



FINAL GROUP – I MAY, 2005

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

FINAL EXAMINATION : MAY, 2005

REVISION TEST PAPERS

GROUP – I

PAPER-1 : ADVANCED ACCOUNTING

QUESTIONS

1. Following are the Balance Sheets of A Limited, B Limited, C Limited and D Limited as at 31st December, 2004:

<i>Liabilities</i>	<i>A Ltd.</i>	<i>B Ltd.</i>	<i>C Ltd.</i>	<i>D Ltd.</i>
Share Capital (Rs. 100 face value)	50,00,000	40,00,000	20,00,000	60,00,000
General Reserve	20,00,000	4,00,000	2,50,000	10,00,000
Profit & Loss Account	10,00,000	4,00,000	2,50,000	3,20,000
Sundry Creditors	3,00,000	1,00,000	50,000	80,000
	83,00,000	49,00,000	25,50,000	74,00,000
<i>Assets</i>				
Investments :				
30,000 shares in B Ltd.	35,00,000	—	—	—
10,000 shares in C Ltd	11,00,000	—	—	—
5,000 shares in C Ltd.	—	5,00,000	—	—
Shares in D Ltd. @ Rs. 120	36,00,000	18,00,000	6,00,000	—
Fixed Assets	—	20,00,000	15,00,000	70,00,000
Current Assets	1,00,000	6,00,000	4,50,000	4,00,000
	83,00,000	49,00,000	25,50,000	74,00,000

Balance in General Reserve Account and Profit & Loss Account, when shares were purchased in different companies were :

	<i>A Ltd.</i>	<i>B Ltd.</i>	<i>C Ltd.</i>	<i>D Ltd.</i>
General Reserve Account	10,00,000	2,00,000	1,00,000	6,00,000
Profit & Loss Account	6,00,000	2,00,000	50,000	60,000

Prepare the consolidated Balance Sheet of the group as at 31st December, 2004 (Calculations may be rounded off to the nearest rupee).

2. On 31st August, 2002 Surekha Ltd. was incorporated with an Authorised Capital of Rs. 75 lakhs. Its first accounts were closed on 31st March, 2003 by which time it had become a listed company

with an issued, subscribed and paid up capital of Rs. 40 lakhs in 4,00,000 Equity Shares of Rs. 10 each.

The company started off with two lines of business namely 'A Division' and 'B Division', with equal asset base with effect from 1st April, 2003. The 'C Division' was added by the company on 1st April, 2004. The following data is gathered from the books of account of Surekha Ltd.:

Trial Balance as on 31st March, 2005

	<i>(Rupees in 000's)</i>	
	<i>Dr.</i>	<i>Cr.</i>
A Division sales	–	6,000
Cost of sales of A Division	2,600	–
B Division sales	–	8,000
Cost of sales of B Division	4,300	–
C Division Sales	–	1,500
Cost of sales of C Division	900	–
Administration costs	2,000	–
Distribution costs	1,500	–
Dividend-Interim	1,200	–
Fixed Assets at cost	9,000	–
Depreciation on Fixed Assets	–	1,500
Stock on 31st March, 2005	400	–
Trade Debtors	440	–
Cash at Bank	160	–
Trade Creditors	–	500
Equity Share Capital in shares of Rs. 10 each	–	4,000
Retained Profits	–	1,000
	<u>22,500</u>	<u>22,500</u>

Additional Information:

- Some of the users of C Division are unhappy with the product and have lodged claims against the company for damages of Rs. 7.5 lakhs. The claim is hotly contested by the company on legal advice.
- Fixed Assets worth Rs. 30 lakhs were added in the C Division on 1.4.2004.
- Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.
- Income tax rate may be assumed at 35%.
- Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.
- Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.
- Directors have proposed a Final Dividend of Rs. 8 lakhs.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2005 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards.

3. Following details are given for Omega Textiles Ltd. for the year ended 31st March, 2004.

(Rs. '000)

<i>Sales:</i>		
Cotton textiles	5,650	
Silk fabrics	625	
Woolen clothes	345	
Others	<u>162</u>	6,782
<i>Expenses:</i>		
Cotton textiles	3,335	
Silk fabrics	425	
Woolen clothes	222	
Others	<u>200</u>	4,182
<i>Other Items:</i>		
General Corporate Expenses		562
Income from investments		132
Interest expenses		65
<i>Identifiable assets:</i>		
Cotton textiles	7,320	
Silk fabrics	1,320	
Woolen clothes	1,050	
Others	<u>665</u>	10,355
General Corporate Assets		722

Other information:

- (a) Inter segment sales are as below:

(Rs. '000)

Cotton textiles	55
Silk fabrics	72
Woolen clothes	21
Others	7

- (b) Operating Profit includes Rs. 33 ('000) on inter segment sales.
(c) Information about inter segment expenses are not available.

You are required to prepare a statement showing financial information about Omega Textiles Ltd.'s operations in different industry segments.

4. Capital structure of Success Ltd., as at 31.3.2004 was as under:

(Rs. in lakhs)

Equity share capital	80
8% Preference share capital	40
12% Debentures	64
Reserves	32

Success Ltd., earns a profit of Rs. 32 lakhs annually on an average before deduction of income-tax, which works out to 35% and interest on debentures.

Normal return on equity shares of companies similarly placed is 9.6% provided:

- (a) Profit after tax covers fixed interest and fixed dividends at least 3 times.
(b) Capital gearing ratio is 0.75.
(c) Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Success Ltd., has been regularly paying equity dividend of 8%.

Compute the value per equity share of the company.

5. The Balance Sheet of RNR Limited as on 31.12.2004 is as follows :

<i>Liabilities</i>	<i>(Rupees in Lakhs)</i>	<i>Assets</i>	<i>(Rupees in Lakhs)</i>
1,00,000 equity shares of Rs. 10 each fully paid	10	Goodwill	5
1,00,000 equity shares of Rs. 6 each, fully paid up	6	Fixed assets	15
Reserves and Surplus	4	Other tangible assets	5
Liabilities	10	Intangible assets (market value)	3
		Miscellaneous expenditure to the extent not written off	2
	30		30

Fixed assets are worth Rs. 24 lakhs. Other Tangible assets are revalued at Rs. 3 lakhs. The company is expected to settle the disputed bonus claim of Rs. 1 lakh not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years' purchase of average super-profit for the last 4 years.

After tax, profits and dividend rates were as follows :

<i>Year</i>	<i>PAT (Rs. in Lakhs)</i>	<i>Dividend %</i>
2000	3.0	11%
2001	3.5	12%
2002	4.0	13%
2003	4.1	14%

Normal expectation in the industry to which the company belongs is 10%.

Akbar holds 20,000 equity shares of Rs. 10 each fully paid and 10,000 equity shares of Rs. 6 each, fully paid up. He wants to sell away his holdings.

- Determine the break-up value and market value of both kinds of shares.
- What should be the fair value of shares, if controlling interest is being sold?

6. Alpha Limited and Beta Limited were amalgamated on and from 1st April, 2004. A new company Gamma Limited was formed to takeover the business of the existing companies. The Balance Sheets of Alpha Limited and Beta Limited as on 31st March, 2004 are given below :

<i>(Rs. in Lakhs)</i>					
<i>Liabilities</i>	<i>Alpha Limited</i>	<i>Beta Limited</i>	<i>Assets</i>	<i>Alpha Limited</i>	<i>Beta Limited</i>
Share Capital			Fixed Assets	1,200	1,000
Equity shares of Rs. 100 each	1,000	800	Current Assets, Loans and Advances	880	565
15% Preference shares of Rs. 100 each	400	300			
Reserves & Surplus					
Revaluation Reserve	100	80			
General Reserve	200	150			
P & L Account	80	60			

Secured Loan				
12% Debentures of Rs. 100 each	96	80		
Current Liabilities & Provisions	204	95		
	2,080	1,565	2,080	1,565

Other informations :

- (1) 12% Debenture holders of Alpha Limited and Beta Limited are discharged by Gamma Limited by issuing adequate number of 16% Debentures of Rs. 100 each to ensure that they continue to receive the same amount of interest.
- (2) Preference shareholders of Alpha Limited and Beta Limited have received same number of 15% Preference shares of Rs. 100 each of Gamma Limited.
- (3) Gamma Limited has issued 1.5 equity shares for each equity share of Alpha Limited and 1 equity share for each equity share of Beta Limited. The face value of shares issued by Gamma Limited is Rs. 100 each.

Prepare the Balance Sheet of Gamma Limited as on 1st April, 2003 after the amalgamation has been carried out using the 'pooling of interest method'.

