquisition profit (20%)	4.820
Share in post-acquisition profit (20%)	0.832
	27.252

4. Consolidated profit and Loss A/c of Kush Ltd. as on 31.03.2010

	(Rs. in lakhs)
Profit and loss account balance of Kush Ltd. on 31.3.2010	70.200
Less: Dividend for the year 2008-09	(8.640)
	61.560
Add: Expenses met by Kush on behalf of Shuk ltd.	0.540
	62.100
Add: Share in post acquisition profit of Shuk Ltd.	3.328
	65.428
Less: Unrealized profit on stock (W.N.5)	(0.900)
	64.528

5. Unrealised profit on stock = $\frac{\text{Rs.4.5 Iakhs x 25}}{125}$ = Rs. 0.9 Lakhs

6. Upward revaluation of Plant of Shuk ltd.

[Rs.90 Iakhs - (Rs. 72.9 lakhs x 100/90)]= Rs. 9 lakhs

7. Downward revaluation of Furniture, Fixtures & Fittings of Shuk Ltd.

[Rs. 8 1akhs - (Rs.7.2 Iakhs x 100/80)] = Rs. 1 1akh

8. Value of Plant in the consolidated balance sheet

			(Rs. in lakhs)
	Kush Ltd.	Shuk Ltd.	Total
Balance as on 313.2010	72.9	86.4	
Add: Upward revaluation	9.0		
	81.9		
Less: Additional depreciation to be charged	(0.9)	-	-
	81.0	86.4	167.4

9. Value of Furniture, Fixture & Fittings in the consolidated balance sheet

			(Rs. in lakhs)
	Kush Ltd.	Shuk Ltd.	Total
	7.2	23.4	
Less: Downward revaluation	(1.0)		
	6.2		
Add. Additional depreciation	0.2	-	-
	6.4	23.4	29.8

10. Value of Stock in the consolidated balance sheet

	(Rs. in lakhs)
Kush Ltd.	18.0
Shuk Ltd.	13.5
	31.5
Less: Unrealized profit	(0.9)
	30.6

11. Sundry Debtors in the consolidated balance sheet

	(Rs. in lakhs)
Kush Ltd.	73.8
Shuk Ltd.	47.6
	121.4
Less: Inter-company debts	(3.5)
	117.9

12. Sundry Creditors in the consolidated balance sheet

	(Rs. in lakhs)
Kush Ltd.	29.7
Shuk Ltd.	19.7
	49.4
Less: Inter-company debts	(3.1)
	46.3

Illustration 4

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

	Aqua Ltd. as on 31.3.09 Rs.	Baqa Ltd. as on 31.12.08 Rs.
Liabilities		
Share capital (equity shares of Rs.10 each)	11,00,000	5,00,000
Accumulated Profits & Reserves	4,50,000	2,05,000
15% Rs.100 non-convertible debentures	-	3,00,000
Accounts Payable	4,80,000	2,80,000
Other liabilities	1,00,000	40,000
Tax Provision	1,50,000	2,50,000
Total	22,80,000	15,75,000
Assets		
Fixed Assets at Cost	8,45,000	5,26,500
Less: Depreciation	1,95,000	1,21,500
	6,50,000	4,05,000
Investments:		
40,000 shares in Baqa Ltd.	8,00,000	-
1,000 debentures in Baqa Ltd.	1,50,000	-
Current Assets:		
Inventories	2,00,000	3,50,000
Accounts Receivable	2,50,000	4,65,000
Cash & Bank	2,30,000	3,55,000
Total	22,80,000	15,75,000

The following information is also available:

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

2. The same fire resulted in destruction of a machine having a written down value of Rs.1,00,000. The Insurance company admitted the Company's claim to the extent of 80 per cent. The machine was insured at its fair value of Rs.1,50,000.

3. On 13th March, 2009, Aqua sold goods costing Rs.1,50,000 to Baqa at a mark-up of 20 per cent. Half of these goods were resold to Aqua who in turn was able to liquidate the entire stock of such goods before closure of accounts on 31st March, 2009. As on 31st March, 2009 Baqa's accounts payable show Rs.60,000 due to Aqua on the two transactions.

4. Aqua acquired the holdings in Baqa on 1st January, 2007 when the reserves and accumulated profits of Baqa Ltd. stood at Rs.75,000.

5. Both Companies have not provided for tax on current year profits. The current year taxable profits are Rs.33,000 and Rs.66,000 for Aqua Ltd. and Baqa Ltd. respectively. The tax rate is 33%.

6. The incremental profits earned by Baqa Ltd. for the period January, 2009 to March 2009 over that earned in the corresponding period in 2008 was Rs.56,000. Except for the profits that resulted from the transactions with Aqua in the aforesaid period, the entire profits have been realised in cash before 31st March, 2009.

You are requested to consolidate the accounts of the two companies and prepare a Consolidated Balance Sheet of Aqua Limited and its subsidiary as at 31st March, 2009. (20 Marks)

Solution

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

Liabilities	Rs.
Share Capital (equity shares of Rs.10 each)	11,00,000
Minority Interest (W.N. 4)	1,50,844
Accumulated Profits & Reserves (W.N. 5)	5,67,486
15% Rs.100 Non-Convertible Debentures (Rs.3,00,000 – Rs.1,00,000)	2,00,000
Accounts Payable (W.N. 6)	7,60,000
Other Liabilities (Rs.1,00,000 + Rs.40,000)	1,40,000
Tax Provision (1,50,000 + 2,50,000+21,780+10,890)	4,32,670
Total	33,51,000
Assets	
Fixed Assets at Cost (W.N. 7)	12,41,500
Less: Depreciation (W.N. 7)	2,86,500
	9,55,000
Goodwill (W.N. 3)	3,90,000
Current Assets:	
Inventories (W.N. 8)	6,05,000
Accounts Receivable (W.N. 6)	6,55,000
Insurance claim Receivable	1,20,000
Cash & Bank (2,30,000 + 3,96,000)	6,26,000
Total	33,51,000

Working Notes:

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

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

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

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

(ix) Balance Sheet of Baqa Ltd. as at 31.3.2009

	Rs.
Liabilities	
Share Capital (equity shares of Rs. 10 each)	5,00,000
Accumulated Profits and Reserves	2,54,220
15% Non-convertible debentures	3,00,000
Accounts Payable	3,40,000
Other Liabilities	40,000
Tax provision (Rs.2,50,000 + Rs.21,780)	2,71,780
	17,06,000
Assets	
Fixed assets at cost	3,96,500
Less: Depreciation ($\frac{1,21,500}{4,05,000}$ x 3,05,000)	91,500
	3,05,000
Inventories	4,20,000
Accounts Receivable	4,65,000
Insurance Claim receivable	1,20,000
Cash and Bank	3,96,000
	17,06,000

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

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

3. Calculation of Goodwill/ Cost of Control

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

4. Minority Interest

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

5. Accumulated Profits and Reserves in the Consolidated Balance Sheet

Balance as on 31.03.2009	4,50,000
Add: 80% Share in revenue reserves(2,54,220-75,000) of Baqa Ltd.	1,43,376
Less: Unrealised profits on inventory (Rs. 1,50,000 x 20% x ½)	15,000
Less: Provision for taxation 33% on Rs.33,000	10,890
	5,67,486

6. Accounts Payable and Accounts Receivable in Consolidated Balance Sheet

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

7. Fixed Assets and accumulated Depreciation in Consolidated Balance Sheet

WDV of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)	4,05,000
Accumulated depreciation	1,21,500

% of Depreciation (1,21,500/ 4,05,000)	30
Original Cost of Destroyed Asset (W.D.V. of Rs.1,00,000)	1,30,000
Original Cost of Fixed Assets of Aqua Ltd. as per Balance sheet (given in question)	8,45,000
Original Cost of Fixed Assets of Baqa Ltd. as per Balance Sheet (given in question)	5,26,500
	13,71,500
Less: Original Cost of Destroyed Asset of Baqa Ltd.	1,30,000
Original Cost of Fixed Assets for Consolidated Balance Sheet	12,41,500
Accumulated Depreciation	
As per Balance Sheet of Aqua Ltd. (given in question)	1,95,000
As per Balance Sheet of Baqa Ltd. (given in question)	1,21,500
	3,16,500
Less: Accumulated Depreciation on Destroyed asset	30,000
Accumulated Depreciation for Consolidated Balance Sheet	2,86,500

8. Inventories

As per Balance Sheet of Aqua Ltd.	2,00,000
Balance in Baqa Ltd. Balance Sheet [W.N. 1(i)]	4,20,000
	6,20,000
Less: Unrealised Profits on closing inventory	15,000
Balance in Consolidated Balance Sheet	6,05,000

Chapter – 3

VALUATION OF GOODWILL, SHARES AND BRAND

Illustration 1

The Balance Sheet of D Ltd. on 31st March, 2009 is as under:			
Liabilities	**Rs.**	**Assets**	**Rs.**
1,25,000 shares of Rs.100 each		Goodwill	10,00,000
fully paid up	1,25,00,000	Building	80,00,000
Bank overdraft	46,50,000	Machinery	70,00,000
Creditors	52,75,000	Stock	80,00,000
Provision for taxation	12,75,000	Debtors (all considered	
Profit and loss account	53,00,000	good)	50,00,000
Total	2,90,00,000		2,90,00,000

In 1989, when the company started its activities the paid up capital was the same. The Profit/Loss for the last five years is as follows:

2004-2005: Loss (13,75,000), 2005-2006: Profit Rs.24,55,000, 2006-2007: Profit Rs.29,25,000, 2007-2008: Profit Rs.36,25,000, 2008-2009: Profit Rs.42,50,000.

