

PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Holding Company Accounts

- The following are the Balance Sheets of Arun Ltd., Brown Ltd. and Crown Ltd. as at 31.12.2008:

Liabilities:	Arun Ltd. Rs.	Brown Ltd. Rs.	Crown Ltd. Rs.
Share Capital (Shares of Rs.100 each)	6,00,000	4,00,000	2,40,000
Reserves	80,000	40,000	30,000
Profit and Loss Account	2,00,000	1,20,000	1,00,000
Sundry Creditors	80,000	1,00,000	60,000
Arun Ltd.	<u>--</u>	<u>40,000</u>	<u>32,000</u>
Total	<u>9,60,000</u>	<u>7,00,000</u>	<u>4,62,000</u>
Assets			

	Arun Ltd. Rs.	Brown Ltd. Rs.	Crown Ltd. Rs.
Goodwill	80,000	60,000	40,000
Fixed Assets	2,80,000	2,00,000	2,40,000
Shares in:			
Brown Ltd. (3,000 Shares)	3,60,000	--	--
Crown Ltd. (400 Shares)	60,000	--	--
Crown Ltd. (1,400 Shares)	--	2,08,000	--
Due from: Brown Ltd.	48,000	--	--
Crown Ltd.	32,000	--	--
Current Assets	<u>1,00,000</u>	<u>2,32,000</u>	<u>1,82,000</u>
Total	<u>9,60,000</u>	<u>7,00,000</u>	<u>4,62,000</u>

- All shares were acquired on 1.7.2008.
- On 1.1.2008 the balances to the various accounts were as under:

Particulars	Arun Ltd. Rs.	Brown Ltd. Rs.	Crown Ltd. Rs.
Reserves	40,000	40,000	20,000
Profit and Loss account	20,000	(Dr.) 20,000	12,000

(iii) During 2008, Profits accrued evenly.

(iv) In August, 2008, each company paid interim dividend of 10%. Arun Ltd. and Brown Ltd. have credited their profit and loss account with the dividends received.

(v) During 2008, Crown Ltd. sold an equipment costing Rs.40,000 to Brown Ltd. for Rs.48,000 and Brown Ltd. in turn sold the same to Arun Ltd. for Rs.52,000.

Prepare the consolidated Balance Sheet as at 31.12.2008 of Arun Ltd. and its subsidiaries.

Corporate Restructuring - Demerger

2. Travels & Tours Ltd. has two divisions – 'Inland' and 'International'. The Balance Sheet as at 31st December, 2008 was as under:

	Inland (Rs. crores)	International (Rs. crores)	Total (Rs. crores)
Fixed Assets:			
Cost	600	600	1,200
Depreciation	<u>500</u>	<u>200</u>	<u>700</u>
W.D.V. (written down value)	100	400	500
Net Current Assets:			
Current assets	400	300	700
Less: Current liabilities	<u>200</u>	<u>200</u>	<u>400</u>
	<u>200</u>	<u>100</u>	<u>300</u>
Total	<u>300</u>	<u>500</u>	<u>800</u>
Financed by:			
Loan funds:			
(Secured by a charge on fixed assets)	—	100	100
Own Funds:			
Equity capital (fully paid up Rs. 10 shares)			50
Reserves and surplus	<u>—</u>	<u>—</u>	<u>650</u>
	<u>—</u>	<u>—</u>	<u>700</u>
Total	<u>300</u>	<u>500</u>	<u>800</u>

It is decided to form a new company 'IT Ltd.' for international tourism to take over the assets and liabilities of international division.

Accordingly 'IT Ltd.' was formed to takeover at Balance Sheet figures the assets and liabilities of international division. 'IT Ltd.' is to allot 5 crore equity shares of Rs. 10 each in the company to the members of 'Travels & Tours Ltd.' in full settlement of the consideration. The members of 'Travels & Tours Ltd.' are therefore to become members of 'IT Ltd.' as well without having to make any further investment.

- (a) You are asked to pass journal entries in relation to the above in the books of 'Travels & Tours Ltd.' and also in 'IT Ltd.'. Also show the Balance Sheets of both the companies as on 1st January, 2009 showing corresponding figures, before the reconstruction also.
- (b) The directors of both the companies ask you to find out the net asset value of equity shares pre and post-demerger.
- (c) Comment on the impact of demerger on "shareholders wealth".

