

PAPER – 1 : FINANCIAL REPORTING

QUESTIONS

Consolidated Balance Sheet (Chain Holding)

- From the following Balance Sheets of a group of companies and the other information provided, draw up the consolidated Balance Sheet as at 31.3.2008.

Balance Sheets as at 31.3.2008

						(Rs. in Lakhs)		
						X	Y	Z
Share capital (in shares of Rs. 10 each)	X	Y	Z	Fixed Assets less depreciation		130	150	100
	300	200	100					
Reserves	50	40	30	Investment in Y Ltd.	180	—	—	
Profit and loss A/c	60	50	40	Investment in Z Ltd.	40	80	—	
Bills payables	10	—	5	Stock	50	20	20	
Creditors	30	10	10	Debtors	70	10	20	
Y Ltd. balance	—	—	15	Bills receivables	—	10	20	
Z Ltd. balance	50	—	—	Z Ltd. balance	—	10	—	
				X Ltd. balance	—	—	30	
				Cash and bank balance	<u>30</u>	<u>20</u>	<u>10</u>	
	<u>500</u>	<u>300</u>	<u>200</u>		<u>500</u>	<u>300</u>	<u>200</u>	

Additional Information:

- X Ltd. holds 1,60,000 shares and 30,000 shares respectively in Y Ltd. and Z Ltd.; Y Ltd. holds 60,000 shares in Z Ltd. These investments were made on 1.7.2007 on which date the balances were as follows:

	Y Ltd.	Z Ltd.
Reserves	Rs. 20 Lakhs	Rs. 10 Lakhs
Profit and loss account	Rs. 30 Lakhs	Rs. 16 Lakhs

- In December, 2007 Y Ltd. invoiced goods to X Ltd. for Rs. 40 lakhs at cost plus 25%. The closing stock of X Ltd. includes such goods valued at Rs. 5 lakhs.
- Z Ltd. sold to Y Ltd. an equipment costing Rs. 24 lakhs at a profit of 25% on selling price on 1.1.2008. Depreciation at 10% per annum was provided by Y Ltd. on this equipment.
- Bills payables of Z Ltd. represent acceptances given to Y Ltd. out of which Y Ltd. had discounted bills worth Rs. 3 lakhs.

(e) Debtors of X Ltd. include Rs. 5 lakhs being the amount due from Y Ltd.

X Ltd. proposes dividend at 10%.

Investment in Associates (Equity method)

2. Consolidated balance sheet of Hydra Ltd. group and its associate Amoeba Ltd., as on 31.03.08 before adjustment for equity method are given below:

(Rs. in '000s)					
Liabilities	Hydra Ltd.	Amoeba Ltd.	Assets	Hydra Ltd.	Amoeba Ltd.
Share Capital (Rs.10)	600	100	Goodwill	10	
P & L A/c	300	-	Sundry Assets	1,175	130
Minority Interest	75	-	Investment in Amoeba Ltd.	15	-
Sundry Liabilities	<u>225</u>	<u>150</u>	P & L A/c	-	<u>120</u>
	<u>1,200</u>	<u>250</u>		<u>1,200</u>	<u>250</u>

Hydra Ltd. acquired 30% of ordinary shares of Amoeba Ltd., on 01.04.06 for Rs.15,000. The balance of Amoeba Ltd., profit and loss account on that date was Rs.40,000 (Debit).

Show adjustment for equity method and redraft the consolidated balance sheet of the group as on 31.3.08.

Demerger

3. The Balance Sheet of Z Ltd. as at 31st March, 2007 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

(All amounts in crores of Rupees)			
	S Division	W Division	Total
Fixed Assets:			
Cost	875	249	
Less: Depreciation	<u>360</u>	<u>81</u>	
Written-down value	<u>515</u>	<u>168</u>	683
Investments			97
Net Current assets:			
Current Assets	445	585	
Less: Current Liabilities	<u>270</u>	<u>93</u>	
	<u>175</u>	<u>492</u>	<u>667</u>
			<u>1,447</u>

Financed by:

Loan funds	15	417
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Own funds:

Equity share capital: shares of Rs. 10 each		345
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Reserves and surplus		<u>685</u>
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1,447

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2006 and 30th September, 2007.

On 1st April, 2007 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs. 900 crore divided into shares of Rs. 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd. allotting to Z Ltd.'s shareholders its two fully paid equity shares of Rs. 10 each at par for every fully paid equity share of Rs. 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs. 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to:

- Show the journal entries in the books of Z Ltd.
- Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).
- Calculate the intrinsic value of one share of Z Ltd. immediately before the demerger and immediately after the demerger; and
- Calculate the gain, if any, per share to the shareholders of Z Ltd. arising out of the demerger.

Valuation of business

- Xeta Ltd. plans to take over Beta Ltd. Independent Cash Flow forecasts of the companies are as follows:

Year	1	2	3	4	5
Xeta Ltd. (Rs. in lakhs)	2,00	2,25	2,50	2,70	2,85
Beta Ltd. (Rs. in lakhs)	50	65	80	95	110
Year	6	7	8	9	10

Xeta Ltd. (Rs. in lakhs)	3,10	3,50	6,00	6,10	6,50
Beta Ltd. (Rs. in lakhs)	1,20	1,30	1,50	1,70	1,80

Following further information is available from the latest Balance Sheet of Beta Ltd.

Assets:		Rs. in lakhs
Fixed Assets		5,00
Stock		1,15
Debtors		<u>50</u>
		6,65
Less: Liabilities		
Sundry creditors	1,65	
Long term loan	<u>2,00</u>	<u>(3,65)</u>
Net assets		<u>3,00</u>

Xeta Ltd. finds that fixed assets of book value Rs.75 lakhs will not be used which will fetch Rs.50 lakhs on immediate disposal. Moreover, stock will fetch Rs.140 lakhs and debtors Rs.48 lakhs immediately. But Xeta Ltd. has to payoff the liabilities immediately. Also it has to pay Rs.110 lakhs to workers of Beta Ltd. whose service cannot be used. It appears that after merger Xeta Ltd. has to invest Rs.210 lakhs for renovation of the plant and machinery at the end of 1st year and Rs.50 lakhs for modernization at the end of 2nd year after merger.

Forecast of cash flows of Xeta Ltd. after merger.

Year	1	2	3	4	5
Cash flows (Rs. in lakhs)	2,40	2,80	3,50	4,00	4,10

Year	6	7	8	9	10
Cash flows (Rs. in lakhs)	4,80	5,50	8,00	8,80	9,50

Determine the maximum value of Beta Ltd. which its management should ask from Xeta Ltd. You may use 20% discount rate.

Valuation of shares

5. Balance Sheet of Symphony Ltd. as at 31st March, 2008 is given below:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed assets:	
6,000 Equity shares of Rs.100 each fully paid up	6,00,000	Building	1,50,000

Reserve and Surplus:		Machinery	2,20,000
Profit and Loss A/c	50,000	Current assets, loans and advances:	
Current liabilities and provisions:		Stock	3,00,000
Bank overdraft	10,000	Sundry debtors	1,60,000
Creditors	60,000	Bank	60,000
Provision for taxation	1,10,000		
Proposed dividend	<u>60,000</u>		
	<u>8,90,000</u>		<u>8,90,000</u>

The net profits of the company, after deducting usual working expenses but before providing for taxation, were as under:

Year	Rs.
2005-06	2,00,000
2006-07	2,40,000
2007-08	2,20,000

On 31st March, 2008, Building was revalued at Rs.2,00,000 and Machinery at Rs. 2,50,000. Sundry debtors, on the same date, included Rs.10,000 as irrecoverable. Having regard to nature of the business, a 10% return, on net tangible capital invested, is considered reasonable.

You are required to value the company's share ex-dividend. Valuation of goodwill may be based on three year's purchase of annual super profits. Depreciation on Building- 2%, and on Machineries-10%. The income-tax rate is to be assumed at 50%. All workings should form part of your answer.

Inflation Accounting

6. High Ltd. had the following monetary items on January 1:

	Rs.
Debtors	41,000
Bills Receivable	10,000
Cash	<u>20,000</u>
	71,000
Less :Bills Payable	10,000
Creditors	<u>25,000</u>
	<u>35,000</u>
	<u>36,000</u>

The transactions affecting, monetary items during the year were

- (a) Sales of Rs.1,40,000 made evenly throughout the year.
- (b) Purchases of goods of Rs.1,05,000 made evenly during the year.
- (c) Operating expenses of Rs.35,000 were incurred evenly throughout the year.
- (d) One machine was sold for Rs.18,000 on July 1.
- (e) One machine was purchased for Rs.25,000 on December 31.

The general price index was as follows:

On January 1	300
Average for the year	350
On July 1	360
On December 31	400

You are required to compute the general purchasing power, gain or loss, for the year stated in terms of the current year-end rupee.

Employee Share Based Payments

7. Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2005 for Rs.20, depending upon the employees at the time of vesting of options. The market price of the share is Rs.50. These options will vest at the end of year 1 if the earning of Choice Ltd. increases 16%, or it will vest at the end of the year 2 if the average earning of two years increases by 13%, or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2006. 4,000 unvested options lapsed on 31.3.2007 and finally 3,500 unvested options lapsed on 31.3.2008.