7. (a) From the following Profit and Loss Account of K Ltd., prepare a Gross Value Added Statement. Show also the reconciliation between Gross Value Added and Profit before Taxation:

Profit and Loss Account for the year ended 31st March, 2004

	Notes	Amount
	(Rs. in lakhs)	(Rs. in lakhs)
Income		
Sales		206.42
Other Income		<u>10.20</u>
		216.62
Expenditure		
Production & Operational Expenses	1	166.57
Administration Expenses	2	6.12
Interest and Other Charges	3	8.00
Depreciation		<u>5.69</u>
		186.38
Profit before Tax		30.24
Provision for Tax		<u>3.00</u>
Profit after Tax		27.24
Investment Allowance Reserve Written Back		0.46
Balance as per Last Balance Sheet		<u>1.35</u>
		<u>29.05</u>
Transferred to:		
General Reserve	24.30	
Proposed Dividend	<u>3.00</u>	27.30
Surplus carried to Balance Sheet		<u>1.75</u>
		<u>29.05</u>

Notes:

1. Production & Operational Expenses	Rs. in lakhs
Increase in Stock	30.50
Consumption of Raw Materials	80.57
Consumption of Stores	5.30
Salaries, Wages, Bonus & Other Benefits	12.80
Cess and Local Taxes	3.20
Other Manufacturing Expenses	<u>34.20</u>
	<u>166.57</u>

2.	Administration expenses include inter-alia Audit fees of Rs. 1 lakh, Salaries & Commission to directors Rs. 2.20 lakhs and Provision for doubtful debts Rs. 2.50 lakhs.	
3.	Interest and Other Charges:	<i>Rs. in lakhs</i>
	On Fixed Loans from Financial Institutions	3.90
	On Debentures	1.80
	On Working Capital Loans from Bank	<u>2.30</u>
		<u>8.00</u>

(b) Differentiate between 'Value Added' and 'Economic Value Added' in brief.

8. (a) Institute of World's Environmental Management provides you with the following details relating to its development fund for the year 2003-2004:

	<i>Rs.</i>
Government Grant for Construction of Building	1,11,00,000
Private Grants for acquisition of land	55,50,000
Transfer from unrestricted fund for purchase of furniture and fittings	18,50,000
Income from fixed deposits (Fixed deposits for 2 years with Citi Bank Rs. 74,00,000)	5,55,000
Cost of land acquired	19,42,500
Advance payment made for acquisition of further land	11,10,000
Furniture purchased	2,03,500
Payments made to contractors for construction of buildings	28,67,500

Prepare statement of changes in balance of development fund for the year 2003-2004 and a balance sheet for the development fund as on 31st March, 2004.

- (b) ABZ University accepts two restricted grants during the year 2003-2004. The first is Rs. 60,00,000 from World Health Organisation to be used for Leprosy research. It is mentioned that out of this grant Rs. 4,00,000 is to cover the indirect overhead costs of the university in administering the grant. The second grant is for Rs. 50,00,000. This is from a private institution, RR Memorial Fund. The second grant is to be used for developing a centre for New Technologies. During 2003-2004, ABZ University expends a total of Rs. 43,00,000 of the grant from WHO. It also incurs from first grant Rs. 4,00,000 overhead costs. It is noticed that Rs. 38,00,000 was spent by university in 2003-2004 from grant received from RR Memorial Fund.

Pass necessary journal entries to account for the above transactions in the books of ABZ University.

9. (a) Given below is the capital structure of S Ltd. as on 31st March, 2004.

<i>Particulars</i>	<i>(Rs. in thousands)</i>
Equity share capital (Shares of Rs. 10 each)	40,000
Share premium	30,000
General reserve	40,000
Revaluation reserve	40,000
14% Fully convertible debentures	40,000

14% convertible debentures are of Rs. 100 each and as per agreement those debentures will be converted into 5 equity shares (for each debenture). The company earned profit after tax amounting ('000) Rs. 20,000 during 2003-2004. You are required to calculate EPS of the company as well as the fully diluted EPS.

- (b) Compute EPS from the given information relating to equity shares of A Ltd. and B Ltd. Two companies amalgamated w.e.f. 1.10.2003. A Ltd. issued the required no. of shares on the basis of the agreed valuation.

	<i>A Ltd.</i>	<i>B Ltd.</i>
No. of outstanding Equity Shares as on 1.4.2003 (No. in lakhs)	500	200
Agreed value per share for acquisition	120	30
Date of acquisition 1.10.2003		
Profit after tax (Rs. in lakhs) of which	1200	350
Profit after tax of B Ltd. during 1.10.2003 – 31.3.2004 (Rs. in lakhs)		200

10. (a) XYZ Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it:

	<i>Cost</i>	<i>Rs. in lakhs Market Price</i>
Equity Shares:		
Scrip A	40.00	40.80
Scrip B	21.00	16.00
Scrip C	40.00	24.00
Scrip D	40.00	80.00
Scrip E	60.00	70.00
Scrip F	50.00	60.00
Scrip G	<u>20.00</u>	<u>4.00</u>
	<u>271.00</u>	<u>294.80</u>
Mutual Funds:		
MF ₁	26.00	16.00
MF ₂	20.00	14.00
MF ₃	<u>4.00</u>	<u>6.00</u>
	<u>50.00</u>	<u>36.00</u>
Government Securities:		
GV ₁	40.00	44.00
GV ₂	<u>50.00</u>	<u>48.00</u>
	<u>90.00</u>	<u>92.00</u>

You are required to answer following questions:

- Can the company adjust depreciation of a particular item of investment within a category?
 - What should be the value of investments?
 - Is it possible to offset depreciation investment in mutual funds against appreciation of value of investments in Equity Shares and Government Securities?
- (b) The details regarding overdue hire purchase instalments of a NBFC are given below. You are required to classify the hire purchase instalment into standard, sub-standard and doubtful assets.

Outstanding hire purchase instalments Rs. 100 lacs of which instalments are overdue on 100 accounts for last three months (amount overdue Rs. 20 lacs), on 12 accounts for eight months (amount overdue Rs. 12 lacs) on 5 accounts for more than 30 months (amount overdue Rs. 10 lacs) and 2 accounts for more than three years (amount overdue Rs. 10 lacs) and 2 accounts for more than three years (amount overdue Rs. 10 lacs- already identified as sub-standard asset) and one account of Rs. 5 lacs which has been identified as non-recoverable by the management. Out of 5 accounts overdue for more than 30 months, 3 accounts are already identified as sub-standard assets (amount Rs. 3 lacs) for more than two years and others are identified as sub-standard asset for a period less than two years.

- 11.(a) Prudential XYZ 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 (Rupees one hundred crores)
Face value of units	:	Rs. 20
Investments	:	in shares
Market value of Shares	:	Rs. 1,50,00,00,000 (Rupees One hundred and fifty crores)

Compute the net assets value per unit of ABC Premier. Is there an appreciation of the value invested in units of ABC Premier?

- (b) What do you mean by 'Open-ended scheme' and 'close-ended scheme' with reference to mutual funds?
12. Write short notes on the following:
- Disclosures required to be made in the balance sheet of a non-banking finance company;
 - Books of accounts maintained by a stock broker;
 - National Level Environmental Accounting.
 - Why R Likert's model of human resource valuation is now totally rejected?
13. (a) For what purposes inspection of records and documents of Merchant Banker is ordered by SEBI?
- Write a short note on accounting issues involved in Environmental Accounting.
 - What are the capital adequacy requirements specified for the merchant bankers.
14. (a) Briefly explain Jaggi and Lau Model on valuation on group basis of human resources.
- "The contents of Corporate Social Report is essentially based on social objectives". Discuss in brief.
 - Define the term 'Subordinated debt' in the context of a NBFC.
15. From the following in respect of Jalan Limited, calculate the total value of human capital by Lev and Schwartz Model.

Distribution of Employees of Jalan Limited

Age	Unskilled		Semiskilled		Skilled	
	No.	Avg. annual earnings	No.	Avg. annual earnings (Rs.)	No.	Average annual earnings (Rs.)
30-39	100	18,000	60	36,000	40	84,000
40-49	50	30,000	30	48,000	20	1,20,000
50-54	30	36,000	20	60,000	10	1,80,000

Retirement age is 55 years. Apply discount factor of 10%. In calculations of total value of human factor lowest value of each class should be taken.

Annuity Factor @ 10%

For 5 years = 3.7908

For 10 years = 6.1446

For 15 years = 7.6061

For 20 years = 8.5136

For 25 years = 9.0770

16. (a) How is the difference between forward rate and exchange rate recognised on the date of transaction in a forward contract ?

(b) What are Equity Index Futures?

17. Mr. Investor buys a stock option of ABC Co. Ltd. in July, 2003 with a strike price Rs. 250 to be expired on 30th August, 2003. The premium is Rs. 20 per unit and the market lot is 100. The margin to be paid is Rs. 120 per unit.