Income-tax rate so far has been 40% and the above profits have been arrived at on the basis of such tax rate. From 2008-2009, the rate of income-tax should be taken at 45%. 10% dividend in 2005-2006, 2006-2007 and 15% dividend in 2007-2008 and 2008-2009 has been paid. Market price of this share on 31st March, 2009 is Rs.125. With effect from 1st April, 2009, the Managing Directors remuneration will be Rs.20,00,000 instead of Rs.15,00,000.

The company has secured a contract from which it can earn an additional Rs.10,00,000 per annum for the next five years.

Calculate the value of goodwill at 3 years purchase of super profit. (For calculation of future maintainable profits weighted average is to be taken). (16 Marks)

Solution:

(i) **Future Maintainable Profit**

Year	Profit (P) Rs.	Weight (W)	Products (PW) Rs.
2005-2006	24,55,000	1	24,55,000
2006-2007	29,25,000	2	58,50,000
2007-2008	36,25,000	3	1,08,75,000
2008-2009	42,50,000	4	1,70,00,000
		10	3,61,80,000

Weighted average annual profit (after tax) * = $\frac{3,61,80,000}{10}$ = Rs. 36,18,000

Weighted average annual profit before tax is 36,18,000 x 100/60	60,30,000
Less: Increase in Managing Director’s remuneration	5,00,000

	55,30,000
Add: Contract advantage	10,00,000
	65,30,000
Less: Tax @ 45%	29,38,500
Future maintainable profit	35,91,500

(ii) **Average Capital Employed**

Assets		**Rs.**
Building		80,00,000
Machinery		70,00,000
Stock		80,00,000
Debtors		50,00,000
		2,80,00,000
Liabilities		
Bank Overdraft	46,50,000	
Creditors	52,75,000	
Provision for taxation	12,75,000	
Additional provision for taxation*	3,54,167	1,15,54,167
Capital employed at the end of the year		1,64,45,833
Add: Dividend 15% during the year		18,75,000
		1,83,20,833
Less: ½ profit after tax for the year [(42,50,000-3,54,167)/2]		19,47,917
Average capital employed		1,63,72,916

(iii) **Normal Profit**

Average dividend for the last four years $\frac{10+10+15+15}{4} = 12.5$

Market Price of share =Rs.125

Normal rate of return* = $^{12.5}/_{125}$ x 100 = 10%

Normal profit 10% of Rs.1,63,72,916 Rs. 16,37,292

(iv) **Valuation of Goodwill**

	Rs.
Future maintainable profit	35,91,500
Less: Normal profit	16,37,292
Super Profit	19,54,208
Goodwill at 3 years' purchase of super profits (Rs. 19,54,208 x 3)	58,62,624

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* Loss amounting Rs.13,75,000 for the year 2004-2005 has not been considered in calculation of weighted average profit assuming that the loss was due to abnormal conditions.

* Additional provision for taxation [5% of Rs. 70,83,333 (Rs. 42,50,000/60%) has also been created assuming that the necessary rectification is being done in the financial statements for the year 2008-2009.

* Normal rate of return has been computed by dividend yield method.

Illustration 2

(a) From the following information, determine the possible value of brand as per potential earning model:

		Rs. in lakhs
(i)	Profit After Tax (PAT)	Rs.2,500
(ii)	Tangible fixed assets	Rs.10,000
(iii)	Identifiable intangilble other than brand	Rs.1,500
(iv)	Weighted average cost of capital (%)	14%
(v)	Expected normal return on tangible assets weighted average cost (14%) + normal spread 4%	18%
(vi)	Appropriate capitalisation factor for intangibles	25%

Solution:

Calculation of Possible Value of Brand

	Rs. in lakhs
Profit after Tax	2,500
Less: Profit allocated to tangible assets [18% of Rs.10,000]	1,800
Profit allocated to intangible assets including brand	700
Capitalisation factor 25%	
Capitalised value of intangibles including brand [$^{700}/_{25}$ x 100	2,800
Less: Identifiable intangibles other than brand	1,500
Brand value	1,300

Illustration 3

(a) The summarized Balance Sheet of Janmejay Private Lid as on 31.03.2010 is as under:

Liabilities	Amount Rs.	Assets		Amount Rs.
Share Capital:		Fixed Assets:		
Equity Shares of		Goodwill		1,75,000
Rs. 10 each	5,00.000	Leasehold Property	1,60,000	
8% Preference Shares		(-) Depreciation	70,000	90,000
of Rs. 10 each fully paid	2,00,000	Plant & Machinery	2,50,000	
Reserve & Surplus:		(-) Depreciation	25,000	2,25,000
General Reserve	1,00,000	Investment at cost		4,00,000
Profit & Loss Account	2,20,250	Current Assets		
Current Liabilities.'		Stock at cost		82,500
Bank Loan	1,00,000	Sundry Debtors		40,500
Sundry Creditors	49.750	Balance at Bank		1.57.000
	11,70,000			11,70.000

A holder of 10,000 equity shares in the company has agreed to sell these shares at a value based on the above Balance Sheet, but subject to adjustment of the valuation of the following.

(1) The leasehold property was acquired on 1.4.2000 and at the Balance Sheet date the lease has a further six years to run. The cost should be written off over the term of the lease by equal annual charges. Till date, Rs. 7,000 per annum had been written off.

(2) In 2007-08, goods costing Rs. 6,000 were purchased and have been included since that date at cost in the Stock lists. The goods were valueless on the Balance Sheet date.

(3) An expense Creditor Rs. 3,750 of the current year has been omitted from being recorded in the books.

(4) A General Reserve of 10 per cent on total Debtors, after specific provision for Doubtful Debts, has been made for the first time in the current year accounts.

(5) Goodwill is to be valued at two years' purchase of the average profits, after the above adjustments, of three years 2007-08, 2008-09, and 2009-10, such profits being those available for dividend for Equity shareholders.

(6) The profits of the company as shown by the accounts before appropriations and before providing for preference dividends were as follows:

Year	Rupees
2007-08	80,400
2008-09	92,900
2009-10	89,650

You are required to compute the total consideration due to the Vending Shareholder.

Solution:

(a) Calculation of Adjusted Profits of Janmeyjay Ltd.

	Year 2007-08	Rs.	Year 2008-09	Rs.	Year 2009-10	Rs.
Profit before appropriation and preference dividend		80,400		92,900		89,650
Less: Under provision of writing off of lease	3,000		3,000		3,000	
Stock written off	-		-		6,000	
Expenses omitted	-		-		3,750	
Dividend on preference shares	16,000	(19,000)	16,000	(19,000)	16,000	(28,750)
	61,400		73,900		60,900	
Add: General reserve created on 31.3.10 on debtors in excess of specific provision		-		-		4,500
Adjusted profits		61.400		73,900		65.400

Adjusted average profit = $\frac{\text{Rs.}61{,}400 + \text{Rs.}73{,}900 + \text{Rs.}65{,}400}{3}$ = Rs. 66,900

Goodwill = Rs. 66,900 x 2 = Rs. 1,33,800

Net Assets owned by Equity Shareholders

		Rs.
Goodwill		1,33,800
Leasehold property ($\frac{\text{Rs.}1{,}60{,}000}{16}$ x 6)		60,000
Plant and machinery		2,25,000
Investments		4,00,000
Stock (Rs. 82,500 - Rs. 6,000)		76,500
Sundry debtors (Rs 40,500 + Rs. 4,500)		45,000
Bank balance		1 ,57,000
		10,97,300
Less: Current liabilities:		
Bank loan	1,00,000	
Sundry creditors (Rs. 49,750 + Rs. 3750)	53,500	(1 ,53,500)
		9,43,800
Less Preference share capital		(2,00.000)
Net assets owned by equity shareholders		7,43,800

Value per equity share =$\frac{\text{Rs.}7\ 43\ 800}{50{,}000}$ = Rs. 14.876

Total consideration due to vending shareholder = 10,000 Equity shares @ Rs. 14.876
= Rs. 1,48,760

Illustration 4

(a) Modern Cars Ltd is engaged in the business of manufacture of electric passenger cars. The Company requires you to determine the value of its goodwill also showing the leverage effect on goodwill. Its Balance Sheet as on 31.03.2010 is as under:

Balance Sheet of Modern Cars Ltd. as at 31st March, 2010

Liabilities	Rs. (Lakh)	Assets	Rs. (Lakh)	Rs. (Lakh)
Share Capital:		Gross Fixed Assets	1,500	
(Equity Shares of		Less: Depreciation till date	500	1,000
Rs. 10 each)	1,500	**Investments:**		
General Reserve	500	Non-trade	300	
12% Term Loan from bank	500	Trade	90	390
Creditors	210	**Current Assets:**		
Provision for Tax	10	Overseas Debtors	420	
Proposed Dividend	140	(1$=INR 42)		
		Indian Debtors	400	820
		Stock in Trade		350
		Cash and Bank Balances		300
	2.860			2.860

Additional information:

The closing exchange rate for the U.S. dollar was INR 48. There was a loss for the year ended 31.03.2010 owing to write do 17 of cost of acquisition of non trade investments by

4%. There was no other transaction under non-trade investments during the year.

Current year depreciation charged on historical cost was Rs. 100lakhs. Current cost of Fixed assets is determined at Rs. 2,000 lakhs.