Following is the earning of Choice Ltd. :

Year ended on	Earning (in %)
31.3.2006	14%
31.3.2007	10%
31.3.2008	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

Financial Instruments

8. (a) What is embedded derivative and when should it be accounted as derivative?
 (b) How is the embedded derivative measured?

- (c) On April 1, 2007, Omega Ltd. borrowed Rs. 10 lakh at annual fixed interest rate of 7% payable half-yearly. The life of the loan is 4 years with no pre-payment permitted. The company expected the interest rate to fall and on the same day, it entered into an interest rate swap arrangement, whereby the company would pay 6-month LIBOR and would receive annual fixed interest of 7% every half-year. The swap effectively converted the company's fixed rate obligation to floating rate obligation.

The following value of swap and debt are available

	Value of swap	Value of debt
	Rs.in lakh	Rs. in lakh
April 1, 2007	+ 0.2	10.2
March 31, 2008	– 0.1	9.9

Six-month LIBOR on April 1, 2007 was 6% and that on October 1, 2007 was 8%.

Show important accounting entries in respect of the swap arrangement.

Economic Value Added

9. Calculate EVA from the following data for the year ended 31st March, 2008

	(Rs. in lakhs)
Average debt	50
Average equity	2766
Cost of debt (post tax)	7.72%
Cost of equity	16.7%
Weighted average cost of capital	16.54%
Profit after tax, before exceptional item	1541
Interest after tax	5

Human Resource Accounting

10. XYZ Ltd., has a capital base of Rs.5,00,000 and it earned profits of Rs.50,000. The return on investment of the same group of firms is 12%. If the services of a particular Engineer, Mr. X is acquired, it is expected that the profits will raise by Rs.30,000 over and above the target profit. Determine the amount of maximum bid price for that particular engineer.

Mutual Fund

11. SBI Plant Chip Mutual Funds have introduced a scheme 'ABC Premier'. Its major details are as follows:

Scheme name	:	ABC Premier
Scheme size	:	Rs. 1,00,00,00,000

Face value of units : Rs. 20
 Investments : In shares
 Market value of shares : Rs. 1,50,00,00,000

You are required to compute the net assets value per unit of ABC Premier. Is there any appreciation of the value invested in units of ABC Premier?

NBFC

12. Mahindra Finance Ltd. is a non-banking finance company. The extracts of its balance sheet are given below:

Liabilities	Amount	Assets	Amount
Paid up equity share capital	100	Leased out Assets Investment:	800
Free Reserves	500	In shares of subsidiaries and	
Loans	400	group companies	100
Deposits	400	In debentures of subsidiaries	
		and	
		group companies	100
		Cash and Bank balances	200
		Deferred Expenditure	<u>200</u>
	<u>1,400</u>		<u>1,400</u>

You are required to compute Tier – I Capital of Mahindra Finance Ltd. according to NBFC Prudential Norms (RBI) Directions 1998.

Brand Valuation

13. What are the difficulties in accounting of brands? Explain in brief.

Corporate Financial Reporting

14. Describe the role of SEBI in Indian financial reporting system.

Indian AS, IFRS and US GAAPs

15. Explain significant differences and similarities between Indian Accounting standards, IAS/IFRS and US GAAPs on the issues of :
- Impairment of assets.
 - Earnings per share- diluted.

Merchant Banker

16. What capital adequacy requirements are required to be followed by a merchant banker?

Theory questions based on Accounting Standards

17. (a) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?
- (b) What are the different forms of joint ventures?
- (c) Elucidate the presentation and disclosure norms of Joint Ventures under AS 27.
- (d) Discuss the provisions relating to recognition of impairment loss.
- (e) Explain the provisions relating to combining of construction contracts.
- (f) How will you recognize the gains and losses on retirement or disposal of fixed assets?
- (g) What accounting treatment is followed in case of refund of government grant?
- (h) Distinguish between
 - (i) Integral foreign operation and Non-integral foreign operation.
 - (ii) Operating lease and Non-operating lease.
- (i) Who are related parties under AS 18? What are the related party disclosure requirements?

Practical questions based on Accounting Standards

18. (a) The financial statement of Constructions Limited for the year ended 31st March, 2008 were considered and approved by the board of directors on 20th May, 2008.
 The company was engaged in construction work involving Rs.10 crores. In the course of execution of work, a portion of factory shed under construction came crashing down on 30th May, 2008. Fortunately, there was no loss of life, but the company will have to rebuild the structure at an additional cost of Rs.2 crores which cannot be recovered from the contractee.
 How should this event be reported?
- (b) Accountants of Poornima Ltd. showed a net profit of Rs.7,20,000 for the third quarter of 2007 after incorporating the following:
 - (i) Bad debts of Rs.40,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
 - (ii) Extra ordinary loss of Rs.35,000 incurred during the quarter has been fully recognized in this quarter.
 - (iii) Additional depreciation of Rs.45,000 resulting from the change in the method of charge of depreciation.
 Ascertain the correct quarterly income.

- (c) ABC Ltd., had reported a net profit of Rs.80,00,000 for the year ended 31st March, 2008 on which date the company is having 25,00,000 equity shares of Rs.10 each outstanding.

The average fair value of one equity share during the year 2007-08 is Rs.32. The details of exercisable option are given below:

Weighted average number of shares under stock option scheme during the year 2007-08	5,00,000
Exercise price for shares under stock option during the year ended 31.3.2008	Rs.25

You are required to calculate (a) Basic EPS, and (b) Diluted EPS.

- (d) A Ltd. purchased fixed assets costing Rs. 3,000 lakhs on 1.1.2007 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = Rs. 40.00 and Rs. 42.50 as on 1.1.2007 and 31.12.2007 respectively. First instalment was paid on 31.12.2007. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

19. (a) An amount of Rs.20,00,000 was incurred for construction of a building and it was ready for occupation on 31.12.2007. The construction expenditure was incurred out of working capital facilities availed from the Bank. Interest payable to it @ 15% p.a. The average working capital loan has never fallen below Rs.25 lakhs during the construction period.

The details of expenditure incurred are as follows:	(Rs.)
July 2007	3,00,000
August, 2007	4,50,000
September, 2007	2,00,000
October, 2007	5,00,000
November, 2007	3,00,000
December, 2007	<u>2,50,000</u>
	<u>20,00,000</u>

Calculate the value of the qualifying asset.

- (b) X Company has entered into a sale contract of Rs.10,00,000 with B Company during financial year 2006-07. The profit on this transaction is Rs.2,00,000. The delivery of the goods to be taken place during the first month of the financial year 2007-2008. In case of failure of X Company to deliver within the schedule, a compensation of Rs.3,00,000 is to be paid to B Company. X Company planned to manufacture the goods during the last month of the financial year 2006-2007. As on the Balance Sheet date (i.e., 31-3-2007), goods were not manufactured and it was unlikely that X Company would be in a position to meet the contractual obligation.

- (a) Should X Company provide for the contingency?

- (b) Should X company measure provision as the excess of compensation to be paid over the profit?
- (c) Alpha Ltd., purchased a Fixed Asset four years back at a cost of Rs.100 lakhs and depreciates it on SLM basis at 10% per annum. At the end of this year, it has revalued the asset at Rs.50 lakhs and has written off the loss on revaluation to the Profit and Loss Account. However, on the date of revaluation, the market price is Rs.45 lakhs and the expected disposal costs are Rs.2 lakhs. What will be the treatment in respect of Impairment Loss on the basis that fair value for revaluation purposes is determined by market value and Value in Use is estimated at Rs.40 lakhs?
- (d) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are Rs. 3,00,000. The amount will be paid in 3 instalments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is Rs. 40,000. The (internal rate of return) IRR of the investment is 10%. The present value of annuity factor of Re. 1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of Re. 1 due at the end of 3rd year at 10% rate of interest is 0.7513.
- (i) State with reason whether the lease constitutes finance lease.
- (ii) Calculate unearned finance income.
20. (a) Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment. Having fulfilled all the conditions under the scheme, the company on its investment of Rs. 50 crore in capital assets, received Rs. 10 crore from the Government in January, 2008 (accounting period being 2007-2008). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2008.
- Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.
- (b) From the following summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2008 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.03.2008

	Rs.'000		Rs.'000
Balance as on 1.4.2007	50	Payment to Suppliers	2,000
Issue of Equity shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead expense	200
Sale of fixed assets	100	Wages and salaries	100

Taxation	250
Dividend	50
Repayment of bank loan	300
<u>Balance on 31.03.2008</u>	<u>150</u>
<u>3,250</u>	<u>3,250</u>

21. (a) Big Ltd. and Small Ltd. have set up a joint venture, JV, in the ratio of 40% and 60% respectively. Both Big Ltd. and Small Ltd. are required to prepare consolidated financial statements. The balance sheets of both co-venturers and JV are given below:

	Big Ltd. Rs.	Small Ltd. Rs.	JV Rs.
Share Capital	5,00,000	3,00,000	1,00,000
Reserves	3,00,000	1,00,000	50,000
Loans	<u>2,00,000</u>	<u>1,00,000</u>	<u>30,000</u>
	<u>10,00,000</u>	<u>5,00,000</u>	<u>1,80,000</u>
Fixed Assets	8,00,000	3,50,000	1,20,000
Investment in JV	40,000	60,000	—
Net working capital	<u>1,60,000</u>	<u>90,000</u>	<u>60,000</u>
	<u>10,00,000</u>	<u>5,00,000</u>	<u>1,80,000</u>

Show the reporting of JV in the consolidated financial statements of Big Ltd. and Small Ltd.