Show the accounting treatment in the books of Buyer when:

- (i) the option is settled by delivery of the asset, and
- (ii) the option is settled in cash and the Index price is Rs. 260 per unit.

18. Differentiate between AS, IAS and US GAAPs on the issue of Inventory valuation.
19. (a) A company has given counter guarantees of Rs. 5 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 2003-2004 were Rs. 4 crores. How should this information be shown in the Financial Statements of the Company.
- (b) SFL Ltd. is a mutual fund. The fund values the investment on "mark to market basis". The Accountant argues since investments are valued on the above basis there is no necessity to disclose depreciation separately in the financial statements. Do you agree?
20. ABC India Ltd. has Rs. 1,02,000 net income for the quarter ended 31st December, 2003 including the following items:-
- (a) Rs. 60,000 extraordinary gain received on July 30 2003, was allocated equally to the second, third and fourth quarter of financial year 2003-2004.
 - (b) Rs. 16,000 cumulative effect loss resulting from change in method of inventory valuation method was recognized on November 2, 2003. Out of this loss Rs. 10,000 relates to the previous quarters.

Compute the profit as per AS-25 for the quarter ended 31st December, 2003 of ABC India Ltd.

21. During 2004, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

	<i>Amount</i>
	<i>Rs.</i>
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?

22. (a) X Ltd. is having a plant (asset) carrying amount of which is Rs. 100 lakhs on 31.3.2004. Its balance useful life is 5 years and residual value at the end of 5 years is Rs. 5 lakhs. Estimated future cash flow from using the plant in next 5 years are:-

<i>For the year ended on</i>	<i>Estimated cash flow (Rs. in lakhs)</i>
31.3.2005	50
31.3.2006	30
31.3.2007	30

31.3.2008	20
31.3.2009	20

Calculate "value in use" for plant if the discount rate is 10% and also calculate the recoverable amount if net selling price of plant on 31.3.2004 is Rs. 60 lakhs.

- (b) A Company has at its financial year ended 31st March, 2004 fifteen law suits outstanding, none of which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible out-comes are as below:

<i>Result</i>	<i>Probability</i>	<i>Amount of loss</i>
<i>For first ten cases:</i>		<i>Rs.</i>
Win	0.6	—
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
<i>For remaining five cases:</i>		
Win	0.5	—
Lose-low damages	0.3	60,000
Lose-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

23. (a) X Ltd. has invested to the extent of 25% in Y & Co., during the end of the financial year, for the purpose of reporting, X Ltd., the investor company values its investment in the associate. It finds that its share of losses of the associate exceeds the amount at which the investment is carried. Further in the current year, the associate reports loss. Should X Ltd. recognise the loss for the current year?
- (b) How long should the discontinuing operation be reported in the financial statements of the Enterprise? When is the discontinuance plan said to be completed?
24. What components of cost should be included, or excluded in recognizing internally generated intangible assets?
25. (a) Whether Deferred Tax Assets can be netted off against Deferred Tax Liabilities of various years?
- (b) A Holding Company entered into business transactions valuing Rs. 100 Cr., with its subsidiary during the financial year 2003-2004. The Holding Company divested its holding in the subsidiary before 31st March, 2004 and as such no related party relationship exist at the end of the year. Should the holding company disclose the relationship and the related transactions in its annual accounts?
26. (a) Jagannath Ltd. had made a rights issue of shares in 2002. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31st March, 2004. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided on the following:
- (i) Value year-end inventory at works cost (Rs. 50 crores) instead of the hitherto method of valuation of inventory at prime cost (Rs. 30 crores).

- (ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at Rs. 27 crores is lower than the amount of Rs. 45 crores which would have been provided had the old method been followed, by Rs. 18 crores.
- (iii) Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to Rs. 600 crores.
- (iv) Provide for permanent fall in the value of investments – This fall had taken place over the past five years – the provision being Rs. 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2003-2004.

- (b) X Co. Ltd. charged depreciation on its asset on SLM basis. For the year ended 31.3.2004 it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to Rs. 20 lakhs being additional charge.

Decide how it must be disclosed in Profit and Loss Account. Also, discuss when such changes in method of depreciation can be adopted by an enterprise as per AS – 6.

- (c) You are an Accountant preparing accounts of A Ltd. as on 31.3.2004. After year end the following events have taken place in April, 2003:
 - (i) A fire broke out in the premises damaging, uninsured stock worth Rs. 10 lakhs (Salvage value Rs. 2 lakhs).
 - (ii) A suit against the company's advertisement was filed by a party claiming damage of Rs. 20 lakhs.
 - (iii) Dividend proposed @ 20% on share capital of Rs. 100 lakhs.

Describe, how above will be dealt with in the account of the company for the year ended on 31.3.2004.

- 27. A Co. Ltd. has generally borrowed funds and used the funds to acquire qualifying assets also. How should the amount of borrowing cost eligible for capitalisation be determined?
- 28. X Limited sold to Y Limited goods having a sales value of Rs. 25 lakhs during the financial year ended 31.03.2004. 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.

- 29. 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.

30. In order to value the inventory of finished goods, HR Ltd. has adopted the standard cost or raw material, labour and overheads. Income tax officer wants to know the method, as per AS-2, for the valuation of raw material.

SUGGESTED ANSWERS/HINTS

1. **Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd., C Ltd. and D Ltd. As at 31st December, 2004**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital	50,00,000.00	Goodwill	6,37,500.00
(Fully paid shares of Rs. 100 each)		Fixed Assets	1,05,00,000.00
General Reserve	25,51,041.67	Current Assets	15,50,000.00
Profit and Loss Account	14,81,145.83		
Sundry Creditors	5,30,000.00		
Minority Interest	31,25,312.50		
	<u>1,26,87,500.00</u>		<u>1,26,87,500.00</u>

Working Notes :

- (i) Analysis of profits of D Ltd.

	<i>Capital Profit Rs.</i>	<i>Revenue Reserve Rs.</i>	<i>Revenue Profit Rs.</i>
General Reserve on the date of purchase of shares	6,00,000.00		
Profit and Loss A/c on the date of purchase of shares	60,000.00		
Increase in General Reserve		4,00,000.00	
Increase in profit			2,60,000.00
	<u>6,60,000.00</u>	<u>4,00,000.00</u>	<u>2,60,000.00</u>
Less : Minority Interest (1/6)	<u>1,10,000.00</u>	<u>66,666.67</u>	<u>43,333.33</u>
	<u>5,50,000.00</u>	<u>3,33,333.33</u>	<u>2,16,666.67</u>
Share of A Ltd. (1/2)	3,30,000.00	2,00,000.00	1,30,000.00
Share of B Ltd. (1/4)	1,65,000.00	1,00,000.00	65,000.00
Share of C Ltd. (1/12)	55,000.00	33,333.33	21,666.67

- (ii) Analysis of profits of C Ltd.

	<i>Capital Profit Rs.</i>	<i>Revenue Reserve Rs.</i>	<i>Revenue Profit Rs.</i>
General Reserve on the date of purchase of shares	1,00,000.00		
Profit and Loss A/c on the date of purchase of shares	50,000.00		
Increase in General Reserve		1,50,000.00	
Increase in Profit and Loss A/c			2,00,000.00
Share in D Ltd.		<u>33,333.33</u>	<u>21,666.67</u>
	<u>1,50,000.00</u>	<u>1,83,333.33</u>	<u>2,21,666.67</u>

Less : Minority Interest (1/4)	<u>37,500.00</u>	<u>45,833.33</u>	<u>55,416.67</u>
	<u>1,12,500.00</u>	<u>1,37,500.00</u>	<u>1,66,250.00</u>
Share of A Ltd. (1/2)	75,000	91,666.67	1,10,833.33
Share of B Ltd. (1/4)	37,500	45,833.33	55,416.67
(iii) Analysis of profits of B Ltd.			
	<i>Capital Profit Rs.</i>	<i>Revenue Reserve Rs.</i>	<i>Revenue Profit Rs.</i>
General Reserve on the date of purchase of shares	2,00,000.00		
Profit and Loss A/c on the date of purchase of shares	2,00,000.00		
Increase in General Reserve		2,00,000.00	
Increase in Profit and Loss A/c			2,00,000.00
Share in D Ltd.		1,00,000.00	65,000.00
Share in C Ltd.		<u>45,833.33</u>	<u>55,416.67</u>
	<u>4,00,000.00</u>	<u>3,45,833.33</u>	<u>3,20,416.67</u>
Less : Minority Interest (1/4)	<u>1,00,000.00</u>	<u>86,458.33</u>	<u>80,104.17</u>
Share of A Ltd. (3/4)	<u>3,00,000.00</u>	<u>2,59,375.00</u>	<u>2,40,312.50</u>
(iv) Cost of control			
Investments in			<i>Rs.</i>
B Ltd.		35,00,000	
C Ltd.		16,00,000	
D Ltd.		<u>60,00,000</u>	1,11,00,000
Paid up value of investments in			
B Ltd.		30,00,000	
C Ltd.		15,00,000	
D Ltd.		<u>50,00,000</u>	(95,00,000)
Capital profits in			
B Ltd.		3,00,000	
C Ltd.		1,12,500	
D Ltd.		<u>5,50,000</u>	<u>(9,62,500)</u>
Goodwill			<u>6,37,500</u>
(v) Minority interest			
Share Capital :			
B Ltd. (1/4)		10,00,000.00	
C Ltd. (1/4)		5,00,000.00	
D Ltd (1/6)		<u>10,00,000.00</u>	25,00,000.00
Share in profits & reserves (Pre and Post-Acquisitions)			
B Ltd.		2,66,562.50	
C Ltd.		1,38,750.00	
D Ltd.		<u>2,20,000.00</u>	<u>6,25,312.50</u>
			<u>31,25,312.50</u>

(vi) General Reserve — A Ltd.