While current cost of closing stock is Rs.367, that of the opening stock was Rs. 200lakhs against its historical cost of Rs. 148 lakhs. The market value of non-trade Investments at the year end was Rs. 300lakhs. The overseas debtors made settlements in US $ only

The industry average rate of return on current cost of capital employed is 12% on long term debt, and 15% on equity The opening balance in general reserve was Rs. 150 lakhs. While prevailing tax rate is 30% such rate is expected to decline by 5%

Using the above information you are required to arrive at value of the goodwill of the company under equity and long-term fund approaches and also show the leverage effect on Goodwill

Solution:

(a) Future Maintainable Profit

			Rs. in Lakhs
Profit made in the year 2009-10			
Increase in reserve (Rs. 500 lakhs - RS.150 lakhs)		350.00	
Add:	Proposed dividend	140.00	
Profit after tax		490.00	
Add back: Income tax $\frac{(490 \times 30\%)}{70\%}$		210.00	700.00
Less:	Additional depredation required(W.N.1)	81.82	
	Adjustment for change in revaluation of stock (opening and c1osing)(W.N.2)	35.00	116.82
			583.18
Add:	Debtors' adjustment- exchange gain (W.N. 3)		60.00
Add:	Loss on non trade investment [Rs. lakhs (300 x 100/96) - 300]		12.50
			655.68
Less:	Tax @ 25%		(163.92)
Profit after tax under equity approach			491.76
Add Back: Interest on term loans (net of taxes) [Rs. 500 lakhs x 12% x 75%]			45:00
Profit after tax under long term fund approach			536.76

Capital Employed

			Rs. in Lakhs
Assets as per Balance Sheet			2,860.00
Less: Non trade investments			300.00
			2,560.00
Add:	Current cost adjustments:		
	Net increase in fixed assets costs [Rs. (2000* -1100) lakhs - Rs. 81.82Iakhs]	818.18	
	Increase in the value of closing stock (Rs. 367 lakhs - Rs. 350 lakhs)	17.00	

	Increase in the value of debtors	60.00	895.18
			3,455.18
Less:	External liabilities:		
	Sundry creditors	210.00	
	Provision for tax	10.00	
	12% Term loan	500.00	720.00
Capital employed under equity approach			2,735.18
Add.' 12% Term Loan			_500.00
Capital employed under long term fund approach			3,235.18

Valuation of Goodwill:

Equity approach

	Rs. in lakhs
Capitalized value of future maintainable profit @ 15% = $\frac{491.76}{15\%}$	3,278.40
Less: Capital employed under equity approach	2.735.18
Goodwill under equity approach	543.22

Long term fund approach

	Rs. in lakhs
Capitalised value of future maintainable profit @ 12% = $\frac{536.76}{12\%}$	4,473.00
Less: Capital employed under long term fund approach	3,235.18
Goodwill under long term fund approach	1,237.82

Leverage effect on goodwill

The adverse leverage effect on goodwill is Rs. 694.60 lakhs (Rs.1 ,237.82 lakhs Rs. 54322 lakhs). Modern Cars ltd. has a low leverage ratio and its goodwill value is lower under equity approach as compared to that under the long term fund approach.

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* It is assumed that Current cost of fixed assets amounting Rs. 2,000 lakhs is determined on 1.4.2009.

* Goodwill has been computed on the basis of closing capital employed

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Working Notes:

1. **Shortfall in depreciation**

		Rs. in lakhs
Current cost of fixed assets as on 1 .4 .2009		2,000
Value of fixed assets as pet balance sheet on 31.3.10	1,000	
Add back: Depreciation for 2009-10	100	
Cost of fixed assets on 1.4.2009	1.100	

Depreciation rate (100/1,100) x 100 = 9.091%	
Revised amount of depreciation (Rs. 2,000 lakhs x 9.091%)	181.82
Less: Depreciation already charged	100.00
Additional depreciation to be provided	81.82

2. Stock Adjustment

	Rs. in lakhs
Increase in current cost of opening stock Rs.(200-148) lakhs	52
Increase in current cost of closing stock Rs.(367 -350) lakhs	17
Stock adjustment	35

3. Debtors Adjustment

		Rs. in lakhs
Overseas Debtors in US$ = 420/42 = $10 lakhs		
Overseas Debtors in INR at the end of the year($ 10x Rs.48)		480
Less: Balance Sheet value of overseas debtors	420	
Gain due to change in exchange rate		60

Chapter – 4

FINANCIAL INSTRUMENTS (AS – 30)

Illustration 1

On 1 April, 2008 Delta Ltd. issued Rs.30,00,000, 6 % convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.12 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 compound financial instrument, you are required to separate equity and debt portion as on 01.04.08.

The present value of Re. 1 receivable at the end of the end of each year based on discount rates of 6% and 10% can be taken as:

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

Solution:

Computation of Equity and Debt Component of Convertible Debentures as on 1.4.08	Rs.
Present value of the principal repayable after four years	
[30,00,000 × 1.10 × 0.68 (10% Discount factor)]	22,44,000
Present value of Interest	5,70,600
[1,80,000 x 3.17 (4 years cumulative 10% discount factor)]	
Value of debt component	28,14,600
Value of equity component	1,85,400
Proceeds of the issue	30,00,000

Illustration 2

Comforts Ltd. granted Rs.10,00,000 loan to its employees on January 1, 2009 at a concessional interest rate of 4% per annum. Loan is to be repaid in five equal annual instalments along with interest. Market rate of interest for such loan is 10% per annum. Following the principles of recognition and measurement as laid down in AS 30 'Financial Instruments : Recognition and Measurement', record the entries for the year ended 31st December, 2009 for the loan transaction, and also calculate the value of loan initially to be recognised and amortised cost for all the subsequent years. The present value of Re.1 receivable at the end of each year based on discount factor of 10% can be taken as:

Year End	1	2	3	4	5
	0.9090	0.8263	0.7512	0.6829	0.6208

Solution:

(i) Journal Entries in the books of Comfort Ltd.
for the year ended 31st December, 2009 (regarding loan to employees)

		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Staff loan A/c	Dr.	10,00,000	
To Bank A/c			10,00,000
(Being the disbursement of loans to staff)			
Staff cost A/c (10,00,000 – 8,54,763) [Refer part (ii)]	Dr.	1,45,237	
To Staff loan A/c			1,45,237
(Being the write off of excess of loan balance over present value thereof, in order to reflect the loan at its present value of Rs. 8,54,763)			
Staff loan A/c	Dr.	85,476	
To Interest on staff loan A/c			85,476
(Being the charge of interest @ market rate of 10% to the loan)			
Bank A/c	Dr.	2,40,000	
To Staff loan A/c			2,40,000
(Being the repayment of first instalment with interest for the year)			
Interest on staff loan A/c	Dr.	85,476	
To Profit and loss A/c			85,476
(Being transfer of balance in staff loan Interest account to P&L A/c)			
Profit and loss A/c	Dr.	1,45,237	
To Staff cost A/c			1,45,237
(Being transfer of balance in staff cost A/c to profit and loss A/c)			

(ii) **Calculation of initial recognition amount of loan to employees**

	Cash Inflow				
Year end	**Principal**	**Interest @ 4%**	**Total**	**P.V. factor**	**Present value**
	Rs.	Rs.	Rs.		Rs.
2009	2,00,000	40,000	2,40,000	0.9090	2,18,160
2010	2,00,000	32,000	2,32,000	0.8263	1,91,702
2011	2,00,000	24,000	2,24,000	0.7512	1,68,269
2012	2,00,000	16,000	2,16,000	0.6829	1,47,506
2013	2,00,000	8,000	2,08,000	0.6208	1,29,126
Present value or Fair value					8,54,763

(iii) **Calculation of amortised cost of loan to employees**

Year	Amortised cost (Opening balance) [1] Rs.	Interest to be recognized @10% [2] Rs.	Repayment (including interest) [3] Rs.	Amortised Cost (Closing balance) [4]=[1]+ [2]-[3] Rs.
2009	8,54,763	85,476	2,40,000	7,00,239
2010	7,00,239	70,024	2,32,000	5,38,263
2011	5,38,263	53,826	2,24,000	3,68,089
2012	3,68,089	36,809	2,16,000	1,88,898
2013	1,88,898	19,102 (Bal. fig.)*	2,08,000	Nil

Illustration 3

Aakshaya Ltd. has given a 12.50% fixed rate loan to its subsidiary Shaya Ltd. Aakshaya Ltd measures this loan at an amortised cost of Rs. 2,50,000. Aakshaya Ltd. has plans to hive off the receivable at a later stage and as a measure to safeguard against fall in value of its dues enters into a pay-fixed, receive floating interest rate swap to convert the fixed interest receipts into floating interest receipts. Aakshaya Ltd. designates the swap as a Hedging instrument in a fair value hedge of the Loan Asset.

Over the following months, market interest rates increase and Aakshaya Ltd. earns interest income of Rs. 25,000 on the loan and Rs. 1,000 as net interest payments on the swap. The Fair value of the Loan Asset decreases by Rs. 5,000 while that of the interest rate swap increases by 5,000. You are informed that all conditions required for the Hedge Accounting are satisfied. You are required to pass Journal Entries, with suitable narrations, in the books of Aakshaya Ltd. to record the above transactions.

Solution:

Journal Entries in the books of Aakshaya Ltd.

		Rs.	Rs.
Cash account	Dr.	25,000	
To Interest account			25,000
(Being the receipt of interest income on the loan asset)			
Derivative account	Dr.	5,000	
To Hedging gain account			5,000
(Being increase in the fair value of the interest rate swap)			
Hedging loss account	Dr.	5,000	
To Loan to Shaya Ltd. account			5,000
(Being decrease in the fair value of loan to Shaya Ltd attributable to the hedged risk recorded)			
Cash Account	Dr.	1,000	
To Interest account·			1,000
(Being the entry to record the interest settlement of the swap as increase in interest income)			

Illustration 4

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 01-04-2008. 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	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

* Loans and receivables should be Measured at amortized cost using the effective interest method as per AS 30 'Financial Instruments: Recognition and Measurement'.