- (b) During 2004, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	Amount (Rs.)
Completion of detailed programme and design	25,000
Coding and Testing	20,000
Other coding costs	42,000
Testing costs	12,000
Product masters for training materials	13,000
Duplication of computer software and training materials, from product masters (2,000 units)	40,000
Packing the product (1,000 units)	11,000

What amount should be capitalized as software costs in the books of the company, on Balance Sheet date?

- (c) X Limited sold to Y Limited goods having a sales value of Rs. 25 lakhs during the financial year ended 31.03.2008. Mr. A, the Managing Director and Chief Executive of X Limited owns nearly 100 percent of the capital of Y Limited. The sales were made to Y Limited at the normal selling price of X Limited. The Chief Accountant of X Limited does not consider that these sales should be treated differently from any other sale made by the company despite being made to a controlled company, because the sales were made at normal and, that too, at arms' length prices.

Discuss the above issue from the view point of AS 18.

- (d) A plant was depreciated under two different methods as under:

Year	SLM (Rs. in lakhs)	W.D.V. (Rs. in lakhs)
1	7.80	21.38
2	7.80	15.80
3	7.80	11.68
4	<u>7.80</u>	<u>8.64</u>
	<u>31.20</u>	<u>57.50</u>
5	7.80	6.38

What should be the amount of resultant surplus/deficiency, if the company decides to switch over from W.D.V. method to SLM method for first four years? Also state, how will you treat the same in Accounts.

22. (a) The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

	Rs. In lakhs						
Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1,200

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

- (b) The following details are available in the books of ABC Ltd.,

Particulars	Rs. in lakhs
Provision for tax:	
For 2005-2006	200
For 2006-2007	300
For 2007-2008	250
Advance tax paid:	
For 2005-2006	175
For 2006-2007	350
For 2007-2008	270

ABC Ltd. estimates its Deferred Tax Liabilities to be Rs.100 lakhs and its Deferred Tax Assets to be Rs.20 lakhs. How will the above be disclosed?

- (c) A healthcare goods producer has changed the product line as follows:

	Washing soap	Bathing soap
January 2007 – September, 2007 per month	2,00,000	2,00,000
October 2007 – December 2007 per month	1,00,000	3,00,000
January, 2008 – March, 2008 per month	0	4,00,000

The company has enforced a gradual enforcement of change in product line on the basis of an overall plant capacity. The Board of Directors of the Company has passed a resolution in March, 2007 to this effect. The company follows calendar year as its accounting year. Should it be treated as discontinuing operation?

- (d) A company reports the following information regarding pension plan assets. Calculate the fair value of plan assets.

	Amount (Rs.)
Fair market value of plan assets (beginning of year)	7,00,000
Employer Contribution	1,00,000
Actual return on plan assets	50,000
Benefit payments to retirees	40,000

23. (a) A firm of contractors obtained a contract for construction of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 2007:

	(Rs. in lakhs)
Total Contract Price	1,000
Work Certified	500

Work not Certified	105
Estimated further Cost to Completion	495
Progress Payment Received	400
To be Received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by your institute.

- (b) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2008.

A claim lodged with the Railways in March, 2005 for loss of goods of Rs. 2,00,000 had been passed for payment in March, 2008 for Rs. 1,50,000. No entry was passed in the books of the Company, when the claim was lodged.

- (c) An unquoted long term investment is carried in the books at a cost of Rs. 2 lakhs. The published accounts of the unlisted company received in May, 2008 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than Rs. 20,000. How will you deal with this in preparing the financial statements of R Ltd. for the year ended 31st March, 2008?

Practical questions based on Guidance Notes

24. Briefly explain as per relevant Guidance Notes:

- (a) HSL Ltd. is manufacturing goods for local sale and exports. As on 31st March, 2008, it has the following finished stocks in the factory warehouse:
- (i) Goods meant for local sale Rs. 100 lakhs (cost Rs. 75 lakhs).
 - (ii) Goods meant for exports Rs. 50 lakhs (cost Rs. 20 lakhs).

Excise duty is payable at the rate of 16%. The company's Managing Director says that excise duty is payable only on clearance of goods and hence is not a cost. Please advise HSL using guidance note, if any issued on this, including valuation of stock.

- (b) SFL Ltd. is a mutual fund. The fund values the investment on "mark to market basis". The Accountant argues since investment are valued on the above basis there is no necessity to disclose depreciation separately in the financial statements. Do you agree?

25. (a) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.
- (b) On 24th January, 2008 A of Chennai sold goods to B of Washington, U.S.A. for an invoice price of \$40,000 when the spot market rate was Rs.44.20 per US \$.

Payment was to be received after three months on 24th April, 2008. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, A immediately acquired a forward contract to sell on 24th April, 2008 US \$ 40,000 @ Rs.43.70. A closed his books of account on 31st March, 2008 when the spot rate was Rs.43.20 per US \$. On 24th April, 2008, the date of receipt of money by A, the spot rate was Rs.42.70 per US \$.

Pass journal entries in the books of A to record the effect of all the above mentioned effects.

SUGGESTED ANSWERS/HINTS

1. Consolidated Balance Sheet of X Ltd.
and its subsidiaries Y Ltd. and Z Ltd.
as at 31st March, 2008

				(Rs. in lakhs)	
Liabilities		Amount	Assets		Amount
Share capital		300.00	Fixed Assets		
Minority (W.N.4)	Interest		X Ltd.		130.00
	Y Ltd.	63.08	Y Ltd.		150.00
	Z Ltd.	<u>16.22</u>	Z Ltd.		<u>100.00</u>
Capital (W.N.3)	Reserve	13.40			380.00
			Less: Unrealised profit (W.N.5)	<u>7.80</u>	372.20
Other (W.N.7)	Reserves	81.60	Stock		
Profit & Loss Account (W.N.6)		56.90	X Ltd.		50.00
Bills Payables			Y Ltd.		20.00
	X Ltd.	10.00	Z Ltd.		<u>20.00</u>
	Y Ltd.	<u>5.00</u>			90.00

	15.00		Less: Unrealised profit (W.N.8)	<u>1.00</u>	89.00
Less: Mutual indebtedness	<u>2.00</u>	13.00	Debtors		
Creditors			X Ltd.	70.00	
X Ltd.	30.00		Y Ltd.	10.00	
Y Ltd.	10.00		Z Ltd.	<u>20.00</u>	
Z Ltd.	<u>10.00</u>			100.00	
	50.00		Less: Mutual indebtedness	<u>5.00</u>	95.00
Less: Mutual indebtedness	<u>5.00</u>	45.00	Cash and Bank Balances		60.00
Current Account Balances			Bills Receivables		
			Y Ltd.	10.00	
X Ltd.	50.00		Z Ltd.	<u>20.00</u>	
Z Ltd.	<u>15.00</u>			30.00	
	65.00		Less: Mutual indebtedness	<u>2.00</u>	28.00
Less: Mutual indebtedness (10+ 30)	<u>40.00</u>	25.00			
Proposed Dividend	<u>30.00</u>				
	<u>644.20</u>				<u>644.20</u>

Working Notes:

(Rs. in lakhs)

(1) Analysis of Profits of Z Ltd.	Capital Profit	Revenue Reserve	Revenue profit
Reserves on 1.7.2007	10.00	-	-
Profit and Loss A/c on 1.7.2007	16.00		-