Balance as on 31.12.2004 (given)	20,00,000.00
Share in	
B Ltd.	2,59,375.00
C Ltd.	91,666.67
D Ltd.	<u>2,00,000.00</u>
	<u>25,51,041.67</u>

(vii) Profit and Loss Account — A Ltd.

Balance as on 31.12.2004 (given)	10,00,000.00
Share in	
B Ltd.	2,40,312.50
C Ltd.	1,10,833.33
D Ltd.	<u>1,30,000.00</u>
	<u>14,81,145.83</u>

2.

Surekha Ltd.

Profit and Loss Account for the year ending 31st March, 2005

		<i>Rs. '000</i>
Sales		15,500
Cost of Sales		<u>(7,800)</u>
		7,700
Distribution costs		(1,500)
Administration costs		<u>(2,000)</u>
Profit before tax		4,200
Taxation	1,239	
Deferred tax (35% of Rs. 660)	<u>231</u>	<u>(1,470)</u>
Profit after tax		2,730
Dividends (Rs. 1,200 + Rs. 800)		<u>(2,000)</u>
Profit for the year		730
Retained profit brought forward (Rs. 1,000 – Rs. 210)		<u>790</u>
Retained Profit carried forward		<u>1,520</u>

Surekha Ltd.

Balance Sheet as at 31st March, 2005

<i>Liabilities</i>	<i>Amount Rs. '000</i>	<i>Assets</i>	<i>Amount Rs. '000</i>
Share Capital:		Fixed Assets:	
Issued and subscribed		Gross block	9,000
4,00,000 shares of Rs. 10 each,		Less: Depreciation	<u>1,500</u>
fully paid up	4,000	Current Assets, Loans	7,500
Reserves and Surplus:		and Advances:	
Retained profits	1,520	(a) Current assets	
Deferred Tax Liability	441	Stock	400
Current liabilities and Provisions:		Debtors	440
(a) Current liabilities		Cash at bank	<u>160</u>
Creditors	500	(b) Loans and	1,000
(b) Provisions		Advances	NIL
Provision for tax	1,239		
Proposed dividend	<u>800</u>		
	<u>8,500</u>		<u>8,500</u>

Notes to Accounts:

1. Segmental Disclosures (Business Segments)

(Figures in Rs. 000's)

	A Division	B Division	C Division	Total
Sales	<u>6,000</u>	<u>8,000</u>	<u>1,500</u>	<u>15,500</u>
Cost of Sales	2,600	4,300	900	7,800
Administration Cost (5:3:2)	1,000	600	400	2,000
Distribution Cost (3:1:1)	900	300	300	1,500
Profit/Loss	<u>1,500</u>	<u>2,800</u>	<u>(100)</u>	<u>4,200</u>
	<u>6,000</u>	<u>8,000</u>	<u>1,500</u>	<u>15,500</u>
Original cost of Assets (Equal Capital Base)	3,000	3,000	3,000	9,000
Depreciation @ 10% p.a.				
For the year ended 31.3.2004	300	300	NIL	600
For the year ended 31.3.2005	300	300	300	900

Note: C division is a reportable segment as per assets criteria.

2. Tax computation

	(Rs. in '000s)
Profit before tax for the year ended 31.3.2005	4,200
Add: Depreciation provided in the books (300 + 300 + 300)	<u>900</u>
	5,100
Less: Depreciation as per Income Tax Act (480 + 480 + 600)	<u>1,560</u>
Taxable Income	<u>3,540</u>
Tax @ 35%	<u>1,239</u>

3. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

	Rs.'000s
Opening Timing Difference on 1.4.2004	
WDV of fixed assets as per books	5,400
WDV of fixed assets as per Income Tax Act	<u>4,800</u>
Difference	<u>600</u>
Deferred Tax Liability @ 35% on 600	210
This has been adjusted against opening balance of retained profits of Current year (ended 31st March, 2005)	

	Rs.'000
Depreciation as per Books	900
Depreciation as per Income Tax Act (480 + 480 + 600)	<u>1,560</u>
Difference	<u>660</u>
Deferred Tax Liability @ 35% on 660 (to be carried forward)	<u>231</u>

4. Contingent Liabilities not provided: Company is contesting claim for damages for Rs.7,50,000 and as such the same is not acknowledged as debts.

3. Information about Omega Textiles Ltd.s' operations in different industry segments is furnished in the following table:

	Cotton textiles	Silk fabrics	Woolen clothes	Others	Inter Segment Elimination	(Amount/Rs.000) Consolidated
External Sales	5,595	553	324	155	—	6,627
Inter Segment	<u>55</u>	<u>72</u>	<u>21</u>	<u>7</u>	<u>155</u>	<u>—</u>
Total	5,650	625	345	162	155	6,627
Segment expenses	<u>3,335</u>	<u>425</u>	<u>222</u>	<u>200</u>	<u>122</u>	<u>4,060</u>
Operating Profit	<u>2,315</u>	<u>200</u>	<u>123</u>	<u>(38)</u>	<u>33</u>	2,567
General corporate expenses						(562)
Income from investment						132
Interest						<u>(65)</u>
Income from continuing operations						<u>2072</u>
Identifiable assets	7,320	1,320	1,050	665		10,355
Corporate assets	—	—	—	—	—	<u>722</u>
Total assets						<u>11,077</u>

4. Calculation of Profit after tax (PAT)

	Rs.
Profit before interest and tax (PBIT)	32,00,000
Less: Debenture interest (Rs. 64,00,000 × 12/100)	<u>7,68,000</u>
Profit before tax (PBT)	24,32,000
Less: Tax @ 35%	<u>8,51,200</u>
Profit after tax (PAT)	15,80,800
Less: Preference Dividend	
(Rs. 40,00,000 × 8/100)	3,20,000
Equity Dividend (Rs. 80,00,000 × 8/100)	<u>6,40,000</u>
Retained earnings (Undistributed profit)	<u>9,60,000</u>
	6,20,800

Calculation of Interest and Fixed Dividend Coverage

$$= \frac{\text{PAT} + \text{Debenture Interest}}{\text{Debenture Interest} + \text{Preference dividend}}$$

$$= \frac{15,80,800 + 7,68,000}{7,68,000 + 3,20,000} = \frac{23,48,800}{10,88,000} = 2.16 \text{ times}$$

Calculation of Capital Gearing Ratio

$$\text{Capital Gearing Ratio} = \frac{\text{Fixed interest bearing funds}}{\text{Equity shareholders' funds}}$$

$$= \frac{\text{Preference Share Capital} + \text{Debentures}}{\text{Equity Share Capital} + \text{Reserves}}$$

$$= \frac{40,00,000 + 64,00,000}{80,00,000 + 32,00,000} = \frac{1,04,00,000}{1,12,00,000} = 0.93$$

Calculation of Yield on Equity Shares:

Yield on equity shares is calculated at 50% of profits distributed and 5% on undistributed profits:

	(Rs.)
50% on distributed profits (Rs. 6,40,000 × 50/100)	3,20,000
5% on undistributed profits (Rs. 6,20,800 × 5/100)	<u>31,040</u>
Yield on equity shares	<u>3,51,040</u>

$$\begin{aligned}\text{Yield on equity shares \%} &= \frac{\text{Yield on shares}}{\text{Equity Share Capital}} \times 100 \\ &= \frac{3,51,040}{80,00,000} \times 100 = 4.39\% \text{ or, } 4.388\%.\end{aligned}$$

Calculation of Expected Yield on Equity shares

Note: There is a scope for assumptions regarding the rates (in terms of percentage for every one time of difference between Success Ltd. and Industry Average) of risk premium involved with respect to Interest and Fixed Dividend Coverage and Capital Gearing Ratio. The below solution has been worked out by assuming the risk premium as:

- (i) 1% for every one time of difference for Interest and Fixed Dividend Coverage.
- (ii) 2% for every one time of difference for Capital Gearing Ratio.
- (i) Interest and fixed dividend coverage of Success Ltd. is 2.16 times but the industry average is 3 times. Therefore, risk premium is added to Success Ltd. Shares @ 1% for every 1 time of difference.

$$\begin{aligned}\text{Risk Premium} &= 3.00 - 2.16 (1\%) \\ &= 0.84 (1\%) = .84\%\end{aligned}$$

- (ii) Capital Gearing ratio of Success Ltd. is 0.93 but the industry average is 0.75 times. Therefore, risk premium is added to Success Ltd. shares @ 2% for every 1 time of difference.

$$\begin{aligned}\text{Risk Premium} &= 0.75 - 0.93 (2\%) \\ &= 0.18 (2\%) \\ &= 0.36\%\end{aligned}$$

	(%)
Normal return expected	9.60
Add: Risk premium for low interest and fixed dividend coverage	0.84
Add: Risk premium for high interest gearing ratio	<u>0.36</u>
	<u>10.80</u>

Value of Equity Share

$$\begin{aligned}&= \frac{\text{Actual yield}}{\text{Expected yield}} \times \text{Paid-up value of share} \\ &= \frac{4.39}{10.80} \times 100 = \text{Rs. } 40.65\end{aligned}$$

5. Working Notes:

(Rs. in lakhs)

- (a) Calculation of average capital employed

Fixed assets	24.00
Other tangible assets	3.00
Intangible assets	<u>3.00</u>

		30.00
Less : Liabilities	10	
Bonus	<u>1</u>	<u>11.00</u>
		19.00
Less : $\frac{1}{2}$ of profits [$\frac{1}{2}$ (4.1 – Bonus 1.0)]		<u>1.55</u>
Average capital employed		<u>17.45</u>
(b) Calculation of super profit		
Average profit	$= \frac{1}{4} (3 + 3.5 + 4 + 4.1 - \text{Bonus } 1.0)$	
	$= \frac{1}{4} \times 13.6$	3.400
Less : Normal profit	$= 10\% \text{ of Rs. } 17.45 \text{ lakhs}$	<u>1.745</u>
Super profit		<u>1.655</u>
(c) Calculation of goodwill		
3 years' purchase of average super-profit	$= 3 \times 1.655 = \text{Rs. } 4.965 \text{ lakhs}$	
Increase in value of goodwill	$= \frac{1}{2} (\text{book value} + 3 \text{ years' super profit})$	
	$= \frac{1}{2} (5 + 4.965)$	
	$= \text{Rs. } 4.9825 \text{ lakhs}$	
Net assets as revalued including book value of goodwill		24.00
Add : Increase in goodwill (round off)		<u>4.98</u>
Net assets available for shareholders		<u>28.98</u>

- (i) Break up value of Re. 1 of share capital $= \frac{\text{Rs. } 28.98 \text{ lakhs}}{\text{Rs. } 16.00 \text{ lakhs}}$
 $= \text{Rs. } 1.81$
 Break up value of Rs. 10 paid up share $= 1.81 \times 10 = \text{Rs. } 18.10$
 Break up value of Rs. 6 paid up share $= 1.81 \times 6 = \text{Rs. } 10.86$
 Market value of shares :

$$\text{Average dividend} = \left(\frac{11\% + 12\% + 13\% + 14\%}{4} \right) = 12.5\%$$

$$\text{Market value of Rs. 10 paid up share} = \frac{12.5\%}{10\%} \times 10 = \text{Rs. } 12.50$$

$$\text{Market value of Rs. 6 paid up share} = \frac{12.5\%}{10\%} \times 6 = \text{Rs. } 7.50$$

- (ii) Break up value of share will remain as before even if the controlling interest is being sold. But the market value of shares will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Average Profit}^*}{\text{Paid up value of shares}} \times 100 = \frac{\text{Rs. } 3.4 \text{ lakhs}}{\text{Rs. } 16 \text{ lakhs}} \times 100 = 21.25\%$$

Market value of shares :

$$\text{For Rs. 10 paid up share} = \frac{21.25\%}{10\%} \times 10 = \text{Rs. } 21.25$$

$$\text{For Rs. 6 paid up share} = \frac{21.25\%}{10\%} \times 6 = \text{Rs. } 12.75$$

$$\text{Fair value of shares} = \frac{\text{Break up value} + \text{Market value}}{2}$$

$$\text{Fair value of Rs. 10 paid up share} = \frac{18.10 + 21.25}{2} = \text{Rs. 19.68}$$

$$\text{Fair value of Rs. 6 paid up share} = \frac{10.86 + 12.75}{2} = \text{Rs. 11.81}$$

Notes : In the above solution, tax effect of disputed bonus and corporate dividend tax have been ignored.

* (Transfer to reserves has been ignored)

6.

**Balance Sheet of Gamma Limited
as at 1st April, 2004**

(Rs. in lakhs)

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
Equity shares of Rs. 100 each	2,300	Fixed assets	2,200
15% Preference shares of Rs. 100 each	700	Current assets, loans	—
Revaluation reserve	180	and advances	1,445
General reserve	—		
Profit and loss account	34		
16% Debentures of Rs. 100 each	132		
Current liabilities and provisions	<u>299</u>		
	<u>3,645</u>		<u>3,645</u>

Working Notes :

(i) Purchase consideration

(Rs. in lakhs)

	<i>Alpha Ltd.</i>	<i>Beta Ltd.</i>	<i>Total</i>
Equity shares	1,500	800	2,300
Preference shares	<u>400</u>	<u>300</u>	<u>700</u>
	<u>1,900</u>	<u>1,100</u>	<u>3,000</u>
Amount of share capital of transferor companies	<u>1,400</u>	<u>1,100</u>	<u>2,500</u>
Difference	<u>500</u>	<u>Nil</u>	<u>500</u>
(ii) Amount of debentures issued	12/16 × 96 = 72	12/16 × 80 = 60	132
Amount of debentures of transferor companies	<u>96</u>	<u>80</u>	<u>176</u>
Difference	<u>(24)</u>	<u>(20)</u>	<u>(44)</u>

The total difference of Rs. 456 (in lakhs) has been adjusted in the balance sheet of Gamma Ltd. against reserves as below :

(Rs. In lakhs)

	<i>Combined Amount</i>	<i>Adjusted Amount</i>	<i>Balance Sheet Amount</i>
General reserve	350	350	Nil
Profit and loss account	<u>140</u>	<u>106</u>	<u>34</u>
	<u>490</u>	<u>456</u>	<u>34</u>

7. (a)

K Ltd.
Gross Value Added Statement
for the year ended 31st March, 2004

	<i>Rs. in lakhs</i>	<i>Rs. in lakhs</i>
Sales		206.42
Less: (a) Cost of bought in material and services. (Note 1)	150.57	
(b) Administration expenses (Note 2)	3.92	
(c) Interest on working capital loan	<u>2.30</u>	<u>156.79</u>
Value added by manufacturing and trading activities		49.63
Add: Other income		<u>10.20</u>
Total Value Added		<u>59.83</u>

Application of Value Added

		<i>Rs. in lakhs</i>	<i>%</i>
To Pay Employees:			
Salaries, wages, bonus and other benefits		12.80	21.39
To Pay Directors:			
Salaries and Commission		2.20	3.68
To Pay Government:			
Cess and Local Taxes	3.20		
Income Tax	<u>3.00</u>	6.20	10.36
To Pay Providers of Capital:			
Interest on debenture	1.80		
Interest on fixed deposits	3.90		
Proposed Dividend	<u>3.00</u>	8.70	14.54
To Provide for maintenance and expansion of the company:			
Depreciation	5.69		
General Reserve (24.30 – 0.46)	23.84		
Returned profit (1.75 – 1.35)	<u>0.40</u>	<u>29.93</u>	<u>50.03</u>
		<u>59.83</u>	<u>100.00</u>

Reconciliation between total value added and Profit Before Taxation

(Rs. in lakhs)

Profit before taxation		30.24
Add: Depreciation	5.69	
Salaries, bonus and other benefits	12.80	
Directors' Remuneration	2.20	
Cess and Local Tax	3.20	
Interest on Debentures	1.80	
Interest on fixed loan	<u>3.90</u>	<u>29.59</u>
Total value added		<u>59.83</u>

Working Notes:

		<i>Rs. in lakhs</i>
(1) Production and operational expenses		166.57
Less: (a) Salaries, Wages, Bonus and other benefits	12.80	
(b) Cess and Local Taxes	<u>3.20</u>	<u>16.00</u>
Cost of bought in material and services		<u>150.57</u>

It is assumed that other manufacturing charges are paid to outsiders for such expenses as machining done outside.