Solution:

Assume that total proceeds of the issue is = Rs. M
Hence, interest payable every year = 6% on Rs. M =.06M
Present value of interest (at 10% discount) = 0.06M x cumulative discount factor of 4 years
= 0.06M x 3.17 = 0.1902M.
Amount refundable (as amount have to be redeemed at 10% premium) = 1.10 x M
Present value of 1.10M at 4th year = 1.10M x 0.68 = 0.748M.
Therefore, total present value of debentures =0.1902M + 0.748M = 0.9382M
Hence, amount of equity = M – 0.9382M = Rs.1,85,400
0.0618M = Rs.1,85,400
M = 1,85,400/0.0618=Rs.30,00,000
Therefore, total proceeds of the issue is Rs.30,00,000
Debt portion = Rs.30,00,000 – Rs.1,85,400 = Rs.28,14,600.

Illustration 5

On February 1, 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 as on 31.01.2010.

The fair value of this forward contract on the different dates were:

(i) Fair value of forward on 01-02-2009 Nil
(ii) Fair value of forward on 31-12-2009 Rs. 6,300
(iii) 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:
(i) If net settled is in cash
(ii) If net is settled by Son Ltd. by delivering shares of Future Ltd.

Solution:

(i) If net is settled in cash

1.2.09	No entry is required because fair value of derivative is zero and no cash is paid or received			
31.12.2009	Forward Asset A/c	Dr.	6,300	
	To Gain A/c			6,300
31.01.2010	Loss A/c	Dr.	4,300	
	To Forward Asset A/c			4,300
31.1.2010	Cash A/c	Dr.	2,000	
	To Forward Asset A/c			2,000

(ii) If net settled by delivery of share

First three entries will be same. Only the last entry will change as under:

Equity A/c	Dr.	2,000	
To Forward Asset A/c			2,000

Chapter – 5

ACCOUNTING STANDARDS AND MISCELLANEOUS QUESTIONS

Illustration 1

(a) Capital adequacy ratio for Non-Banking Financial Companies (NBFC)

(b) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Solution

(a) Non-Banking Financial Companies (NBFC) are required to maintain adequate capital. Every NBFC shall maintain a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than 12% of its aggregate risk-weighted assets. The total of Tier II capital, at any point of time , shall not exceed 100% of Tier I capital. Capital adequacy is calculated as under:

$$\frac{\text{TierI+ Tier II Capital}}{\text{Risk Adjusted Assets}} \times 100$$

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1 "Tier-I Capital" means owned fund as reduced by investment in shares of other NBFCs and in shares, debenture, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, 10% of the owned fund.

2 "Tier-II capital" includes (i) Preference shares, (ii) Revaluation reserves at discounted rate of 55%, (iii) General provisions and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets, (iv) hybrid debt capital instruments, (v) subordinated debt.

(b) Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

(i) Gradual or evolutionary phasing out of a product line or class of service;

(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Illustration 2

(a) Mr. A bought a forward contract for three months of US $ 1,00,000 on 1st December at 1 US $ = Rs.47.10 when exchange rate was US $ 1 = Rs.47.02. On 31st December when he closed his books, exchange rate was US $ 1 = Rs.47.15. On 31st January, he decided to sell the contract at Rs.47.18 per dollar. Show how the profits from contract will be recognised in the books.

(b) Sun Ltd. has entered into a sale contract of Rs.5 crores with X Ltd. during 2009-10 financial year. The profit on this transaction is Rs.1 crore. The delivery of goods to take place during the first month of 2010-11 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs.1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2009-10 financial year. As on balance sheet date (31.3.2010), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

Solution:

(a) It is apparent from the facts given in the question that Mr. A entered into forward exchange contract for speculation purpose*. According to paragraphs 38 and 39 of AS 11(Revised) 'The Effects of Changes in Foreign Exchange Rates', gain or loss on forward exchange contracts intended for trading or speculation purpose should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be recognised in the statement of profit and loss for the period and the premium or discount on the forward exchange contract is ignored and not recognised separately. In recording such contract, at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Thus, the premium on contract i.e., the difference between the contract rate and the spot rate amounting Rs. 8,000 [US$ 1,00,000 x (Rs.47.10 – Rs.47.02)] will be ignored and not be recorded in the books. However, the profit on contract i.e. the difference between the sale rate and contract rate amounting Rs. 8,000 [US$ 1,00,000 x 0.08* (Rs.47.18 – Rs.47.10)] will be recognized in the books of Mr. A on 31st January.

Note: The answer has been given on the basis that Mr. A is a small and medium-sized entity and AS 30 "Financial Instruments: Recognition and Measurement" is not applicable to him.

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* The forward contract is sold before its due date, hence considered as speculative.

* The current market value of the forward contract on 31st December has not been given in the question. Therefore, no gain or loss can be recognised in the books on 31st December. The profit amounting Rs. 8,000 will be recognised in the year of sale only.

(b) (i) AS 29 “Provisions, Contingent Liabilities and Contingent Assets” provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2010 and no profit had accrued for the financial year 2009-2010. Therefore, provision should be made for the full amount of compensation amounting Rs.1.50 crores.

Illustration 3

A plant was acquired 15 years ago at a cost of Rs. 5 crores. Its accumulated depreciation as at 31st March, 2009 was Rs. 4.15 crores. Depreciation estimated for the Financial year 2009-10 is Rs. 25lakhs. Estimated Net Selling Price as on 31st March, 2009 was Rs. 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at Rs. 35 lakhs as on 1st (April, 2009, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 2010?

(ii) How much will be the amount of write off for the financial year ended 31st March, 2010?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be Rs. 12 lakhs, how would you answer to questions (i) and (ii) above?

(iv) If the value in use was zero and the enterprise were required to incur a cost of Rs. 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

Solution:

As per AS 28 "Impairment of Assets", if the recoverable amount' of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

In the given case, recoverable amount (higher of asset's net selling price and value in use) will be Rs. 24.5 lakhs on 31.3.2010 according to the provisions of AS 28 [Refer working note].

		Rs. in lakhs
(i)	Carrying amount of plant (after impairment) as on 31st March, 2010	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 2010 [Rs. 60 lakhs - Rs. 24.5 lakhs)	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00
	Amount charged to profit and loss account (Rs. 35.50 lakhs-Rs. 12lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Net selling price (b)	(-)2.00
	Recoverable amount [higher of (a) and (b))	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss)(Rs. 60 lakhs - Nil)	60.00
	Entire book value of plant will be written off and charged to profit and loss account.	

* Recoverable amount is the higher of an asset's net selling price and its value in use.

* It is assumed that the market value has been determined in an arm's length transaction between knowledgeable and willing buyer and seller.

Working Note:

Calculation of Closing Book Value, Estimated Net Selling Value and Estimated Value in Use of Plant at 31st March, 2010.

	Rs. in lakhs)
Opening book value as on 1.4.2009 (Rs. 500lakhs -Rs. 415 lakhs)	85
Less: Depreciation for financial year 2009 - 10	(25)
Closing book value as on 31.3.2010	60
Estimated net selling price as on 1.4.2009	30
Less: Estimated decrease during the year (20% of Rs. 30 lakhs)	(6)
Estimated net selling price as on 31.3.2010	24
Estimated value in use as on 14.2009	35.0
Less: Estimated decrease during the year (30% of Rs. 35 lakhs)	(10.5)
Estimated value in use as on 31.3.2010	24.5

Illustration 4

Suram Ltd. wants to re-classify its Investment in accordance with AS 13. Decide on theatreatment to be given in each of the following cases:

(1) A portion of Current Investments purchased for Rs. 20 lakhs to be reclassified as long-term Investments, as the company has decided to retain them. The market value as on the date of Balance Sheet was Rs. 25 lakhs.

(2) Another portion of Current Investments purchased for Rs. 15 lakhs has to be re classified as

Long-term Investments. The market value of these investments as on the date of Balance Sheet was Rs. 6.5 lakhs.

(3) Certain Long-term Investments no longer considered for holding purposes have to be re-classified as Current Investments. The original cost of these was Rs. 18 lakhs but they had been written down to Rs. 12 lakhs to recognize permanent decline as per AS 13.

Solution:

As per Para 24 of AS 13 'Accounting for Investments', where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer. In the first case, the market value' of the investment is Rs. 25lakhs, which is higher than its cost i.e. Rs. 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. Rs. 20 lakhs.

In the second case, the market value' of the investment is Rs. 6.5 lakhs, which is lower than its cost i.e. Rs. 15lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. Rs. 6.5 lakhs. The loss of Rs8.5 lakhs should be charged to profit and loss account.

As per para 23 of AS 13, where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

In the third case, the book value of the investment is Rs. 12 lakhs, which is lower than its cost i.e. Rs. 18 lakhs. Here, the transfer should be at carrying amount and hence this reclassified current investment should be carried at Rs. 12 lakhs.

Illustration 5

Refiners and Projects Limited is a company in the oil and gas sector. It undertakes extensive research and development work as part of its operations. It has till the end of the financial year 31 March, 2008 spent Rs. 592.23 crores on research expenses.

The development of a new process was completed in the accounting year 2008-2009 after incurring an expenditure of Rs. 322.26 crores. In the accounting year 2009-2010, the company implemented the new process resulting in a post tax saving of Rs. 100 crores in the first year of operation and savings of Rs. 80 crores per annum thereafter for the next four years.

The cost of capital to the company is 12 per cent.