Amalgamations

3. The summarised Balance Sheets of R Ltd. and P Ltd. for the year ending on 31.3.2009 are as under:

	R Ltd.	P Ltd.		R Ltd.	P Ltd.
	Rs.	Rs.		Rs.	Rs.
Equity share Capital (in shares of Rs. 10 each)	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
			Current Assets	25,00,000	23,00,000
8% Preference Share Capital (in shares of Rs. 10 each)	8,00,000	—			
10% Preference Share Capital (in shares of Rs. 10 each)	—	4,00,000			
Reserves	30,00,000	24,00,000			
Current Liabilities	<u>18,00,000</u>	<u>10,00,000</u>			
	<u>80,00,000</u>	<u>50,00,000</u>		<u>80,00,000</u>	<u>50,00,000</u>

The following information is provided:

		R Ltd.	P Ltd.	
		Rs.	Rs.	
(1)	(a)	Profit before tax	10,64,000	4,80,000
	(b)	Taxation	4,00,000	2,00,000
	(c)	Preference dividend	64,000	40,000
	(d)	Equity dividend	2,88,000	1,92,000
(2)	The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.			
(3)	R Ltd. proposes to absorb P Ltd. as on 31.3.2009. The terms of absorption are as under:			
	(a)	Preference shareholders of P Ltd. will receive 8% preference shares of R Ltd. sufficient to increase the income of preference shareholders of P Ltd. by 10%.		
	(b)	The equity shareholders of P Ltd. will receive equity shares of R Ltd. on the following basis:		
	(i)	The equity shares of P Ltd. will be valued by applying to the earnings per share of P Ltd. 75% of price earnings ratio of R Ltd. based on the results of 2008–2009 of both the companies.		
	(ii)	The market price of equity shares of R Ltd. is Rs. 40 per share.		
	(iii)	The number of shares to be issued to the equity shareholders of P Ltd. will be based on the above market value.		
	(iv)	In addition to equity shares, 8% preference shares of R Ltd. will be issued to the equity shareholders of P Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2008–2009.		
(4)	The assets and liabilities of P Ltd. as on 31.3.2009 are revalued by professional valuer as under:			

	Increased by Rs.	Decreased by Rs.
Fixed Assets	1,00,000	–
Current Assets	–	2,00,000
Current Liabilities	–	40,000

(5) For the next two years, no increase in the rate of equity dividend is expected.

You are required to:

- (i) Set out in detail the purchase consideration.
- (ii) Give the Balance Sheet as on 31.3.2009 after absorption.

Note: Journal entries are not required.

Valuation of Goodwill

4. The following is the extract from the Balance Sheets of Popular Ltd.:

	As at 31.3.2008	As at 31.3.2009		As at 31.3.2008	As at 31.3.2009
Liabilities	Rs. in lakhs	Rs. in lakhs	Assets	Rs. in lakhs	Rs. in lakhs
Share capital	500	500	Fixed assets	550	650
General reserve	400	425	10% investment	250	250
Profit and Loss account	60	90	Stock	260	300
18% term loan	180	165	Debtors	170	110
Sundry creditors	35	45	Cash at bank	46	45
Provision for tax	11	13	Fictitious assets	10	8
Proposed dividend	<u>100</u>	<u>125</u>			
	<u>1,286</u>	<u>1,363</u>		<u>1,286</u>	<u>1,363</u>

Additional information:

- (i) Replacement values of Fixed assets were Rs.1,100 lakhs on 31.3.08 and Rs.1,250 lakhs on 31.3.2009 respectively.
- (ii) Rate of depreciation adopted on Fixed assets was 5% p.a.
- (iii) 50% of the stock is to be valued at 120% of its book value.
- (iv) 50% of investments were trade investments.
- (v) Debtors on 31st March, 2009 included foreign debtors of \$35,000 recorded in the books at Rs.35 per U.S. Dollar. The closing exchange rate was \$ 1 = Rs.39.
- (vi) Creditors on 31st March, 2009 included foreign creditors of \$60,000 recorded in the books at \$ 1 = Rs.33. The closing exchange rate was \$ 1 = Rs.39.
- (vii) Profits for the year 2008-09 included Rs.60 lakhs of government subsidy which was not likely to recur.
- (viii) Rs.125 lakhs of Research and Development expenditure was written off to the Profit and Loss Account in the current year. This expenditure was not likely to recur.