(2) Administration expenses	6.12
Less: Salaries and Commission to Directors	<u>2.20</u>
Administration expenses assumed to have been paid to outsiders	<u>3.92</u>

- (b) Economic Value Added (EVA) for short, is primarily a benchmark to measure earning efficiency. EVA as a residual income measure of financial performance, is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. In addition, EVA is a management tool to focus managers on the impact of their decisions in increasing shareholders' wealth. These include both strategic decisions such as what investments to make, which businesses to exit, what financing structure is optimal as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment or whether to make short or long production runs etc. Most importantly the real key to increasing shareholders wealth is to integrate the EVA framework in four key areas viz., (1) to measure business performance, (2) to guide managerial decision making, (3) to align managerial incentives with shareholders' interests and (4) to improve the financial and business literacy throughout the organisation.

Value Added (VA) on the other hand is the wealth, a reporting entity has been able to create through the collective effort of capital, management and employees. It is the market price of the output of an enterprise less the price of the goods and services acquired by transfer from other firms. Value Added can provide a useful measure in gauging performance and activity of the reporting entity. Value Added is commonly reported in terms of Gross Value Added (GVA) which is arrived at by deducting from sales revenue the cost of all materials and services which were brought in from outside suppliers. Value Added may also be reported in terms of Net Value Added (NVA) which can be defined as GVA less depreciation.

8. (a).

Statement of Change – Development Fund

<i>Receipts:</i>	<i>Rs.</i>	<i>Rs.</i>
Government Grants	1,11,00,000	
Private Grants	55,50,000	
Income from fixed deposits	5,55,000	
Transfer from unrestricted fund	<u>18,50,000</u>	1,90,55,000
<i>Deductions/Transfers</i>		
Cost of land acquired	19,42,500	
Furniture purchased	<u>2,03,500</u>	<u>21,46,000</u>
		<u>1,69,09,000</u>

**Balance Sheet – Development Fund
as at 31st March, 2004**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Fund Balance	1,69,09,000	Capital Work-in-Progress	28,67,500
		Advance for Land acquisition	11,10,000
		Fixed Deposits	74,00,000
		Bank Balance (as per Bank A/c)	<u>55,31,500</u>
	<u>1,69,09,000</u>		<u>1,69,09,000</u>

Working Notes:

1. Bank A/c					
<i>Dr.</i>			<i>Cr.</i>		
	<i>Rs.</i>			<i>Rs.</i>	
To Government Grants	1,11,00,000	By Fixed Deposit		74,00,000	
To Private Grants	55,50,000	By Cost of Land		19,42,500	
To Interest Income	5,55,000	By Advance Payment of Land		11,10,000	
To Transfer from		By Payment to Contractors		28,67,500	
Unrestricted Fund	18,50,000	By Furniture		2,03,500	
		By Balance c/d		55,31,500	
	<u>1,90,55,000</u>			<u>1,90,55,000</u>	

2. In general balance sheet, land (Rs. 19,42,500) and Furnitures (Rs. 2,03,500) will be shown as assets and unrestricted fund balance will increase by Rs. 21,46,000 as transfer from development funds.
3. Students should note that development fund is a separate accounting entity and its assets and liabilities should be treated accordingly.

(b) Journal Entries in the books of ABZ University

<i>Particulars</i>	<i>Dr. (Rs.)</i>	<i>Cr. (Rs.)</i>
(i) On receipt of grants		
Bank A/c	Dr. 1,10,00,000	
To Revenue Fund (Restricted)		1,10,00,000
(Being the receipt of restricted funds from WHO and RR Memorial Fund)		
(ii) For expenditure incurred		
Expenditure (Appropriate Heads)	Dr. 81,00,000	
To Bank A/c		81,00,000
(Being the expenditure made out of grants on appropriate heads)		
(iii) For recognizing revenue		
Revenue Fund (Restricted)	Dr. 81,00,000	
To Income – Government grants		43,00,000
To Income – Private grants		38,00,000
(Being the entry to record income to the extent of expenditure made)		
(iv) Revenue (Restricted Fund)	Dr. 4,00,000	
To Bank A/c		4,00,000
(Overhead incurred to administer the grant)		

9. (a) Statement showing calculation of EPS

	<i>(Amount/Rs. '000 where applicable)</i>
(a) Number of fully convertible debentures (400 lac/100)	4,00,000
(b) Number of equity shares to be issued (4,00,000 × 5)	20,00,000
(c) Capital structure after diluted FCD	
(i) Equity share capital (60 lac shares × 10 each)	60,000
(ii) Share premium (30,000 + 20,000)	50,000
(iii) General reserve	40,000
(iv) Revaluation reserve	<u>40,000</u>
(d) Total	1,90,000

(e)	Net asset value per share (1,90,000 / 6,000)	Rs. 31.67 per share
(f)	Fully diluted EPS (20,000 / 6,000)	Rs. 3.33 per share

(b) Computation of EPS:

<i>Amalgamation in the nature of purchase</i>	<i>No. of shares</i>	<i>Period Outstanding</i>	<i>Weighted average</i>
Equity shares as on 1.4.2003 – upto 30.09.2003	5,00,00,000	6	2,50,00,000
Post acquisition equity shares	<u>50,00,000</u>		
From 1.10.2003 – 31.03.2004	5,50,00,000	6	<u>2,75,00,000</u>
Weighted average no. of equity shares			5,25,00,000
Profit available to equity shareholders (Rs.)			14,00,00,000
EPS (Rs.)			2.67
<i>Amalgamation in the nature of merger</i>			
Equity shares as on 1.4.2003 – upto 30.09.2003	5,00,00,000		
Post acquisition equity shares	<u>50,00,000</u>		
Total equity shares	5,50,00,000	12	5,50,00,000
Profit available to equity shareholders (Rs.)			15,50,00,000
EPS (Rs.)			2.82

In the above-mentioned solution, the numerator for computing EPS in the amalgamation in the nature of purchase is profit of A Ltd. plus post merger profit of B Ltd., which is now a division of A Ltd., i.e. Rs.1,400 lakhs. Whereas in the case amalgamation in the nature of merger, the numerator should be the entire profit of A Ltd. and B Ltd. including post-merger profit of B Ltd.

10. (a) (i) Yes, Costs and Market price of current investments should be aggregated under each group.

(ii)	Rs.
Equity Shares	271.00
Mutual Funds	36.00
Government Securities	90.00

- (iii) No.

(b) Statement showing classification of hire purchase instalments

	<i>(Rs. in lakhs)</i>
Standard Assets	63.00
Sub-standard Asset:	
2 accounts identified as sub-standard asset for a period less than 2 years	3.00
12 accounts overdue for a period of eight months	12.00
Doubtful Asset:	
3 accounts identified as sub-standard asset for a period more than 2 years	7.00
2 accounts identified as sub-standard asset for a period of more than 3 years	10.00
Loss Asset:	
Account identified by the management as loss asset	<u>5.00</u>
Total overdue	<u>100.00</u>

$$\begin{aligned}
 11.(a) \quad \text{NAV of Mutual Fund} &= \frac{\text{Total Market Value of All Mutual Fund holdings} - \text{All Mutual Fund liabilities}}{\text{No. of Mutual Fund units or share}} \\
 &= \frac{\text{Rs. 1,50,00,00,000}}{5,00,00,000} \\
 &= \text{Rs. 30}
 \end{aligned}$$

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.

- (b) 'Open-ended scheme' means a scheme of mutual fund which offers units for sale without specifying any duration of redemption.

'Close-ended scheme' means any scheme of a mutual fund in which the period of maturity is specified.

12. (a) Disclosure in the balance sheet required to be made by a non-banking finance company:

- (1) Every NBFC shall, separately disclose in its balance sheet the required provisions without netting them from the income or against the value of assets.
- (2) The provisions shall be distinctly indicated under separate heads of accounts as under:
 - (i) provisions for bad and doubtful debts; and
 - (ii) provisions for depreciation in investments.
- (3) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC.
- (4) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads 'general provisions and loss reserves' may be written back without making adjustment against them.

- (b) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

- (a) Register of transactions (Sauda book)/Daily transaction list;
- (b) Clients ledger;
- (c) General ledger;
- (d) Journals;
- (e) Cash book;
- (f) Bank Pass Book;
- (g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;
- (h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
- (i) Counterfoils or duplicates of contract notes issued to clients;
- (j) Written consent of clients in respect of contracts entered into as principals;
- (k) Margin deposit book;
- (l) Register of accounts of sub-brokers;
- (m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scripwise clientwise list in respect of scripts of specified group, client upla statement,

duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of value balance sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorising directors and employees and copies of pool account statements.