Kindly indicate how you will, in the background of accounting standards prescribed, proceed to record the transactions in the books of accounts of the company.

You are given to understand that the research expenses shown above do not include any general or selling and administrative expenses.

The present value discounted at 12 per cent of a Rupee can be adopted at .893, .797, .712, .636 and .567 for the purposes of calculation. (12+4= 16 Marks)

Solution:

As per para 41 of AS 26 "Intangible Assets", no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Therefore, the amount of Rs. 592.23 crores incurred on research till the end of financial year ended 31st March, 2008 cannot be capitalised and hence has to expensed in the year in which ii is incurred. In case the same is still un-expensed it will have to be written off under 'Prior period Expenditure' As per para 44 of the standard, an intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the conditions specified in the standard.

From the facts given in the question, it can be reasonably assumed that the criteria specified in the standard for recognition of an internally generated intangible asset arising in the development phase are met and the Refiners and Projects Ltd. can demonstrate that future economic benefits from the intangible asset are probable. Hence, development cost of Rs. 322.26 crores is eligible for capitalization.

As per para 62 of AS 26, after initial recognition, an intangible asset should be carried at its cost less any accumulated amortization and any accumulated impairment losses. In the given case, present value of future cash flows amounting RS.306.26 crores [(Rs 100 crores x 0.893) + (Rs. 80 crores x 0.797) + (Rs.80 crores x 0.712) + (Rs. 80 crores x 0.636) + (Rs. 80 crores x 0.567)) is less than the cost incurred, it is prudent to carry the intangible asset at the discounted value of future cash flows (Rs. 306.26 crores). The excess of cost incurred over present values amounting Rs. 16 crores (32226 - 306.26) has to be recognised as an impairment loss in the year 2008 - 09.

According to para 63 of the standard, depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortization should commence when the asset is available for use. In the given case, the value of intangible asset should be amortized over a period of five years by following the straight line method. Therefore, an annual depreciation of Rs. 61.25 crores (Rs. 306.26 crorest5) should be charged for each year beginning with 2009-10.

Illustration 6

As on 1st April, 2008 the fair value of plan assets was Rs.1,00,000 in respect of a pension plan of Zeleous Ltd. On 30th September, 2008 the plan paid out benefits of Rs.19,000 and received inward contributions of Rs.49,000. On 31st March, 2009 the fair value of plan assets was Rs.1,50,000 and present value of the defined benefit obligation was Rs.1,47,920. Acturial losses on the obligations for the year 2008-09 were Rs.600.

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

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

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

Solution:

Computation of Expected and Actual Returns on Plan Assets

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

Illustration 7

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

(i) An unquoted long term investment is carried in the books at its cost of Rs.5 lakhs. The Published Accounts of the unlisted company received in May, 2009 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs.80,000.

(ii) The Company invested Rs.560 lakhs in April, 2009 in the acquisition of another company doing similar business, the negotiations for which had started during the current financial year.

(iii) There was a major theft of stores valued at Rs.46 lakhs in the preceding year which was detected only during the current financial year. (5+5+6= 16 Marks)

Solution:

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

(i) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 ‘Accounting for Investments’ states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On this basis, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to Rs. 80,000 in the financial statements for the year ended 31st March, 2009.

(ii) The acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2009. Applying Para 15 of AS 4 (Revised), which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 560 lakhs in April, 2009 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

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

Chapter – 6

VALUE ADDITIONS (EVA, MVA AND SVA)

Illustration 1

From the following data compute the Economic Value Added.

Share Capital	Rs. 1,600 crores
Long-term Debt	Rs. 320 crores
Interest	Rs. 32 crores
Reserve and Surplus	Rs. 3. 200 crores
Profit before Interest and Tax	Rs. 1,432 crores
Tax Rate	30%
Beta Factor	1.05
Market Rate of Return	14%
Risk Free Rate	10%

Solution:

Computation of Economic Value Added

	Rs. in crores
Net operating profit after lax (Refer working note 5)	980.0
Add· Cost of debt (7% of Rs. 320 crores)	22.4
	1002.4
Less: Cost of capital (13.75% of Rs. 5,120 crores)	704.0
Economic Value Added	298.4

Working Notes:

1. **Cost of Equity**

Cost of equity = Risk Free Rate + Beta factor x (Market Rate - Risk Free Rate)
= 10 + 1.05 (14 -10) = 14.20%

2. **Cost of Debt**

	Rs. in crores
Interest	32.0
Less: Tax @ 30%	9.6
	22.4

Cost of Debt = $\frac{22.4}{320}$ x 100 = 7%

3. **Capital Employed**

	Rs. in crores
Share capital	1,600
Reserves and surplus	3,200
Long term debt	320

5.120

4. Weighted Average Cost of Capital (WACC)

	Rs. in crores
Cost of Equity (14.20% of Rs. 4,800 crores)	681.6
Cost of Debt [7% (Refer W.N.2) of Rs. 320 crores]	22.4
	704.0

WACC = $\frac{704}{5,120}$ x 100 = 13.75%

5. Calculation of Net Operating Profit after Tax

	Rs. in crores
Profit before interest and tax	1,432
Less:' Interest on long term debt	(32)
	1,400
Less: Tax (30% of Rs. 1,400)	(420)
Net operating profit after tax	980

Chapter – 7

HUMAN RESOURCE ACCOUNTING

Illustration 1

From the following details, compute according to Lev and Schwartz (1971) model, the total value of human resources of the employee groups skilled and unskilled.

		Skilled	Unskilled
(i)	Annual average earning of an employee till the retirement age	Rs.50,000	Rs.30,000
(ii)	Age of retirement	65 years	62 years
(iii)	Discount rate	15%	15%
(iv)	No. of employees in the group	20	25
(v)	Average age	62 years	60 years

Solution:

Value of skilled employees:

$$= \frac{50{,}000}{(1+0.15)^{(65\ 62)}} + \frac{50{,}000}{(1+0.15)^{(65\ 63)}} + \frac{50{,}000}{(1+0.15)^{(65\ 64)}}$$

Rs. 32,875.81 + Rs. 37,807.18 + Rs.43,478.26 = Rs.1, 14,161.25

Total value of skilled employees is Rs.1, 14,161.25 × 20 = Rs.22,83,225.

Value of unskilled employees

$$= \frac{30{,}000}{(1+0.15)^{(62-60)}} + \frac{30{,}000}{(1+0.15)^{(62-61)}}$$

$$= \frac{30{,}000}{(1+0.15)^{2}} + \frac{30{,}000}{(1+0.15)^{1}}$$

= 22,684.31 + 26,086.96 = 48,771.27

Total value of the unskilled employees = Rs. 48,771.27× 25 = Rs.12,19,282

∴ Total value of human resources (skilled and unskilled) = Rs.22,83,225 + Rs.12,19,282 = Rs.35,02,507.

Chapter – 8

BUY BACK OF SHARES

Illustration 1

Perrotte Ltd. has the following Capital Structure as on 31.03.2009.

	Particulars		(Rs. in crores)
(1)	Equity Share Capital (Shares of Rs. 10 each fully paid)	-	330
(2)	Reserves and Surplus		
	General Reserve	240	-
	Securities Premium Account	90	-
	Profit & Loss Account	90	-
	Infrastructure Development Reserve	180	600
(3)	Loan Funds		1,800

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.2009 a proposal to buy back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is Rs. 25 per share and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either Rs. 1,200 crores or Rs. 1,500 crores.

Assuming that the entire buy back is completed by 09.12.2009, show the accounting entries in the company's books in each situation. Narrations should form part of your answer

Solution:

Statement determining the maximum number of shares to be bought back

	Number of shares		
Particulars	**Situation 1**	**Situation 2**	**Situation 3**
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	5.00	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	5.00	Nil

Journal Entries for the Buy Back (applicable for situation 2)

		Rs. in crores Debit	Credit
(a) Equity share buy back account	Dr.	150	
To Bank account			150
(Being buy back of five crores equity shares of Rs. 10 each @ Rs. 30 per share)			
(b) Equity share capital account	Dr.	50	
Securities premium account	Dr.	90	
General reserve account (Balancing figure.)	Dr.	10	
To Equity share buy back account			150
(Being cancellation of shares bought back)			
(c) General reserve account	Dr.	50	
To Capital redemption reserve account			50
(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital redeemed through free reserves)			

* Situation 1: When loan funds are Rs. 1,800 crores.
* Situation 2: When loan funds are Rs. 1,200 crores.
* Situation 3. When loan funds are Rs. 1,500 crores.

Note: Under Situations 1 & 3 the company does not qualify for buy back of shares as per the provisions of Section 77 A of the Companies Act, 1956.