Increase in Reserves	-	20.00	-
Increase in Profit	<u>-</u>	<u>-</u>	<u>24.00</u>
Total	26.00	20.00	24.00
Less: Minority Interest (10%)	<u>2.60</u>	<u>2.00</u>	<u>2.40</u>
	<u>23.40</u>	<u>18.00</u>	<u>21.60</u>
Share of X Ltd. (30% of total)	7.80	6.00	7.20
Share of Y Ltd. (60% of total)	15.60	12.00	14.40
(2) Analysis of Profits of Y Ltd.			
Reserves on 1.7.2007	20.00	-	-
Profit and Loss A/c on 1.7.2007	30.00	-	-
Increase in Reserves	-	20.00	-
Increase in Profit	<u>-</u>	<u>-</u>	<u>20.00</u>
	50.00	20.00	20.00
Share in Z Ltd.	<u>-</u>	<u>12.00</u>	<u>14.40</u>
	50.00	32.00	34.40
Less: Minority Interest (20%)	<u>10.00</u>	<u>6.40</u>	<u>6.88</u>
Share of X Ltd. (80%)	<u>40.00</u>	<u>25.60</u>	<u>27.52</u>
(3) Cost of Control		(Rs. in Lakhs)	
Investments in Y Ltd.			180.00
Investments in Z Ltd.			<u>120.00</u>
			300.00
Less: Paid up value of investments			
in Y Ltd.	160.00		
in Z Ltd.	<u>90.00</u>	250.00	
Capital Profit			

	in Y Ltd.	40.00	
	in Z Ltd.	<u>23.40</u>	<u>63.40</u> (313.40)
	Capital Reserve		<u>13.40</u>
(4)	Minority Interest	Y Ltd.	Z Ltd.
	Share Capital	40.00	10.00
	Capital Profit	10.00	2.60
	Revenue Reserves	6.40	2.00
	Revenue Profits	<u>6.88</u>	<u>2.40</u>
		63.28	17.00
	Less: Unrealised profit on stock (20% of 1)	0.20	-
	Unrealised profit on equipment (10% of 7.8)	<u>-</u>	<u>0.78</u>
		<u>63.08</u>	<u>16.22</u>
(5)	Unrealised Profit on sales of equipment		
	Cost		24.00
	Profit		<u>8.00</u>
	Selling Price $\left[\left(\frac{24}{75} \right) \times 100 \right]$		<u>32.00</u>
	Unrealised profit = $8 - 8 \times \frac{10}{100} \times \frac{3}{12} = 8.00 - 0.20 =$		7.80
(6)	Consolidated Profit and Loss Account		(Rs. in Lakhs)
	Balance		60.00
	Less: Proposed Dividend		<u>30.00</u>
			30.00
	Share in Y Ltd.		27.52
	Share in Z Ltd.		<u>7.20</u>
			64.72
	Less: Unrealised profit on equipment (90% of 7.8)		<u>7.02</u>
			57.70
	Less: Unrealised profit on stock $\left(5 \times \frac{25}{125} \times 80\% \right)$		<u>.80</u>
			<u>56.90</u>

(7) Consolidated reserves	
X Ltd.	50.00
Share in Y Ltd.	25.60
Share in Z Ltd.	<u>6.00</u>
	<u>81.60</u>
(8) Unrealised profit on stock $\left(\frac{5}{125} \times 25 \right)$	1.00

2. (Rs. in '000s)

Closing equity = 30% of (100 – 120) = (6)

Pre-acquisition equity = 30% of (100 – 40) = 18

Calculation of capital reserve/ goodwill

	(Rs. '000s)
Investments in Amoeba Ltd.	15
Less : Pre-acquisition equity	<u>18</u>
Capital Reserve	<u>3</u>
Post-acquisition loss = 30% of (120 – 40) = 24	

Adjustment for equity method

	Rs.	Rs.
P & L A/c	18	Balancing figure
To Capital Reserve		3
To Investment in Amoeba Ltd.		15
		Carrying amount

Note: Loss not recognized = Rs.24 – Rs.18 = Rs.6

Consolidated Balance Sheet of Hydra Ltd., group as at 31.3.2008

Liabilities	Rs.000	Assets	Rs.000
Share Capital (Rs.10)	600	Goodwill	10
P & L A/c (300 – 18)	282	Sundry Assets	1,175
Capital Reserve	3		
Minority Interest	75		
Sundry Liabilities	<u>225</u>		
	<u>1,185</u>		<u>1,185</u>

3. (i) In Z Ltd.'s Books
Journal Entries

		(Rs. in crores)	
		Dr.	Cr.
		Amount	Amount
		Rs.	Rs.
Bank Account (Current Assets)	Dr.	102	
To Investments			97
To Profit and Loss Account (Reserves and Surplus)			5
(Sale of investments at a profit of Rs. 5 crore)			
Debentures (Loan Funds)	Dr.	125	
To Bank Account (Current Assets)			125
(Redemption of debentures at par)			
Current Liabilities	Dr.	93	
Bank Loan (Loan Funds)	Dr.	15	
Provision for Depreciation	Dr.	81	
Reserves and Surplus (Loss on Demerger)	Dr.	645	
To Fixed Assets			249
To Current Assets			585
(Assets and liabilities pertaining to W Division taken out of the books on transfer of the division to Y Ltd.)			

(ii) (a) Z Ltd.'s Balance Sheet after demerger

	Rs. in crores	Rs. in crores
Fixed Assets		
Gross Block	875	
Less: Depreciation	<u>360</u>	515
Net Current Assets		
Current Assets	422	
Less: Current Liabilities	<u>270</u>	<u>152</u>
		<u>667</u>
Financed by Shareholders' Funds		
Equity Share Capital	345	

Reserves and Surplus	<u>45</u>	390
Loan Funds		<u>277</u>
		<u>667</u>

Working Notes:

Rs. in crores

1. Reserves and Surplus		
Balance as on 31st March, 2007		685
Add: Profit on sale of investments		<u>5</u>
		690
Less: Loss on demerger		<u>645</u>
Balance shown in balance sheet after demerger		<u>45</u>
2. Loan Funds		
Balance as on 31st March, 2007		417
Less: Bank Loan transferred to Y Ltd.	15	
Debentures redeemed	<u>125</u>	<u>140</u>
Balance shown in balance sheet after demerger		<u>277</u>
3. Current Assets		
Balance as on 31st March, 2007		445
Add: Cash received from sale of investments		<u>102</u>
		547
Less: Cash paid to redeem debentures		<u>125</u>
Balance shown in balance sheet after demerger		<u>422</u>

(b) Initial Balance Sheet of Y Ltd.

	Rs. in crores	Rs. in crores
Fixed Assets		218
Net Current Assets		
Current Assets	585	
Less: Current Liabilities	<u>93</u>	<u>492</u>
		<u>710</u>

Financed by	
Shareholders' funds:	
Capital (Issued for acquisition of business)	690
Capital Reserve*	5
Loan Funds	<u>15</u>
	<u>710</u>

(iii) Calculation of intrinsic value of one share of Z Ltd.

	Rs. in crores
Before demerger	
Fixed Assets	683
Net current assets Rs.(667 + 102 – 125)	<u>644</u>
	1,327
Less: Loan funds Rs.(417 – 125)	<u>292</u>
	<u>1,035</u>

$$\text{Intrinsic Value per share} = \text{Rs. } \frac{1,035 \text{ crores}}{34.5 \text{ crores}} = \text{Rs. 30 per share}$$

After demerger	
Fixed Assets	515
Net Current Assets Rs.(175 + 102 – 125)	<u>152</u>
	667
Less: Loan funds	<u>277</u>
	<u>390</u>

$$\text{Intrinsic Value of one share} = \text{Rs. } \frac{390 \text{ crores}}{34.5 \text{ crores}} = \text{Rs. 11.30 per share}$$

(iv) Gain per share to Shareholders:

After demerger, for every share in Z Ltd. the shareholder holds 2 shares in Y Ltd.

	Rs.
Value of one share in Z Ltd.	11.30
Value of two shares in Y Ltd. (Rs. 10 × 2)	<u>20.00</u>
	31.30
Less: Value of one share before demerger	<u>30.00</u>
Gain per share	<u>1.30</u>

* Capital Reserve has been calculated as		Rs. in crores
Purchase consideration		690
Less: Assets transferred	710	
Less: Loan funds transferred	<u>(15)</u>	<u>695</u>
Capital reserve		<u>5</u>

The gain per share amounting Rs. 1.30 is due to appreciation in the value of fixed assets by Y Ltd.

4. Statement Showing maximum value to be quoted

Particulars	Rs.in Lakhs	Rs.in Lakhs
Value of merged entities as per discounted cashflows (W.N.1)		502.38
Add: Cash to be collected immediately on disposal of assets		
i. Fixed assets	50.00	
ii. Stock	140.00	
iii. Debtors	<u>48.00</u>	238.00
Less:		
i. Sundry creditors	165.00	
ii. Long term loan	200.00	
iii. Compensation to workers	110.00	
iv. Renovation of plant and machinery (210×0.8333) [PV]	174.99	
v. Modernisation of Plant and machinery (50 x 0.6944)	<u>34.72</u>	<u>(684.71)</u>
Maximum value to be quoted (a+b-c)		<u>55.67</u>

So, Beta Ltd. can quote as high as Rs.55,67,000 for take over.