- (c) Environmental accounting demands necessary amendments to the System of National Accounts (SNA) to incorporate the use or depletion of natural resources. The SNA is a set of accounts which every national government compiles routinely to track activities of the economy. For details refer to para 9.4.1, Unit 9 – Chapter 6 of Final Course study material.
 - (d) R Likert's, Model of human resource valuation is now totally rejected for the following reasons:-
 - (i) It considers capitalisation of historical costs which are actually sunk costs and irrelevant for decision-making.
 - (ii) It failed to provide a reasonable value to human assets.
 - (iii) It capitalises only training and development costs incurred on employees and ignores the future expected cost to be incurred for their maintenance.
 - (iv) It distorts the value of highly skilled human resources.
13. (a) SEBI has the right to appoint one or more persons as inspecting authority to undertake inspection of the books of account, records and documents of the merchant banker for any of the following purposes:
- (i) To see that books of account are being maintained in the required manner;
 - (ii) To ensure that provisions of SEBI Act, rules and regulations are complied with;
 - (iii) To investigate into complaints received from investors, other merchant bankers, or any other person on any matter having a bearing on the activities of merchant banker; or
 - (iv) To investigate *suo moto* in the interest of securities business or investors' interest into the affairs of merchant bankers.
- (b) Major accounting issues involved in environmental accounting can be explained as follows:
- (i) *Distinction between environmental expenditure and normal business expenditure:* Many new machines may incorporate state-of-the-art environmental technology and accordingly, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. It is necessary to frame guidelines indicating whether the reporting entity should properly allocate the capital and revenue expenditures between environmental expenditure and normal business expenditure.
 - (ii) *Capitalisation of environmental expenditures vis-a-vis expensing them during the current accounting period:* Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is resorted to and/or persuaded to follow environmental accounting, the adverse impact on EPS is a major concern. Accordingly many Western Corporations prefer to capitalise environment costs instead of immediate expensing and adopt an amortisation policy extending upto 10 years. Although this accounting practice has no theoretical support and rather contradicts the well established accounting concept of "prudence", it is considered as a practical solution to off-load burden of accumulated environmental costs without abruptly disturbing the cash flows attributable to the lenders, Government and finally to the shareholders. However, recognition of environmental costs should not necessarily be restricted to the expenses accrued in view of the applicable environmental laws. It should be guided by ethical consideration.

- (iii) *Recognition of environment related contingent liabilities:* Environmental contingent liabilities are a matter of increasing concern throughout the world. Recognising a liability of hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably.

In fact, identification and measurement of contingent liabilities are highly debatable accounting aspects. The United Nations Conference on Environment and Development (UNCEAD) papers raise the basic question why environmental contingencies should not be merged with other business contingencies. There is an urgent need for tightening the reporting rules on contingencies incorporating specific requirements for disclosure of environmental contingencies along with other contingencies.

- (c) Refer to Para 3.2, Unit 3 Chapter 5 of study material.

14. (a) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

- (i) Ascertain the number of employees in each rank.
- (ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.
- (iii) Ascertain the economic value of an employee in a specified rank during each time period.
- (iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process, they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

- (b) The contents of Corporate Social Report is essentially based on social objectives. Corporate Social Report gives information communique with respect to discharge of social responsibilities of corporate entity. For details, refer to unit 3, chapter 6 of Final course study material.
- (c) "Subordinated debt" means a fully paid-up capital instrument, which is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of the NBFC. The book value of such instrument shall be subjected to discounting as provided hereunder:

Remaining Maturity of the instruments	Rate of discount
(a) Upto one year	100%
(b) More than one years but upto two years	80%
(c) More than two years but upto three years	60%
(d) More than three years but upto four years	40%
(e) More than four years but upto five years	20%

to the extent such discount value does not exceed fifty percent of Tier-I capital.

15. Statement showing the total value of Human Capital of Jalan Limited

<i>Particulars</i>	<i>Age Group</i>	<i>Age Group</i>	<i>Age Group</i>	<i>(Value in Rs.)</i>
	<i>30 – 39 years</i>	<i>40 – 49 years</i>	<i>50 – 55 years</i>	<i>Total</i>
Unskilled Employee	2,01,95,520	1,18,47,600	40,94,064	3,61,37,184
Semiskilled Employee	2,21,23,296	1,14,78,924	45,48,960	3,81,51,180
Skilled Employee	3,60,73,536	2,00,08,440	68,23,440	<u>6,29,05,416</u>
				<u>13,71,93,780</u>

Working Notes:

<i>Particulars</i>	<i>No.</i>	<i>Annual Salary</i>	<i>Total Salary</i>	<i>PV Factor</i>	<i>Present Value</i>
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Unskilled Employees

Age Group 30 – 39 Years

For next 10 years	100	18,000	18,00,000	6.1446	1,10,60,280
For year 11 – 20	100	30,000	30,00,000	2.3690	71,07,000
For year 21 – 25	100	36,000	36,00,000	0.5634	<u>20,28,240</u>
					<u>2,01,95,520</u>

Age Group 40 – 49 Years

For next 10 years	50	30,000	15,00,000	6.1446	92,16,900
For year 11 – 15	50	36,000	18,00,000	1.4615	<u>26,30,700</u>
					<u>1,18,47,600</u>

Age Group 50 – 55 Years

For next 5 years	30	36,000	10,80,000	3.7908	<u>40,94,064</u>
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Semiskilled Employees

Age Group 30 – 39 Years

For next 10 years	60	36,000	21,60,000	6.1446	1,32,72,336
For year 11 – 20	60	48,000	28,80,000	2.3690	68,22,720
For year 21 – 25	60	60,000	36,00,000	0.5634	<u>20,28,240</u>
					<u>2,21,23,296</u>

Age Group 40 – 49 Years

For next 10 years	30	48,000	14,40,000	6.1446	88,48,224
For year 11 – 15	30	60,000	18,00,000	1.4615	<u>26,30,700</u>
					<u>1,14,78,924</u>

Age Group 50 – 55 Years

For next 5 years	20	60,000	12,00,000	3.7908	<u>45,48,960</u>
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Skilled Employees

Age Group 30 – 39 Years

For next 10 years	40	84,000	33,60,000	6.1446	2,06,45,856
For year 11 – 20	40	1,20,000	48,00,000	2.3690	1,13,71,200
For year 21 – 25	40	1,80,000	72,00,000	0.5634	<u>40,56,480</u>
					<u>3,60,73,536</u>

Age Group 40 – 49 Years

For next 10 years	20	1,20,000	24,00,000	6.1446	1,47,47,040
For year 11 – 15	20	1,80,000	36,00,000	1.4615	<u>52,61,400</u>
					<u>2,00,08,440</u>

Age Group 50 – 55 Years

For next 5 years	10	1,80,000	18,00,000	3.7908	<u>68,23,440</u>
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16. (a) Para 13 of AS 11 Revised – “Accounting for the Effects of changes in Foreign Exchange Rate” states that an enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward contract, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The difference between the forward rate and the exchange rate on the date of the transaction should be recognized as income or expense over the life of the contract except in respect of liabilities incurred for acquiring fixed assets in which case such difference should be adjusted in the carrying amount of the respective fixed assets.

- (b) *Equity Index Future*: Equity index futures are instruments where the underlying variable is a stock index future. It has been recently introduced in India. Both the Bombay Stock Exchange and the National Stock Exchange have introduced index futures in June 2000 and they permit trading on the Sensex Futures and the Nifty Futures respectively. The Institute of Chartered Accountants of India has issued “Guidance note on Accounting for Equity Index and Equity Stock Futures and Options”.

17. Accounting entries in the books of buyer

July, 2003	Equity stock option premium Account	Dr.	2,000	
	To Bank Account			2,000
	(Being premium paid to acquire stock option)			
	Equity Stock Option Margin Account	Dr.	12,000	
	To Bank Account			12,000
	(Being initial margin paid on option)			
	(i) <u>Option is settled by delivery of assets</u>			
August, 2003	Equity shares of ABC Ltd. Account	Dr.	25,000	
	To Equity Stock Option Margin Account			12,000
	To Bank Account			13,000
	(Being option exercised and shares acquired. Rs. 12,000 Margin adjusted and the balance amount was paid)			
	Profit and loss Account	Dr.	2,000	
	To Equity Stock Option Premium Account			2,000
	(Being the premium transferred to profit and loss account on exercise of option)			
	Bank Account	Dr.	12,000	
	To Equity Stock Option Margin Account			12,000
	(Being margin on equity stock option received back on exercise /expiry of option)			

(ii) Option is settled in cash

Profit and loss Account	Dr.	2,000	
To Equity Stock Option Premium Account			2,000
<u>(Being the premium transferred to profit and loss account)</u>			
Bank Account (Rs100x10)	Dr.	1,000	
To Profit and loss Account			1,000
<u>(Being profit on exercise of option)</u>			
Bank Account	Dr.	12,000	
To Equity Stock Option Margin Account			12,000
<u>(Being margin on equity stock option received back on exercise /expiry of option)</u>			

18.