Working Notes:

1. Shares Outstanding Test

Particulars	(Shares in crores)
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. Resources Test

Particulars	
Paid up capital (Rs. in crores)	330
Free reserves (Rs. in crores)	420
Shareholders' funds (Rs. in crores)	750
25% of Shareholders fund (Rs. in crores)	187.5
Buy back price per share	Rs.30
Number of shares that can be bought back (shares in crores)	6.25

3. Debt Equity Ratio Test

Particulars	Situation 1	Situation 2	Situation 3
(a) Loan funds (Rs. in crores)	1,800	1,200	1,500
(b) Minimum equity to be maintained after buy back in the ratio of 2: 1 (Rs. in crores)	900	600	750
(c) Present equity shareholders fund (Rs. in crores)	750	750	750
(d) Maximum permitted buy back of Equity (Rs. in crores) [(b) - (c)]	Nil	150	Nil
(e) Maximum number of shares that can be bought back @ Rs. 30 per share (shares in crores)	Nil	5	Nil

Chapter – 9

ACCOUNTING BY MUTUAL FUNDS

Illustration 1

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

	Rs.'000
Opening Balance of net assets	12,00,000
Net Income for the year (Audited)	85,000
8,50,200 units issued during 2008-09	96,500
7,52,300 units redeemed during 2008-09	71,320
The par value per unit is Rs100	

Solution:

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

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

Working Note:

Particulars	**Issued**	**Redeemed**
Units	8,50,200	7,52,300

	Rs.'000	**Rs.'000**
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve /Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund		15,390

Chapter – 10

IAS AND IFRS

Illustration 1

Give a presentation of the statement of income as per IFRS under the following two approaches taking the following figures for the calendar year 31.12.2009

1. One statement approach (CI and OCI together)
2. Two statement approach (CI and OCI separate)

		$
Revenues		230,000
Expenses		- 140,000
Other Gains and Losses		10,000
Gains on Sale of Securities		2,000
Income Tax Expense		-34,000
Extraordinary Item, Net of tax		-2,000
Cumulative Effect of Accounting Change, Net of tax		2,000
Foreign Currency Translation Adjustments		40
Unrealized Gains on Securities		
(a) Unrealized Holding Gains arising during the period	300	
(b) *Less*: Reclassification Adjustment for Gains included in Net Income	- 50	
Minimum pension liability adjustment		-100

Note: Gain on sale of securities already includes the reclassification adjustment as it arises from actual realization of profit by sale.

Solution:

One Statement Approach

Statement of Income and Comprehensive Income Year ended 31-12-2009	**$**
Revenues	230,000
Expenses	-140,000
Other Gains and Losses	10,000
Gains on Sale of Securities	2,000
Income From Operations Before Tax	102,000
Income Tax Expense	-34,000
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	68,000
Extraordinary Item, Net of tax	-2,000
Income Before Cumulative Effect of Accounting Change	66,000
Cumulative Effect of Accounting Change, Net of tax	2,000
Net Income (A)	68,000

Other Comprehensive Income, net of tax

(i)	Foreign Currency Translation Adjustments		40
(ii)	Unrealized Gains on Securities		
	(a) Unrealized Holding Gains arising during the period	300	
	(b) *Less*: Reclassification Adjustment for Gains included in Net Income	- 50	250
(iii)	Minimum pension liability adjustment		-100
Other Comprehensive Income (B)			190
Total Comprehensive Income (A +B)			68,190

Notes: Alternatively, it is possible to present various items of other comprehensive income at gross amount from which income tax should be deducted.

Two-Statement Approach

Statement of Income and Comprehensive Income Year ended 31-12-2009	$
Revenues	230,000
Expenses	-140,000
Other Gains and Losses	10,000
Gains on Sale of Securities	2,000
Income From Operations Before Tax	102,000
Income Tax Expense	-34,000
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	68,000
Extraordinary Item, Net of tax	-2,000
Income Before Cumulative Effect of Accounting Change	66,000
Cumulative Effect of Accounting Change, Net of tax	2,000
Net Income	68,000

Statement of Comprehensive Income Year ended 31-12-2009		$	$
Net Income (A)			68,000
Other Comprehensive Income, net of tax			
(i)	Foreign Currency Translation Adjustments	40	
(ii)	Unrealized Gains of Securities		
	(a) Unrealized Holding Gains arising during the period	300	
	(b) *Less*: Reclassification Adjustment for Gains included in Net Income	-50	250
(iii)	Minimum pension liability adjustment		-100
Other Comprehensive Income (B)			190
Total Comprehensive Income (A+ B)			68,190

Notes: Alternatively, it is possible to present various items of other comprehensive income at gross amount from which income tax should be deducted.

Illustration 2

A Ltd. purchased 2,000 equity securities that are classified as “available for sale” instruments for $ 5. Fair value of such securities was $ 7.5 as on December 31, 2009 and $ 8 as on December 31,

2010. There was no dividend declared on such securities. Those securities were sold as on December 31, 2010. Assume 30% tax rate.

Show how to compute unrealized holding gain for inclusion in other comprehensive income and how to reclassify such unrealized holding gain when the securities were sold.

Solution:

Computation of Holding Gain	**Before Tax**	**Income Tax**	**After Tax**
Holding Gain recognized in Other Comprehensive Income			
Year ended December 31, 2009	5000	1500	3500
Year ended December 31, 2010	1000	300	700
	6000	1800	4200

Amounts Reported in Net Income and Other Comprehensive Income For the year ended December 31, 2009 and December 31, 2010	**2009**	**2010**
Net Income:		
Gain on sale of securities		6,000
Income Tax Expense		1,800
Net Gain Realized in Net Income		4,200
Other Comprehensive Income		
Holding Gain arising during the period, net of tax	3,500	700
Reclassification Adjustments, net of tax	0	-4,200

Illustration 3

When comparing the use of the percentage of completion method with the completed contract method during a long-term project's life, the percentage-of-completion method will result in:

(i) earlier recognition of cash flows,
(ii) a higher return on assets,
(iii) a lower debt-to-equity ratio, and
(iv) a higher asset turnover.

Solution:

(i) **No:** The choice of accounting method has no effect on cash flow.

(ii) **Yes:** Because the periodic earnings will be higher under the percentage-of-completion method, the return on assets ratio will be higher.

(iii) **Yes:** Because the percentage-of-completion method reports lower liabilities and higher net worth, the debt-to-equity ratio will be lower.

(iv) **Yes:** The asset turnover ratio is higher under the percentage-of-completion method because sales are reported during the life of the project.

Illustration 4

Winners reported net earnings of $25,000 for the year ending 2010. The company had 12,500 shares of $1 par value common stock and 3,000 shares of $40 par value convertible preference shares outstanding during the year. The dividend rate on the preference shares is $2 per share. Each share of the convertible into two shares of Winners' Class A common shares. During the year no convertible preference shares were converted.

What is Winners' basic earnings per share?

Solution:

Basic earnings = $\frac{\text{Net income} - \text{Preference dividends}}{\text{Weighted average common shares}}$

$$\frac{(\$\ 25{,}000-(\$2 \text{ x } 3{,}000 \text{ shares})}{12{,}500 \text{ shares}}$$

$$= \frac{\$\ 19{,}000}{12{,}500} = \$\ 1.52 \text{ per share}$$

Illustration 5

Winners reported net earnings of $25,000 for the year ending 2010. The company had 12,500 shares of $1 par value common stock and 3,000 shares of $40 par value convertible preference shares outstanding during the year. The dividend rate on the preference shares is $2 per share. Each share of the convertible preference shares can be converted into two shares of Winners' Class A common shares. During the year no convertible preference shares were converted.

What is Winners' diluted earnings per share?

Solution:

Diluted earnings per share = $\frac{\text{Net income} - \text{preference dividends} + \text{Dividends on convertedsecurities}}{\text{Sharesouts tanding} + \text{Additional shares if securities were converted}}$

$$= \frac{\$\ 25{,}000-\$\ 6{,}000+\$\ 6{,}000}{12{,}500+(3{,}000 \text{ x } 2)}$$

Illustration 6

The following information relates to individual equipment items of an entity at a balance sheet date:

	Carrying amount $	Fair value less costs to sell $	Value in use $
Item #1	11,900	12,100	11,400
Item #2 (note 1)	23,700	20,700	20,500
Item #3 (note 1)	11,500	11,700	12,300
Item #4	8,300	7,500	7,900
Item # 5 (note 2)	3,100	2,600	

Further information:

1. Items #2 and #3 are carried at revalued amounts, and the cumulative revaluation surpluses included in equity for the items are $1,200 and $600 respectively. Both items are manufacturing equipment.

2. Item #5 is a bus used for transporting employees in the mornings and evenings. It is not possible to determine the value in use of the bus separately because the bus does not generate cash inflows from continuing use that are independent of the cash flows from other assets.

Solution:

The major issues related to the possible impairment of the above-mentioned items can be analyzed as follows:

Item #1

The recoverable a mount is defined as the higher of an asset's net selling price and its value in use. No impairment loss is recognized because the recoverable amount of $12,100 is higher than the carrying amount of $11,900.

Items #2

Item #2 is impaired because its recoverable amount ($20,700) is lower than its carrying amount ($23,700) giving rise to an impairment loss of $3,000. The loss should be treated as a revaluation decrease. Therefore, $1,200 of the loss is debited to revaluation surplus in equity and the balance of the loss ($1,800) is recognized in profit or loss.

Item #3

Item #3 is not impaired.

Item #4

Item #4 is impaired because its recoverable amount ($7,900) is lower than its carrying amount ($8,300), giving rise to an impairment loss of $400 which is recognized as an expense in profit or loss.

Item #5

The recoverable amount of the bus cannot be determined because the asset's value in use cannot be estimated to be close to its net selling price and it does not generate cash inflows from continuing use that a re largely independent of those from other assets. Therefore, management must determine the cash-generating unit to which the bus belongs and estimate the recoverable amount of this unit as a whole. If this unit consists of items #1 to #5, the carrying amount of the cash-generating unit (after recognizing the impairment losses on items #2 and #4) is $55,100. the fair value less costs to sell of the cash-generating unit is $54,600 (assuming that the assets could not be sold for more than the aggregate of their individual fair values). The value in use of the cash-generating unit is $52,100 (assuming, again, that the assets do not collectively produce cash flows that are higher than those used in the determination of their individual values in use). Therefore, the recoverable amount of the cash-generating unit is $54,600, giving rise to a further impairment loss of $500. the loss should be allocated on a pro rata basis to items #1, #3, and #5 provided that the carrying amount of each item is not reduced below the highest of its fair value less costs to sell and value in use. This means in practice, that the whole of the loss is allocated to item #5, the bus.