Working Note:

Valuation of Xeta Ltd. in case of merger

Year	Cash flow after merger	Cash flow of Xeta Ltd before merger	Incremental cash flow	Discount factor 20%	Discounted cash flow @
(1)	(2)	(3)	(4)= (2)-(3)	(5)	(6) = (4) ×(5)
1	240	200	40	0.8333	33.33
2	280	225	55	0.6944	38.19
3	350	250	100	0.5787	57.87
4	400	270	130	0.4823	62.70
5	410	285	125	0.4019	50.24
6	480	310	170	0.3349	56.93
7	550	350	200	0.2791	55.82
8	800	600	200	0.2326	46.52
9	880	610	270	0.1938	52.33
10	950	650	300	0.1615	<u>48.45</u>
					<u>502.38</u>

5. Statement showing valuation of shares (ex-dividend)

	Rs.
Net trading assets (W.N.2)	7,80,000
Add: Goodwill (W.N.3)	79,000
Less: Proposed dividend	<u>(60,000)</u>
Net assets available for equity shareholders	<u>7,99,000</u>
No. of shares outstanding	<u>6,000 Shares</u>
Value per share (7,99,000 ÷ 6,000)	<u>133.17</u>

Working Notes

1. Calculation of FMP (Future Maintainable Profits)

Particulars	Rs.	Rs.
Profits for the year		
2005- 06	2,00,000	
2006- 07	2,40,000	
2007- 08	<u>2,20,000</u>	6,60,000
Less: Bad debts as on 31.03.08		<u>(10,000)</u>
Profits for 3 years		<u>6,50,000</u>
Average profits for 3 years (Rs. 6,50,000 ÷ 3)		2,16,667
Less: Additional depreciation on revaluation of assets		
(i) Buildings 2% on Rs.50,000 (Rs.2,00,000 – Rs.1,50,000)	1,000	
(ii) Machinery 10% on Rs.30,000 (Rs.2,50,000 – Rs.2,20,000)	<u>3,000</u>	<u>(4,000)</u>
Profit before tax		2,12,667
Less : Income tax @ 50%		<u>1,08,334*</u>
Profit after tax/FMP		<u>1,04,333</u>

* Income tax

Particulars	Rs.
Profit before tax	2,12,667
Add: Depreciation not allowable	<u>4,000</u>
Taxable income	<u>2,16,667</u>
Income tax @ 50%	1,08,334

2. Trading capital employed

Particulars	Rs.	Rs.
Assets		
(i) Buildings	2,00,000	
(ii) Machinery	2,50,000	
(iii) Stock	3,00,000	
(iv) Sundry debtors (1,60,000 – 10,000)	1,50,000	
(v) Bank	<u>60,000</u>	9,60,000
Less: Liabilities		
(i) Creditors	60,000	
(ii) Provision for taxation	1,10,000	
(iii) Bank overdraft	<u>10,000</u>	<u>(1,80,000)</u>
Net trading assets/ closing capital employed		<u>7,80,000</u>

3. Valuation of goodwill (Super profits method)

Particulars	Rs.
Closing capital employed (W.N. 2)	7,80,000
Normal rate of return	10%
Normal profit	78,000
Future maintainable profit (W.N. 1)	1,04,333
Super profit (FMP – Normal profit)	26,333
No. of years of purchase (given)	3 years
Goodwill (rounded off)	79,000

6. STATEMENT OF GENERAL PURCHASING POWER GAIN OR LOSS

	Historical Amount	Adjusted Factor	Price Level Adjusted Amount	Purchasing Power Gain or Loss
	Rs.	Rs.	Rs.	Rs.
Conversion of Monetary Assets:				
Net monetary assets at the beginning of the year	36,000	400/300	48,000	-
Increase in net monetary assets during the year				

Sales	1,40,000	400/350	1,60,000	
Sale of machine	<u>18,000</u>	400/360	<u>20,000</u>	
Total	<u>1,94,000</u>		<u>2,28,000</u>	
Purchasing power loss (2,28,000-1,94,000)				34,000
Decrease in net monetary assets:				
Purchases	1,05,000	400/350	1,20,000	
Operating expenses	35,000	400/350	40,000	
Purchase of machine	<u>25,000</u>	400/400	<u>25,000</u>	
Total	<u>1,65,000</u>		<u>1,85,000</u>	
Purchasing power gain (1,85,000-1,65,000)				<u>20,000</u>
Net Purchasing Power Loss				<u>14,000</u>
Net monetary assets at the end of the year:				
Price level adjusted amount of net monetary assets (2,28,000 – 1,85,000)				43,000
Less: Purchasing power loss				<u>14,000</u>
Net monetary assets at the end of the year (1,94,000 – 1,65,000)				<u>29,000</u>

7.

Journal Entries

Date	Particulars		Rs.	Rs.
31.3.2006	Employees compensation expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of Rs. 30 each, amortised on straight line basis over vesting years- Refer W.N.)			
31.3.2006	Profit and Loss Account	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being compensation expense charged to Profit & Loss A/c)			

31.3.2007	Employees compensation expenses A/c	Dr.	3,95,000	
	To ESOS outstanding A/c			3,95,000
	(Being compensation expense recognized in respect of the ESOP- Refer W.N.)			
31.3.2007	Profit and Loss Account	Dr.	3,95,000	
	To Employees compensation expenses A/c			3,95,000
	(Being compensation expense charged to Profit & Loss A/c)			
30.3.2008	Employees compensation Expenses A/c	Dr.	8,05,000	
	To ESOS outstanding A/c			8,05,000
	(Being compensation expense recognized in respect of the ESOP- Refer W.N.)			
30.3.2008	Bank A/c (85,000 X Rs.20)	Dr.	17,00,000	
	ESOS outstanding A/c [(26,25,000/87,500)x85,000]	Dr.	25,50,000	
	To Equity share capital (85,000 x 10)			8,50,000
	To Securities premium A/c (85,000 X Rs.40)			34,00,000
	(Being 85,000 options exercised at an exercise price of Rs. 50 each)			
	Profit and Loss A/c	Dr.	8,05,000	
	To Employees compensation expenses A/c			8,05,000
	(Being compensation expenses charged to Profit & Loss A/c)			
	ESOS outstanding A/c	Dr.	75,000	
	To General Reserve A/c			75,000
	(Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Note:

Statement showing compensation expenses to be recognised

Particulars	Year 1 (31.3.2006)	Year 2 (31.3.2007)	Year 3 (31.3.2008)
Expected vesting period (at the end of the year)	2nd year	3rd year	3rd year
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expenses accrued @ 30 (i.e. 50-20)	<u>Rs. 28,50,000</u>	<u>Rs. 27,30,000</u>	<u>Rs. 26,25,000</u>
Compensation expenses of the year	28,50,000 x 1/2 = Rs.14,25,000	27,30,000 x 2/3 = Rs.18,20,000	Rs. 26,25,000
Compensation expenses recognized previously	<u>Nil</u>	<u>Rs.14,25,000</u>	<u>Rs. 18,20,000</u>
Compensation expenses to be recognized for the year	<u>Rs.14,25,000</u>	<u>Rs. 3,95,000</u>	<u>Rs. 8,05,000</u>

8. (a) An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An embedded derivative should be separated from the host contract and accounted for as a derivative if (i) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract and (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. However, a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss need not be separated.

- (b) Where fair value of an embedded derivative cannot be measured reliably on the basis of terms and conditions of the contract, e.g. when the embedded derivative is based on an unquoted equity instrument, then the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) instrument and the fair value of the host contract.

If the fair value of the embedded derivative cannot be reliably measured using the method described above, the hybrid (combined) instrument is designated as at fair value through profit or loss.

- (c) The interest rate swap is used to hedge fair value of fixed-rate debt. This is a case of fair value hedge.

In the books of Omega Ltd.

Journal Entries

		Rs. in lakh	Rs. in lakh	
Interest A/c	Dr.	0.35		$10 \times 7\% \times 6/12$
To Cash A/c			0.35	
(Being interest on fund borrowed for first half-year 2007-08)				
Loss on valuation of debt A/c	Dr.	0.20		$10.2 - 10$
To Loan A/c			0.20	
(Being increase in value of debt recognised)				
Swap Hedge A/c	Dr.	0.20		
To Gain on Swap Hedge A/c			0.20	
(Being increase in value of swap recognised)				
Cash A/c	Dr.	0.05		$10 (7\% - 6\%) \times 6/12$
To Interest A/c			0.05	
(Being swap settlement received for first half-year 2007-08)				
Interest A/c	Dr.	0.35		$10 \times 7\% \times 6/12$
To Cash A/c			0.35	
(Being interest on fund borrowed for second half-year 2007-08)				
Loan A/c	Dr.	0.30		$10.2 - 9.9$
To Gain on valuation of debt			0.30	
(Being decrease in value of debt recognised)				
Loss on Swap Hedge A/c	Dr.	0.30		$0.2 - (-0.1)$
To Swap Hedge A/c			0.30	
(Being cumulative loss on swap recognised)				
Interest A/c	Dr.	0.05		$10 (8\% - 7\%) \times 6/12$
To Cash A/c			0.05	
(Being swap settlement paid for second half-year 2007-08)				

9. Calculation of weighted average cost of capital

Source	Amount (Rs. in lakhs)	Proportion	Cost of Capital (%)	Weighted average cost of Capital (%)
Equity	2,766	0.982	16.7	16.4
Debt	<u>50</u>	<u>0.018</u>	7.72	<u>0.14</u>
	<u>2,816</u>	<u>1.000</u>		<u>16.54</u>

Cost of Capital employed (COCE) = $2,816 \times 16.54/100 = \text{Rs.}465.77$ lakhs.

Calculation of Net Operating Profit After Tax (NOPAT)	(Rs. in lakhs)
Profit after tax, before exceptional items	1,541
Add: Interest after tax	<u>5</u>
NOPAT	<u>1,546</u>

Calculation of Economic Value Added (EVA)

EVA = NOPAT – COCE = $1546 - 465.77 = \text{Rs.}1080.23$ lakhs.