IAS	US GAAPs	AS in India
Inventories should be valued at the lower of cost and net realizable value. If specific cost is not determinable, the bench-mark treatment is to use FIFO or weighted average. LIFO is also allowed but then there should be disclosure of the lower of (i) net realizable value and (ii) FIFO, weighted average or current cost.	Inventories should be stated at the lower of cost or market except in certain exceptional cases where it may be stated above cost. Exceptional cases where inventories be stated above cost include precious metals having a fixed monetary value with no substantial cost of marketing stated at such monetary value. Cost of inventory may be determined under any of several assumptions as to the flow of cost factors (such as FIFO; average; and LIFO).	Inventories are valued at the lower of cost and net realizable value. AS 2 (Revised) permits only FIFO or weighted average cost formula for determining the cost of inventories where the specific identification of cost is not possible.

19. (a) The counter guarantee given by the company is, in fact, an undertaking to perform what is in any event, an obligation of the company.

In any case, this is a matter which is in the control of the company itself and the possibility of the company defaulting in future does not mean that contingent liability exists on the Balance Sheet date.

No separate disclosure is required in respect of the counter-guarantees. This is as per guidance note on "guarantees and counter-guarantees given by companies".

- (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.

20.

ABC India Ltd.
Statement showing computation of the
correct amount of profit attributable
for the quarter

	<i>Amount (Rs.)</i>
Net income for the quarter as shown by the company	1,02,000
Extra ordinary gains should be recognized in the quarter in which it is accrued. Hence, allocation of Rs. 20,000 for the current quarter should be adjusted	(20,000)
Effect of change in the method of inventory valuation pertaining to earlier period, to be adjusted	<u>10,000</u>
Net profit for the period	<u>92,000</u>

Note: It is also required to restate the result of previous quarter, based on the above adjustments.

21. 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.

22. (a)

Present value of future cash flow

<i>Year ended</i>	<i>Future Cash Flow</i>	<i>Discount @ 10% Rate</i>	<i>Discounted cash flow</i>
31.3.2005	50	0.909	45.45
31.3.2006	30	0.826	24.78
31.3.2007	30	0.751	22.53
31.3.2008	20	0.683	13.66
31.3.2009	20	0.620	<u>12.40</u>
			118.82
Present value of residual price on 31.3.2009 = 5×0.620			<u>3.10</u>
Present value of estimated cash flow by use of an asset and residual value, which is called "value in use".			<u>121.92</u>

If net selling price of plant on 31.3.2004 is Rs. 60 lakhs, the recoverable amount will be higher of Rs. 121.92 lakhs (value in use) and Rs.60 lakhs (net selling price), hence recoverable amount is Rs.121.92 lakhs

- (b) As per AS-29 Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in first ten cases	= Rs. 90,000 × 0.3 + Rs. 1,60,000 × 0.1
	= Rs. 43,000 × 10
	= Rs. 4,30,000
Expected loss in remaining five cases	= Rs. 60,000 × 0.3 + Rs. 95,000 × 0.2
	= Rs. 37,000 × 5
	= Rs. 1,85,000
Total Contingent Liability	= Rs. 4,30,000 + Rs. 1,85,000 = Rs. 6,15,000

23. (a) Para 18 of AS-23 on “Accounting for Investments in Associates in CFS” speaks about the recognition of losses. As per the aforesaid para, if the carrying amount of the investment exceeds or equals the investor’s share of losses, the investor stops recognizing further losses and carries the investment at ‘NIL’ value. Therefore X Ltd. need not recognise its share of loss for the current year and shall carry the investment at ‘NIL’ value for the purpose of CFS. However, in the case of “separate financial statement”, permanent diminution in value, if any, should be adjusted from the carrying amount.
- (b) As per para 28 of AS-24:-
- Disclosure should continue in financial statements up to and including the period in which discontinuance is completed.
 - Discontinuance plan is said to be completed where the plan is substantially completed or abandoned – irrespective of whether or not full payments have been received from the buyer(s).
24. Paragraphs 53 and 54 of the Accounting Standard 26 prescribe what components of costs can be included, and what should be excluded in the recognition of an intangible asset. A summary is given below:
- Cost for recognizing an internally generated intangible asset (R & D related) represents direct, and allocable indirect expenditure incurred for making the intangible asset ready for intended use – such as
 - Materials and services
 - Salaries and wages of personnel directly associated with the creation of intangible asset.
 - Reasonable, and rational allocation of attributable overheads based on canons in AS 2.
 - Borrowing costs, if criteria under AS 16 are met
 - Selling, general and administration costs, inefficiencies (waste, scrap) training of staff etc, do not form part of cost for measurement. Similarly, certain costs relating to inefficiencies, and expenses on staff employed to operate the asset cannot form part of cost.
25. (a) The deferred tax balance at a particular balance sheet date can either be an asset or a liability. The conditions under which a set-off can be made, is laid down in the Standard, as under:

Deferred Tax items can be set off, only and only if two conditions are met. First is the legal right, and the second is common applicable tax law for both the items.

Enterprise should have a legally enforceable right to set off the tax items that stand recognized in the balance sheet.

DTA and DTL should relate to taxes on income levied by the same governing tax laws (An excise duty liability cannot be set off against an income tax asset).

- (b) The issue revolves round whether a related party transactions should be reported by a Parent, in its separate financial statement – even if, on balance sheet date the relationship does not exist.

Paragraph 23 of AS 18 provides a clear answer to this issue. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise, should disclose details of transactions.

In the instant case, the relationship is one of Control. The transaction took place, during the existence of Related Party Relationship. Hence, the parent is required to disclose the details of transaction, of a sum of Rs. 100 crore worth of business transactions in its separate financial statements.

26. (a) As per AS-1 “Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.” Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

- (i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognisance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at Rs. 50 crores and the profit for the year is greater by Rs. 20 crores.
 - (ii) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at Rs. 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by Rs. 18 crores. To that extent, the profit for the year is greater.
 - (iii) So far, the company has been providing 2% of sales for meeting “after sales expenses” during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is greater by Rs. 12 crores than would have been the case if the old policy were to continue.
 - (iv) The company has decided to provide Rs. 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. The provision so made has reduced the profit disclosed in the accounts by Rs. 10 crores.
- (b) The company should disclose the change in method of depreciation adopted for the accounting year. The impact of depreciation charge due to change in method must be quantified and reported by the enterprise.

Following aspects may be noted in this regard as per AS 6.

- (a) The depreciation method selected should be applied consistently from period to period.

- (b) A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise.
- (c) When such 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 to 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.
- (d) In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss.
- (e) In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.
- (c) Events occurring after the Balance Sheet date that represent material changes and commitments affecting the financial position of the enterprise must be disclosed. (AS 4 para 15). Hence, fire accident and loss thereof must be disclosed.

Suit filed against the company being a contingent liability must be disclosed with the nature of contingency, an estimate of the financial effect and uncertainties which may affect the future outcome must be disclosed as per para 16 of AS 4.

Events which take place after the Balance Sheet date because of statutory requirement can be adjusted in the financial statements of the audited enterprise. The proposed dividend though recommended and approved after the end of the account year it must be adjusted in the books of the enterprise. Hence, proposed dividend must be reflected in the financial statements.

27. It is possible that a company may raise borrowings for general purpose. A part of such funds could be used for production, or acquisition of a qualifying asset. In such circumstances, the rate of capitalization should be determined by applying a capitalization rate which should be the weighted average of the borrowing costs applicable to the general borrowings of the enterprise that are outstanding during the period.
28. 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.
29. 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
30. The use of standard cost of elements of cost of production has been suggested by AS-2 as a matter of convenience only. In fact, AS-2 aims to suggest the use of absorption costing based on normal capacity. AS-2 says that standard cost system may be used for convenience if the results approximate the actual cost. If the company can adopt absorption costing for value of inventory, then the standard cost systems need not be adopted.

APPENDIX-I

The students are advised to refer the latest Accounting Standards from the Chartered Accountant Journal or Students Newsletter

		<i>Chartered Accountant Journal</i>	<i>Students Newsletter</i>
AS 24	Discontinuing Operations	February, 2002	April, 2002
AS 25	Interim Financial Reporting	February, 2002	May, 2002
AS 26	Intangible Assets	February, 2002	June, 2002
AS 27	Financial Reporting of Interests in Joint Venture	February, 2002	July, 2002
AS-28	Impairment of Assets	June, 2002	
AS 7 (Revised)	Construction Contracts	June, 2002	
AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates	March, 2003	January, 2004
AS 29	Provisions, Contingent Liabilities and Contingent Assets	November, 2003	January, 2004

Note: AS 1 to AS 29 (including revised AS 7 and revised AS 11) are applicable for May, 2005 examinations.