Illustration 7

Bank A purchases 50,000 units of 90 days T-Bills @ Rs.99 from Bank B. at the end of the same day Bank A repurchases from Bank B 50,000 units of 90 day T-Bills @ Rs.99.10. So as per the gross obligation for the first leg of the transaction Bank B needs to pay Rs.49,50,00,000 and for the second lag Bank A needs to pay Rs.49,55,000. By notification to the securities custodian both Bank A and Bank B can make arrangement for the net payment of Rs.5,000. The transactions should be carried out through the same clearing bank. If these conditions are fulfilled, then offsetting is allowed.

The reporting enterprise has the choice to offset the qualified repurchase and reverse repurchase agreements. Such a choice should be applied consistently. However, net receivable arising out of such a transaction cannot be offset against net payables arising out of another set of transactions.

Illustration 8

[Pooling of interest method accounting for business combination]

This is discussed to explain the principle of pooling interest which should be applied for consolidation as well.

Company A acquires 100% of the shares of Company B and Company C on the basis of the following information:

Amount in $ million	**A**	**B**	**C**
Liabilities	100	15	15
Common Stock Par $	500	200	200
Additional Paid in Capital	300	0	100
Retained Earnings	200	20	100
Liabilities & Equity	1100	235	415
Assets	1100	235	415
Shares issued by A (No.)		15	35
Par Value		150	350

In the pooling of A and B, A paid $ 150 million to B which is $ 50 million less than the latter’s Common Stock. So this excess should be added to the paid in capital of the combined balance sheet. in the pooling of A and C, A paid $ 350 million to C which is more than latter’s common stock, so the difference is deducted from the Paid in Capital of C first and in case the deficit remains, it is deducted from the retained earnings of C.

Rule 1: Sum of the individual Common Stock > Combined Common Stock, the Combined Paid In Capital should be increased by the difference.

Rule 2: Sum of the individual Common Stock < Combined Common Stock, first decrease the Combined Paid In Capital and then retained earnings by the difference.

Pooling of Interest Between A & B and A&C

	A&B	A&C
Liabilities	115	115
Common Stock par $ 10	650	850
Additional Paid in Capital	350	300
Retained Earnings	220	250
Liabilities & Equity	**1335**	**1515**

In case the amount paid exceeds the combined equity then deficit should be shown as asset.

Illustration 9

Determining Weighted-Average Shares

Common stock outstanding, 1/1/20X6	200,000 shares
Preferred stock (convertible into 2 shares of common stock) outstanding, 1/1/20X6	50,000 shares
Convertible debentures (convertible into 100 shares of common stock for each $1,000 bond)	$100,000

On March 31, ABC reacquired 5,000 shares of its own common stock.
On May 1, 20,000 shares of ABC preferred stock were converted into common stock.
On July 1, $50,000 of ABC convertible debentures was converted into common stock.
On September 30, ABC reacquired 5,000 shares of its common stock.

Computation of Weighted-Average Shares

1. Common stock outstanding, 1/1/X6	200,000
2. Common stock reacquired, 3/31/X6 (5,000 x 9/12)	(3,750)
3. Conversion of preferred stock on 5/1/X6 (20,000 x 2 x 8/12)	26,667
4. Conversion of convertible debentures on 7/1/X6 (50 x 100 x 6/12)	2,500
5. Common stock reacquired on 9/30/X6 (5,000 x 3/12)	(1,250)
Total weighted average shares, 20 X 6	224,167

Illustration 10

Hari Co. Ltd. has decided to reconcile its financial statements in line with International Financial Reporting Standards. The statement of financial position of Hari Co. Ltd. as at 1st April, 2010 is as follows:

	Rs. '000
Assets	
Fixed Assets	1200
Intangible Assets	400
Financial Assets	400
Inventories	600
Trade & Other Receivables	500
Cash & Cash Equivalents	100
	3200
Liabilities	
Trade & other payables	800

10% Loans from Bank	1300
Current Tax Liability	80
Deferred Tax Liability	20
	2200
Total Assets less Liabilities	1000
Equity	
Issued share Capital	600
Retained Earnings	400
	1000

Other Information:

a. The provision for depreciation was made as per the Indian statutes. Due to reconciliation with the IFRS provisions, the carrying amount of fixed assets needs to be increased by 2,00,000.

b. All financial assets costing Rs.4,00,000 are classified as available for sale category under IAS 39. The fair value of these assets is calculated as 5,00,000 on 1st April, 2010

c. A pension liability of 1,00,000 is recognized under IFRS (not provided earlier). However, no tax implication arises due to recognition of this liability.

d. The value of inventories is Rs.4,00,000 as per IAS 2. The necessary adjustment needs to be done in the book value.

e. Unrealized gain Rs.3,00,000 on unmatured forward foreign exchange contracts (included in receivables) which were not recognized under Indian Accounting Standards are required to be recognized under IFRS.

You are required to prepare reconciled financial statements (in convergence to IFRS), assuming tax rate of 30%. Give necessary working notes.

Solution:

Assets	**Previous GAAPs**	**Adjustment due to Translation to IFRS**	**IFRS**
	Rs. '000	**Rs. '000**	**Rs. '000**
Fixed Assets	1200	200	1400
Intangible Assets	400		400
Financial Assets	400	100	500
Inventories	600	(200)	400
Trade & Other Receivables	500	300	800
Cash & Cash Equivalents	100		100
	3200		3600
Liabilities			
Trade & other payables	800		800
10% Loan from bank	1300		1300
Current Tax Liability	80		80
Deferred tax liability	20	90	110
Pension liability	nil	100	100
(A)	2200		2390

Equity			
Issued Share capital	600		600
Retained Earnings	400	140	540
Investment Revaluation Reserves	nil	70	70
(B)	1000		1210
Total (A+B)	3200		3600

Working Notes:

1. Journal Entries

Particular			Dr.	Cr.
(i)	Fixed Assets	Dr.	2,00,000	
	To Retained Earnings			2,00,000
(ii)	Financial Assets	Dr.	1,00,000	
	To Investment Revaluation Reserves			1,00,000
(iii)	Retained Earnings	Dr.	1,00,000	
	To Pension Liability			1,00,000
(iv)	Retained Earnings	Dr.	2,00,000	
	To Inventories			2,00,000
(v)	Trade & Other Receivables	Dr.	3,00,000	
	To Retained Earnings			3,00,000
(vi)	Investment Revaluation Reserves	Dr.	30,000	
	To Deferred Tax Liability			30,000
(vii)	Retained Earnings	Dr.	60,000	
	To Deferred Tax Liability			60,000

Note: Deferred Taxes are to be created whenever Assets & Liabilities as per books of accounts change.

Balance sheet drafted in the IFRS format.

Assets	
Non Current Assets	
Fixed Assets	1400
Intangible Assets	400
Financial Assets	500
Current Assets	
Inventories	400
Trade & Other Receivables	800
Cash & Cash Equivalents	100
	3600

Liabilities	
Current Liabilities:	
Trade & other payables	800
Current Tax Liability	80
Non current Liabilities	
10% Loan from bank	1300
Deferred tax liability	110
Pension liability	100
(A)	2390
Equity	
Issued Share capital	600
Retained Earnings	540
Investment Revaluation Reserves	70
(B)	1210
Total (A+B)	3600

Chapter – 11

EMPLOYEE STOCK OPTIONS

CANCELLATION AND SETTLEMENTS DURING VESTING PERIOD

If an enterprise cancels or settles a grant of shares or stock options during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) The entire amount of unamortised value of option should be recognised immediately.

(b) Payments made to the employees on cancellation or settlement should be debited to ESOP Outstanding A/c to the maximum extent of fair value of options granted, measured at the cancellation / settlement date. Any payment in excess of the fair value is recognised as an expense.

(c) If new options are granted to the employees in replacement for the cancelled options, the replacement is regarded as modification. The incremental fair value for the purpose is the difference between the fair value of replaced option and net fair value of cancelled option, as on the date of replacement. The net fair value of the cancelled option is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation, that is debited to ESOP Outstanding A/c, in accordance with (b) above.

Illustration 1

The following particulars in respect of stock options granted by a company are available:

Grant date	April 1,2006
Number of employees covered	300
Number options granted per employee	50
Vesting condition: Continuous employment for 4 years	
Nominal value per share (Rs.)	100
Exercise price per share (Rs.)	125
Vesting date	March 31, 2010
Exercise Date	March 31, 2011
Fair value of option per share on grant date (Rs.)	12

The above stock option was cancelled on 31/03/09 on payment of Re. 1.80 per option and was replaced by a new stock option granted on 01/04/09. The fair value of cancelled option on 01/04/09 was Rs. 14.55 per share.

The particulars of new stock option are given below:

Grant date	April 1,2009
Number of employees covered	300
Number options granted per employee	60
Vesting condition: Continuous employment for 3 years	
Nominal value per share (Rs.)	100
Exercise price per share (Rs.)	120
Vesting date	March 31, 2012

Exercise Date	March 31, 2013
Fair value of option per share on grant date (Rs.)	15.75

There were no departures of employees during the period from 2006-07 to 2012-13.

Compute the amount of expense the company should recognise in each of the years from 2006-07 to 2010-12 and show important accounts in books of the company.