10. Capitalised value of Rs.30,000 at 12% rate of return
- $$= 30,000 \times 100/12 = \text{Rs.}2,50,000$$
- Limit upto which the company may bid for an Engineer
- $$= \text{Rs.}2,50,000$$
- New Capital base
- $$= 5,00,000 + 2,50,000 = \underline{\text{Rs.}7,50,000}$$
- Required rate of return on new capital base
- $$= 7,50,000 \times 12/100 = \text{Rs.}90,000$$
- Profit generated at old capital base
- $$= \underline{\text{Rs.}50,000}$$
- Additional profit generated by the Engineer
- $$= 90,000 - 50,000 = \underline{\text{Rs.}40,000}$$

Therefore, the maximum bid can go upto the capitalized value of additional profit of Rs.3,33,333 (i.e., $40,000 \times 100/12$).

11. Net asset value of mutual fund = $\frac{\text{Total Market Value of all Mutual Fund holdings} - \text{All Mutual Fund liabilities}}{\text{No. of Mutual Fund units}}$
- $$= \frac{\text{Rs.}1,50,00,00,000}{5,00,00,000}$$
- $$= \text{Rs. } 30$$

Thus, each unit of Rs. 20 is worth Rs. 30. Thus NAV is more than the face value of Rs. 20. It means money invested in this scheme has appreciated.

12. Statement Showing Computation of Tier–I Capital

		(Rs. in lakhs)
Paid up Equity Capital		100
Free Reserve		<u>500</u>
	(A)	600
Deduct deferred expenditure	(B)	<u>200</u>
	(C)	<u>400</u>
Investments:		
In shares of subsidiaries and Group Companies		100
In Debenture of subsidiaries and Group Companies		<u>100</u>
		200
10% of (C)	(D)	<u>40</u>
Excess of Investment over 10% of (C) = (E)		<u>160</u>
Tier–I Capital [(C - E)]		<u>240</u>

13. Intangibles are not easily measurable and it poses severe challenges in valuation of brands also. Some of the difficulties faced by the accountants in brand valuation are as follows:

1. Distinctiveness: Brands need to be valued distinctively as different from other intangibles such as Goodwill etc. For instance, any attempt to commonly treat brand as a part of Goodwill as is done at present may create serious distortions in accounting position. Besides, this would create handicaps in brand accounting.
2. Disclosure: There is always a problem of making disclosure of brand values in financial statements. This is because, there is no standard accounting practice requiring statement and disclosure of brand values in a particular way.
3. Uncertainty: The problem that is associated with the brand, as an item of intangibles, is that its possible returns are uncertain, immeasurable and non-current in nature. Any expected on such intangibles are usually either written off or treated as Deferred Revenue Expenditure.
4. The Dilemma: Another area of challenge posing brand accounting is whether to amortise or capitalise the value of brand. There is no question of amortising brand values as either the economic life of the brand cannot be determined in advance or its value depreciates over time.
5. No Market: The prevailing practice is that the intangibles are not required to be revalued according to some accounting standards on account of the non-existence

of an active secondary market for them. In fact, the need for brand accounting arises mainly on account of conditions warranted by acquisition and merger.

6. Joint Costs: It is very difficult to segregate and account for joint costs that are incurred and the cost of brand developed as a result of general operations of the business.
14. During the initial years of SEBI's working, its function was confined to monitoring the activities of stock exchanges, mutual funds, merchant bankers and other intermediaries engaged in investment business. Subsequently, the SEBI has also taken various initiatives to improve corporate reporting practices to provide investors and other users with quality information that is useful in making economic decisions. SEBI has imposed a number of disclosures and other requirements through this route. Some important requirements are as follows:
 - ◆ Dispatch of a copy of the complete & full annual report to the shareholders (Clause 32).
 - ◆ Disclosure on the Y2K preparedness level (Clause 32).
 - ◆ Disclosure of Cash Flow Statement (Clause 32).
 - ◆ Disclosure of material developments and price sensitive information (Clause 36).
 - ◆ Compliance with Takeover Code (Clause 40B)
 - ◆ Disclosure of interim unaudited financial result (Clause 41).
 - ◆ Disclosure regarding listing fee payment status and the name and address of each stock exchange where the company's securities are listed (Clause 48B).
 - ◆ Corporate governance report (Clause 49).
 - ◆ Compliance with Accounting Standards issued by the ICAI (Clause 50).

SEBI has also appointed certain expert committees from time to time to use the power to direct changes in the disclosure requirements effectively.

15. (i)	Indian AS	IAS / IFRS	US GAAPs
Impairment of assets	Assets are impaired at higher of fair value less costs to sell and value in use based on discounted cash flows. Impairment test is to be conducted every year and if there is upward increase in the value of asset than reversal of impairment losses is	Similar to Indian Accounting Standard. However, assets are classified and disclosed separately on the face of the balance sheet as held for sale or disposal.	Impairment is assessed on undiscounted cash flows for assets to be held and used. If less than carrying amount, impairment loss is measured using market value or discounted cash flows. Reversal of losses is

required in certain circumstances. prohibited.

Assets are not separately classified or disclosed as held for sale on the face of the balance sheet.

(ii)	Indian AS	IAS / IFRS	US GAAPs
Earnings per share – diluted	Weighted average potential dilutive shares are used as denominator for diluted EPS, except in certain circumstances where advance share application money received is treated as dilutive potential equity shares.	Weighted average potential dilutive shares are used as denominator for diluted EPS.	Similar to IFRS.

16. The capital adequacy requirement specified in regulation 7 shall not be less than the net worth of the person making the application for grant of registration.

For the purpose, the net worth shall be as follows :

Category	Minimum Amount Rs.
Category I (Merchant bankers who carry on activity of the issue management, which will, inter alia, consist of preparation of prospectus and other information relating to the issue, determining financial structure, tie up of financiers and final allotment and refund of subscriptions; and act as advisor, consultant, manager, underwriter, portfolio manager)	5,00,00,000
Category II (Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager)	50,00,000
Category III (Merchant bankers who act as underwriter, advisor, consultant to an issue)	20,00,000
Category IV (Merchant bankers who act only as advisor or consultant to an issue)	NIL

17. (a) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:
 - (a) a description of the discontinuing operation(s);
 - (b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;
 - (c) the date and nature of the initial disclosure event;
 - (d) the date or period in which the discontinuance is expected to be completed if known or determinable;
 - (e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
 - (f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
 - (g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
 - (h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.
- (b) Joint ventures take many different forms and structures. This Statement identifies three broad types – jointly controlled operations, jointly controlled assets and jointly controlled entities – which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:
 - (a) two or more venturers are bound by a contractual arrangement; and
 - (b) the contractual arrangement establishes joint control.
- (c) A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:
 - (a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;
 - (b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and
 - (c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- (a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
- (b) its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.

A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

- (d) An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.

In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:

External sources of information

- (a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;
- (b) significant changes with an adverse effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated;
- (c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;
- (d) the carrying amount of the net assets of the reporting enterprise is more than its market capitalisation;

Internal sources of information

- (e) evidence is available of obsolescence or physical damage of an asset;
- (f) significant changes with an adverse effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously

expected date; and

- (g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.
- (e) When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:
 - (a) separate proposals have been submitted for each asset;
 - (b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and
 - (c) the costs and revenues of each asset can be identified.

A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

- (a) the group of contracts is negotiated as a single package;
- (b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- (c) the contracts are performed concurrently or in a continuous sequence.
- (f) An item of fixed asset is eliminated from the financial statements on disposal.

Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognised immediately in the profit and loss statement.

In historical cost financial statements, gains or losses arising on disposal are generally recognised in the profit and loss statement.

On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

- (g) Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item [see Accounting Standard (AS) 5, Prior Period Extraordinary Items and Changes in Accounting Policies]¹.

¹ AS 5 has been revised in February, 1997. The title of revised AS 5 is 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfilment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

(h) (i)	Integral Foreign Operation (NFO)	Non-Integral Foreign Operation (NFO)
Meaning	It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.	It is a foreign operation that is not an integral Foreign Operation.
Business	The business of IFO is carried on as if it were an extension of the reporting enterprise's operations.	The business of NFO is carried on in a substantially independent manner by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowings, in its local currency.
Example	Sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.	Production in a foreign country out of resources available in such nation independent of the reporting enterprise.
Currencies operated	Generally, IFO carries on business in a single foreign currency, i.e. of the country where it is located.	NFO business may also enter into transactions in foreign currencies, including transactions in the reporting currency.
Cash	Cash flows from operations of	Change in the exchange

flows from operations	the reporting enterprise are directly and immediately affected by a change in the exchange rate between the reporting currency and the currency in the country of IFO.	rate between the reporting currency and the local currency, has little or no direct effect on the present and future Cash Flows from Operations of either the NFO or the reporting enterprise.
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Effect of Change in Exchange Rate	Change in the exchange rate affects the individual monetary items held by the IFO rather than the reporting enterprise's Net Investment in the IFO.	Change in the exchange rate affects the reporting enterprise's net investment in the NFO rather than the individual monetary and non-monetary items held by that NFO.
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- (ii) Leases are classified based on the extent to which risks and rewards incident to ownership of a leased asset lie with the Lessor or the Lessee.

Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

A lease is called a Finance Lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is called an Operating Lease if it does not transfer substantially all the risks and rewards incident to ownership.

- (iii) Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

- (i) the name of the transacting related party;
- (ii) a description of the relationship between the parties;
- (iii) a description of the nature of transactions;
- (iv) volume of the transactions either as an amount or as an appropriate proportion;
- (v) any other elements of the related party transactions necessary for an understanding of the financial statements;
- (vi) the amounts or appropriate proportions of outstanding items pertaining to

related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

- (vii) amounts written off or written back in the period in respect of debts due from or to related parties.

18. (a) Accounting Standard 4 defines 'events occurring after the Balance sheet date' as follows:

'Events occurring after the Balance sheet date are 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'.

The facts of the case are as under:

- ◆ Financial Statements are prepared for the year ended 31st March, 2008.
- ◆ Board of Directors of the Company approved the said financial statements on 20th May, 2008.
- ◆ Construction crashed down resulted in a loss of Rs.2 crores, on 30th May, 2008.

In view of the above definition, the said unfavourable event does not come under the definition of 'events occurring after the balance sheet date'.

Therefore, no adjustment to assets and liabilities need be required. And also it would not require disclosure in the financial statements. Since it is a material change affecting the financial position of the enterprise that took place due to the event occurring after the balance sheet date, the fact and financial implications thereof need to be disclosed in the Directors' Report.

- (b) In the above case, the quarterly income has not been correctly stated. As per AS 25 "Interim Financial Reporting", the quarterly income should be adjusted and restated as follows:

Bad debts of Rs. 40,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) Rs. 20,000 to the next quarter. Therefore, Rs. 20,000 should be deducted from Rs. 7,20,000. The treatment of extra-ordinary loss of Rs. 35,000/- being recognized in the same quarter is correct.

Recognising additional depreciation of Rs. 45,000 in the same quarter is in tune with AS 25. Hence, no adjustments are required for these two items.

Poornima Ltd should report quarterly income as Rs.7,00,000 (Rs. 7,20,000 – Rs. 20,000).

- (c) (a) Calculation of Basic EPS

Net profit for the year ended 31-3-2008	Rs.80,00,000
No. of equity shares outstanding	25,00,000

Basic EPS (Rs.80,00,000/25,00,000 shares) Rs.3.20

(b) Calculation of diluted EPS

Net profit for the year ended 31-3-2008 Rs.80,00,000

No. of equity shares outstanding Rs.25,00,000

No. of shares under stock option 5,00,000

Less: No. of shares that would have been issued

at fair value $(5,00,000 \times 25/32)$ 3,90,625 1,09,375

Diluted EPS [Rs.80,00,000/26,09,375 shares = Rs.3.07 (approx.)] 26,09,375

- (d) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{\text{Rs. 3,000 lakhs}}{\text{Rs. 40}} = 75 \text{ lakhs US Dollars}$$

$$\begin{aligned} \text{Exchange difference} &= 75 \text{ lakhs US Dollars} \times (42.50 - 40.00) \\ &= \text{Rs. 187.50 lakhs} \end{aligned}$$

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting Rs. 187.50 lakhs should be charged to profit and loss account for the year.

19. (a) Month	Expenditure on qualifying asset	Interest	Cumulative expenditure including interest
July 2007	3,00,000		3,00,000
August, 2007	4,50,000	3,750	7,53,750
September, 2007	2,00,000	9,422	9,63,172
October, 2007	5,00,000	12,040	14,75,212
November, 2007	3,00,000	18,440	17,93,652
December, 2007	<u>2,50,000</u>	<u>22,421</u>	20,66,073
	<u>20,00,000</u>	<u>66,073</u>	

The value of the qualifying asset is Rs.20,66,073.

- (b) (a) Yes, X company should provide for the contingency because it is unlikely that X Company should be in a position to meet contractual obligation.
- (b) No, X Company can't measure provision as the excess of compensation to be paid over profit. It has to provide for the total compensation amount.
- (c) Recognition of Loss on Revaluation:

Particulars	Computation	Rs. in lakhs
(1) Original Cost of the Asset	Given	100.00
(2) Accumulated Depreciation for four years	$100 \times 10\% \times 4 \text{ years}$	40.00
(3) Carrying amount before Revaluation	Net Book Value (1)-(2)	60.00
(4) Fair Value = Revalued amount	Given	50.00
(5) Loss on Revaluation debited to Profit and Loss Account (3) – (4)	10.00	
(6) Carrying amount after revaluation	(3) – (5) [or] Fair Value (Market Value)	50.00

Recognition of Impairment Loss,

(1) Net Selling Price = Market Value – Disposal Costs = Rs.45 lakhs – Rs.2 lakhs	Rs.43 lakhs
(2) Value in use	Rs.40 lakhs
(3) Recoverable Amount = Net Selling Price or Value in Use, whichever is higher	Rs.43 lakhs
(4) Carrying Amount after revaluation	Rs.50 lakhs
(5) Impairment Loss = Carrying amount Less Recoverable Amount.	Rs.7 lakhs

- (d) (i) Present value of residual value = Rs. 40,000 $\times$ 0.7513 = Rs. 30,052
 Present value of lease payments = Rs. 3,00,000 – Rs. 30,052 = Rs. 2,69,948.
- The present value of lease payments being 89.98% $\left(\frac{2,69,948}{3,00,000} \times 100 \right)$ of the fair value, i.e. being a substantial portion thereof, the lease constitutes a finance lease.
- (ii) Calculation of unearned finance income

Rs.

Gross investment in the lease [(Rs.1,08,552* × 3) + Rs. 40,000]	3,65,656
Less: Cost of the equipment	<u>3,00,000</u>
Unearned finance income	<u>65,656</u>

Note: - In the above solution, annual lease payment has been determined on the basis that the present value of lease payments plus residual value is equal to the fair value (cost) of the asset.

20. (a) As per para 10 of AS 12 'Accounting for Government Grants', where the government grants are of the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment followed by the company is not proper.

(b) X Ltd.

Cash flow statement for the year ended 31st March, 2008

(Using the direct method)

	Rs.'000	Rs.'000
Cash flow from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	<u>(200)</u>	
Cash generated from operations	500	
Income tax paid	<u>(250)</u>	
Net cash from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	

* Annual lease payments = $\frac{\text{Rs. 2,69,948}}{2.4868} = \text{Rs. 1,08,552 (approx.)}$

Proceeds from sale of fixed assets	<u>100</u>	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	<u>(50)</u>	
Net cash used in financing activities		<u>(50)</u>
Net increase in cash		100
Cash at beginning of period		<u>50</u>
Cash at end of period		<u>150</u>

21. (a) The interest of Big Ltd. and Small Ltd. in Joint Venture can be reported in the consolidated financial statements as per the proportionate consolidation method as follows:

Consolidated Balance Sheets

	Big Ltd.		Small Ltd.
	Rs.	Rs.	Rs.
Share Capital	5,00,000		3,00,000
Reserves			
(Rs. 3,00,000 + 20,000)	3,20,000	(Rs. 1,00,000 + 30,000)	1,30,000
Loans			
(Rs. 2,00,000 + 12,000)	<u>2,12,000</u>	(Rs. 1,00,000 + 18,000)	<u>1,18,000</u>
	<u>10,32,000</u>		<u>5,48,000</u>
Fixed Assets			
(Rs. 8,00,000 + 48,000)	8,48,000	(Rs. 3,50,000 + 72,000)	4,22,000
Net working capital			
(Rs. 1,60,000 + 24,000)	<u>1,84,000</u>	(Rs. 90,000 + 36,000)	<u>1,26,000</u>
	<u>10,32,000</u>		<u>5,48,000</u>

Joint Venture has been consolidated on a line by line basis in the ratio of 40% and 60%.

- (b) As per para 44 of AS 26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria has been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological

feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs.13,000) Rs. 67,000.

- (c) Para 3 of AS 18 on Related Party Disclosures describes related party relationships as follows:
- (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprises (this includes holding companies, subsidiaries and fellow subsidiaries);
 - (b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;
 - (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;
 - (d) key management personnel and relatives of such personnel; and
 - (e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

Accordingly, the sale of goods worth Rs. 25 lakhs falls under the purview of AS 18 and hence the following information should be disclosed by X Limited as per para 23 of AS 18.

- (i) the name of the transacting related party;
 - (ii) a description of the relationship between the parties;
 - (iii) a description of the nature of transactions;
 - (iv) volume of the transactions either as an amount or as an appropriate proportion;
 - (v) any other elements of the related party transactions necessary for an understanding of the financial statements;
 - (vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provision for doubtful debts due from such parties at that date; and
 - (vii) amounts written off or written back in the period in respect of debts due from or to related parties.
- (d) As per para 21 of AS 6 on Depreciation Accounting, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the

new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, there is a surplus of Rs. 26.30 lakhs on account of change in the method of depreciation, which will be credited to Profit and Loss Account. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed

22. (a) As per para 27 of AS 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

- (i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue- external and internal of all segments; or
- (ii) Its segment result whether profit or loss is 10% or more of:
 - (1) The combined result of all segments in profit; or
 - (2) The combined result of all segments in loss, whichever is greater in absolute amount; or
- (iii) Its segment assets are 10% or more of the total assets of all segments.