Solution:

Year 2006-07 to 2008-09

Fair value of option per share = Rs. 12
Number of shares expected to vest under the scheme = 300 × 50 = 15,000
Fair value = 15,000 × Rs. 12 = Rs. 1,80,000
Vesting period = 4 years
Value of option recognised in each of the years 2006-07 to 2008-09
= Rs. 1,80,000/4 = Rs. 45,000
Payment on cancellation on 31/03/09 = 15,000 × Rs. 1.80 = Rs. 27,000

Year 2009-10 to 2011-12

Fair value of new option per share on 01/04/09 = Rs. 15.75
Fair value of cancelled option per share on 01/04/09 = Rs. 14.55
Net fair value of cancelled option per share on 01/04/09
= Rs. 14.55 – Re. 1.80 = Rs. 12.75
Incremental fair value of option per share = Rs. 15.75 – Rs. 12.75 = Rs. 3
Number of shares expected to vest under the scheme = 300 × 60 = 18,000
Fair value of new option = 18,000 × Rs. 15.75 = Rs. 2,83,500
Incremental fair value = 18,000 × Rs. 3 = Rs. 54,000
Vesting period = 3 years;
Value of option recognised in each of the years 2009-10 to 2011-12
= (Rs. 2,83,500 + Rs. 54,000)/3 = Rs. 1,12,500

Employees' Compensation A/c

Year		Rs.	Year		Rs.
2006-07	To ESOP Outstanding A/c	45,000	2006-07	By Profit & Loss A/c	45,000
		45,000			45,000
2007-08	To ESOP Outstanding A/c	45,000	2007-08	By Profit & Loss A/c	45,000
		45,000			45,000
2008-09	To ESOP Outstanding A/c	45,000	2008-09	By Profit & Loss A/c	45,000
		45,000			45,000
2009-10	To ESOP Outstanding A/c	1,12,500	2009-10	By Profit & Loss A/c	1,12,500
		1,12,500			1,12,500
2010-11	To ESOP Outstanding A/c	1,12,500	2010-11	By Profit & Loss A/c	1,12,500
		1,12,500			1,12,500
2011-12	To ESOP Outstanding A/c	1,12,500	2011-12	By Profit & Loss A/c	1,12,500
		1,12,500			1,12,500

ESOP Outstanding A/c

Year		Rs.	Year		Rs.
2006-07	To Balance c/d	45,000	2006-07	By Employees' Compensation A/c	45,000
		45,000			45,000
2007-08	To Balance c/d	90,000	2007-08	By Balance b/d	45,000
				By Employees' Compensation A/c	45,000
		90,000			90,000
2008-09	To Bank	27,000	2008-09	By Balance b/d	90,000
	To Balance c/d	1,08,000		By Employees' Compensation A/c	45,000
		1,35,000			1,35,000
2009-10	To Balance c/d	2,20,500	2009-10	By Balance b/d	1,08,000
				By Employees' Compensation A/c	1,12,500
		2,20,500			2,20,500
2010-11	To Balance c/d	3,33,000	2010-11	By Balance b/d	2,20,500
				By Employees' Compensation A/c	1,12,500
		3,33,000			3,33,000
2011-12	To Balance c/d	4,45,500	2011-12	By Balance b/d	3,33,000
				By Employees' Compensation A/c	1,12,500
		4,45,500			4,45,500
2009-10	To Share Capital (18,000 × 100)	18,00,000	2009-10	By Balance b/d	4,45,500
	To Securities Premium	8,05,500		By Bank (18,000 × 120)	21,60,000
		26,05,500			26,05,500

Chapter – 12

INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC).

IFRIC 1: CHANGES IN EXISTING DECOMMISSIONING, RESTORATION AND SIMILAR LIABILITIES

Most entities account for their property, plant and equipment using the cost model. Where this is so, these changes are required to be capitalised as part of the cost of the item and depreciated prospectively over the remaining life of the item to which they relate. The corresponding adjustment is given to the liability account.

Where entities account for their property, plant and equipment using the fair value model, a change in the liability does not affect the valuation of the item for accounting purposes. Instead, it alters the revaluation surplus or deficit on the item, which is the difference between its valuation and what would be its carrying amount under the cost model. The effect of the change is treated consistently with other revaluation surpluses or deficits. Any cumulative deficit is taken to profit or loss, but any cumulative surplus is credited to equity. The corresponding adjustment is given to the liability account.

IFRIC 2: MEMBERS' SHARES IN CO-OPERATIVE ENTITIES AND SIMILAR INSTRUMENTS

Shares for which the member has the right to request redemption are normally liabilities. However, they are equity if: the entity has an unconditional right to refuse redemption, or local law, regulation, or the entity's governing charter imposes prohibitions on redemption.

IFRIC 4: DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE

An arrangement that meets the following criteria should be accounted for in accordance with IAS 17 Leases:

- The arrangement conveys a right to control the use of the underlying asset. This is the case if any of the following conditions is met:

  (i) the purchaser in the arrangement has the ability or right to operate the asset or direct others to operate the asset.

  (ii) the purchaser has the ability or right to control physical access to the asset.

  (iii) there is only a remote possibility that parties other than the purchaser will take more than an insignificant amount of the output of the asset and the price that the purchaser will pay is neither fixed per unit of output nor equal to the current market price at the time of delivery.

IFRIC 5: RIGHTS TO INTERESTS ARISING FROM DECOMMISSIONING, RESTORATION AND ENVIRONMENTAL FUNDS

- If an entity recognises a decommissioning obligation under IFRSs and contributes to a fund to segregate assets to pay for the obligation, it should apply consolidation requirements.

- When a fund is not consolidated, the contributor should recognise:

  - its obligation to pay decommissioning costs as a liability, and
  - its rights to receive reimbursement from the fund as a reimbursement.

- When a contributor has an obligation to make potential additional contributions to the fund, that obligation is a contingent liability. When it becomes probable that the additional contributions will be made, a provision should be recognised.

IFRIC 6: LIABILITIES ARISING FROM PARTICIPATING IN A SPECIFIC MARKET - WASTE ELECTRICAL AND ELECTRONIC EQUIPMENT

If an entity has an obligation to contribute to waste management costs based on its share of the market in a measurement period, it should recognize the liability one the liability is trigerred (risen).

The measurement period is a period in which market shares are determined for the purposes of allocating waste management costs.

IFRIC 9: REASSESSMENT OF EMBEDDED DERIVATIVES

An entity must assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

IFRIC 10: INTERIM FINANCIAL REPORTING AND IMPAIRMENT

An entity shall **not** reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

An entity shall not extend this consensus by analogy to other areas of potential conflict between IAS 34 and other standards.

IFRIC 12: SERVICE CONCESSION ARRANGEMENTS

Service concession arrangements are arrangements whereby a government or other body grants contracts for the supply of public services – such as roads, energy distribution, prisons or hospitals – to private operators.

There are two types of service concession arrangement.

- In one, the operator receives a financial asset, a contractual right to receive cash or another financial asset from the government in return for constructing or upgrading the public sector asset.

- In the other, the operator receives an intangible asset – a right to charge for use of the public sector asset that it constructs or upgrades.

Accounting – Financial asset model

The operator recognises a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The operator measures the financial asset at fair value.

Accounting – Intangible asset model

The operator recognises an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. The operator measures the intangible asset at fair value.

IFRIC 13: CUSTOMER LOYALTY PROGRAMMES

Customer Loyalty Programmes addresses accounting by entities that grant loyalty ward credits (such as 'points' or travel miles) to customers who buy other goods or services.

- An entity that grants loyalty award credits shall allocate some of the proceeds of the initial sale to the award credits as a liability (its obligation to provide the awards). The amount of proceeds allocated to the award credits is measured by reference to their fair value.

- The entity shall recognise the deferred portion of the proceeds as revenue only when it has fulfilled its obligations.

IFRIC 14: THE LIMIT ON A DEFINED BENEFIT ASSET, MINIMUM FUNDING REQUIREMENTS AND THEIR INTERACTION

When determining the limit on a defined benefit asset, entities are required to measure any economic benefits available to them in the form of refunds or reductions in future contributions.

It shall recognise an asset measured as the amount of the surplus at the balance sheet date that it has a right to receive as a refund. This is the fair value of the plan assets less the present value of the defined benefit obligation, less any associated costs, such as taxes.

IFRIC 15: AGREEMENTS FOR THE CONSTRUCTION OF REAL ESTATE

An agreement for the construction of real estate is a construction contract within the scope of IAS 11 only when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not).

- If the buyer has that ability, IAS 11 applies.

- If the buyer does not have that ability, IAS 18 applies.

If IAS 11 applies (Construction contract) revenue is recognised on a percentage-of-completion basis provided that reliable estimates of construction progress and future costs can be made.

If IAS 18 applies (Revenue), the agreement may be to provide construction services rather than goods.
If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement is accounted for as the sale of goods under IAS 18.

IFRIC 17: DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS

- a dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity . An entity should measure the dividend payable at the fair value of the net assets to be distributed

- an entity should remeasure the liability at each reporting date and at settlement, with changes recognised directly in equity

IFRIC 18: TRANSFERS OF ASSETS FROM CUSTOMERS (against services or goods)

The recipient must recognise the asset in its financial statements, if the ownership of the asset is transferred.

If the customer continues to control the transferred item, the asset definition would not be met even if ownership of the asset is transferred to the utility or other recipient entity.

IFRIC 19: EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS

- If a debtor issues equity instruments to a creditor to extinguish all or part of a financial liability, the debtor should derecognize the financial liability fully or partly.

- The debtor should measure the equity instruments issued to the creditor at fair value, unless fair value is not reliably determinable, in which case the equity instruments issued are measured at the fair value of the liability extinguished.

- The debtor recognizes in profit or loss the difference between the carrying amount of the financial liability (or part) extinguished and the measurement of the equity instruments issued.