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

- (a) On the basis of turnover criteria segments M and N are reportable segments.
- (b) On the basis of the result criteria, segments M, N and R are reportable segments (since their results in absolute amount is 10% or more of Rs.200 lakhs).
- (c) On the basis of asset criteria, all segments except R are reportable segments.

Since all the segments are covered in atleast one of the above criteria all segments have to be reported upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong.

- (b) Disclosure of Current and Deferred Tax balances will be on the basis of principles laid down in AS-22. These are:
 - (a) Current tax assets and liabilities can be set off, if the enterprise has a legally enforceable right to set off the recognized amounts and intends to settle them on a net basis.
 - (b) Deferred tax assets and liabilities can be set off, if the items relate to taxes on

income levied by the same governing taxation laws.

Applying these principles, the required disclosures will be as follows:

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Deferred tax liabilities	100		Current assets, loans and advances:		
Less: Deferred tax assets	<u>20</u>	80	Advance tax paid	795	
			Less: Provisions	<u>750</u>	45

- (c) Business enterprises frequently close facilities, abandon products, or even product lines, and reduce the size of their workforce in response to market forces. These kinds of terminations, generally, are not in themselves discontinuing operations unless they satisfy the definition criteria. By gradually reducing the size of operations in the product line of Washing Soap, the company has increased its scale of operations in Bathing Soap. Such a change is a gradual or evolutionary, phasing out of a product line or class of services does not meet definition criteria in paragraph 3(a) of AS 24 – namely, disposing of substantially in its entirety, a component of the enterprise. Hence, changeover is not a discontinuing operation.

- (d) The actual return on pension plan assets follows:

	Amount (Rs.)
Fair market value of plan assets (beginning of year)	7,00,000
Employer Contribution	1,00,000
Actual return on plan assets	<u>50,000</u>
	8,50,000
Benefit payments to retirees	<u>(40,000)</u>
Fair market value of plan assets (end of year)	<u>8,10,000</u>

23. (a) (a) Amount of foreseeable loss	(Rs in lakhs)
Total cost of construction (500 + 105 + 495)	1,100
Less: Total contract price	<u>1,000</u>
Total foreseeable loss to be recognized as expense	<u>100</u>

According to para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b) Contract work-in-progress i.e. cost incurred to date are	(Rs in lakhs)
Rs. 605 lakhs	
Work certified	500
Work not certified	<u>105</u>
	<u>605</u>

This is 55% ($605/1,100 \times 100$) of total costs of construction.

- (c) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised).

55% of Rs. 1,000 lakhs = Rs. 550 lakhs

- (d) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received)

= [605 + Nil – 100 – (400 + 140)] Rs. in lakhs

= [605 – 100 – 540] Rs. in lakhs

Amount due to customers = Rs. 35 lakhs

The amount of Rs. 35 lakhs will be shown in the balance sheet as liability.

- (e) The relevant disclosures under AS 7 (Revised) are given below:

	Rs. in Lakhs
Contract revenue	550
Contract expenses	605
Recognised profits less recognized losses	(100)
Progress billings (400 + 140)	540
Retentions (billed but not received from contractee)	140
Gross amount due to customers	35

- (b) Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on Revenue Recognition states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only Rs. 1,50,000 were collected against a claim of Rs. 2,00,000. So this transaction can not be taken as a Prior Period Item.

In the light of revised AS 5, it will not be treated as extraordinary item. However, para 12 of AS 5 (Revised) states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately as per para 12 of AS 5 (Revised).

- (c) As it is stated in the question that financial statements for the year ended 31st March, 2008 under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

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 these bases, 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. 20,000 in the financial statements for the year ended 31st March, 2008

24. (a) Guidance Note on Accounting Treatment for Excise Duty says that excise duty is a duty on manufacture or production of excisable goods in India.

According to Central Excise Rules, 2002, excise duty should be collected at the time of removal of goods from factory premises or factory warehouse. The levy of excise duty is upon the manufacture or production, the collection part of it is shifted to the stage of removal.

Further, paragraph 23(i) of the Guidance Note makes it clear that excise duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation.

Therefore, in the given case of HSL Ltd., the Managing Director's contention that "excise duty is payable only on clearance of goods and hence is not a cost is incorrect. Excise duty on the goods meant for local sales should be provided for at the rate of 16% on the selling price, that is, Rs. 100 lakhs for valuation of stock.

Excise duty on goods meant for exports, should be provided for, since the liability for excise duty arises when the manufacture of the goods is completed. However, if it is assumed that all the conditions specified in Rule 19 of the Central Excise Rules, 2002 regarding export of excisable goods without payment of duty are fulfilled by HSL Ltd., excise duty may not be provided for.

- (b) The Guidance Note on Accounting for Investments in the Financial statements of Mutual Funds provides that the investments should be marked to market on the balance sheet date. The provision for depreciation in the value of investments should be made in the books by debiting the Revenue Account. The provision so created should be shown as a deduction from the value of investments in the balance sheet. Clause 2(i) of the Eleventh Schedule provides that "where the financial statements are prepared on a mark to market basis, there need not be a separate provision for depreciation." However keeping in view, 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of

depreciation on investments, the guidance note recommends that the gross value of depreciation on investments should be reflected in the Revenue Account rather than the same being netted off with the appreciation in the value of other investments. In other words, depreciation/appreciation on investments should be worked out on an individual investment basis or by category of investment basis, but not on an overall basis or by category of investment.

In the given case of SFL Ltd., depreciation should be separately disclosed in the financial statements.

25. (a) The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.

Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

(b) Journal Entries in the books of A

2008			Rs.	Rs.
Jan. 24	B	Dr.	17,68,000	
	To Sales Account			17,68,000
	(Credit sales made to B of Washington, USA for \$40,000 recorded at spot market rate of Rs.44.20 per US \$)			
" "	Forward (Rs.) Contract Receivable Account	Dr.	17,48,000	
	Deferred Discount Account	Dr.	20,000	
	To Forward (\$) Contract Payable			17,68,000
	(Forward contract acquired to sell on 24 th April, 2008 US \$40,000 @ Rs.43.70)			
March 31	Exchange Loss Account	Dr.	40,000	
	To B			40,000
	(Record of exchange loss @ Re.1 per \$ due to market rate becoming Rs.43.20 per US \$ rather than Rs.44.20 per US \$)			
" "	Forward (\$) Contract Payable	Dr.	40,000	
	To Exchange Gain Account			40,000

		(Decrease in liability on forward contract due to fall in exchange rate)		
"	"	Discount Account	Dr.	14,667
		To Deferred Discount Account		14,667
		(Record of proportionate discount expense for 66 days out of 90 days)		
April 24		Bank Account	Dr.	17,08,000
		Exchange Loss Account	Dr.	20,000
		To B		17,28,000
		(Receipt of \$40,000 from B, USA customers @ Rs.42.70 per US \$; exchange loss being Rs.20,000)		
"	"	Forward (\$) Contract Payable Account	Dr.	17,28,000
		To Exchange Gain Account		20,000
		To Bank Account		17,08,000
		(Settlement of forward contract by payment of \$40,000)		
"	"	Bank Account	Dr.	17,48,000
"	"	To Forward (Rs.) Contract Receivable		17,48,000
		(Receipt of cash in settlement of forward contract receivable)		
"	"	Discount Account	Dr.	5,333
		To Deferred Discount Account		5,333
		(Recording of discount expense for 24 days: $\text{Rs.20,000} \times \frac{24 \text{ days}}{90 \text{ days}} = \text{Rs.5,333}$)		

Note : AS 1 to AS 29 are applicable for November, 2008 Examination.

Announcement

Withdrawal of the Announcement issued by the Council on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956'

1. The Council of the Institute of Chartered Accountants of India had issued an Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', which was published in the November 2003 issue of 'The Chartered Accountant' (pp. 497)¹
2. Subsequent to the issuance of the above Announcement, the Ministry of Company Affairs (now known as the Ministry of Corporate Affairs) issued the Companies (Accounting Standards) Rules, 2006, by way of Notification in the Official Gazette dated 7th December, 2006. As per Rule 3(2) of the said Rules, the Accounting Standards shall come into effect in respect of accounting periods commencing on or after the publication of these accounting standards under the said Notification.
3. AS 11, as published in the above Government Notification, carries a footnote that "it may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the relevant provisions of Schedule VI to the Companies Act, 1956".
4. In view of the above footnote to AS 11, the Council of the Institute of Chartered Accountants of India has decided at its 269th meeting held on July 18, 2007, to withdraw the Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', published in 'The Chartered Accountant' of November 2003. Accordingly, the accounting treatment of exchange differences contained in AS 11 notified as above is applicable and not the requirements of Schedule VI to the Act, in respect of accounting periods commencing on or after 7th December, 2006.