- (ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.
- (x) Tax rate during 2008-09 was 50%, effective future tax rate will be 40%.
- (xi) Normal rate of return expected is 15%.

One of the directors of the company Arvind, fears that the company does not enjoy a goodwill in the prevalent market circumstances.

Critically examine this and establish whether Popular Co. has or has not any goodwill.

If your answers were positive on the existence of goodwill, show the leverage effect it has on the company's result.

Industry average return was 12% on long-term funds and 15% on equity funds.

Valuation of Shares

5. The following abridged Balance Sheet as at 31st March, 2009 pertains to Glorious Ltd.

Liabilities	Rs. in lakhs	Assets	Rs. in lakhs
Share Capital:		Goodwill, at cost	420
180 lakh Equity shares of Rs. 10 each, fully paid up	1,800	Other Fixed Assets	11,166
90 lakh Equity shares of Rs. 10 each, Rs. 8 paid up	720	Current Assets	2,910
150 lakh Equity shares of Rs. 5 each, fully paid-up	750	Loans and Advances	933
Reserves and Surplus	5,628	Miscellaneous Expenditure	171
Secured Loans	4,500		
Current Liabilities	1,242		
Provisions	<u>960</u>		
	<u>15,600</u>		<u>15,600</u>

You are required to calculate the following for each one of the three categories of equity shares appearing in the above mentioned Balance Sheet:

- (i) Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;
- (ii) Value per share on the basis of dividend yield.
Normal rate of dividend in the concerned industry is 15%, whereas Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and
- (iii) Value per share on the basis of EPS.

For the year ended 31st March, 2009 the company has earned Rs. 1,371 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of Rs. 10 of a Company in the same industry is Rs. 2.

Value Added Statement

6. From the following Profit and Loss Account of Kalyani 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, 2009

Income	Notes	(Rs. in lakhs)	Amount (Rs. in lakhs)
Sales			206.42
Other Income			<u>10.20</u>
			216.62
Expenditure			
Production and Operational Expenses	1	166.57	
Administration Expenses	2	6.12	
Interest and Other Charges	3	8.00	
Depreciation		<u>5.69</u>	<u>186.38</u>
Profit before Taxes			30.24
Provision for taxes			<u>3.00</u>
			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 and Operational Expenses (Rs. in lakhs)
- | | |
|---|---------------|
| Increase in Stock | 30.50 |
| Consumption of Raw Materials | 80.57 |
| Consumption of Stores | 5.30 |
| Salaries, Wages, Bonus and 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 and commission to directors Rs. 2.20 lakhs and Provision for doubtful debts Rs. 2.50 lakhs.

(3) Interest and Other Charges:	(Rs. in lakhs)
On Fixed Loans from Financial Institutions	3.90
Debentures	1.80
On Working Capital Loans from Bank	<u>2.30</u>
	<u>8.00</u>

Economic Value Added

7. Explain the concept of 'Economic value added' (EVA for short) and its uses. How is it calculated?

Corporate Social Reporting

8. (a) "The content of corporate social report is essentially based on social objectives." Discuss.
- (b) From the following information of Steel India Ltd. for the year ended 31st March, 2008, prepare their Social Balance Sheet as on that date:
- (i) A specialist has valued their human assets at Rs.828 lakhs.
- (ii) Their investments were classified as:

				(Rs. in lakhs)
	Residential	Hospital	School	Welfare
Buildings	17.00	1.00	1.40	0.80
Equipments	2.80	1.00	1.00	-

(iii) Water, electricity and gas supply systems totalled Rs.1 lakh.

(iv) Their Net owned funds were Rs.26 lakhs.

Financial Reporting of Financial Institutions

9. For what purposes inspection of records and documents of Merchant Banker is ordered by SEBI?
10. Write short note on Books of account required to be maintained by a Stock Broker.
11. SBI Blue 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?

12. ABC 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 ABC Finance Ltd. according to NBFC Prudential Norms (RBI) Directions 1998.

Human Resource Accounting

13. Write short notes on:

- Jaggi and Lau model on valuation on group basis of Human Resources.
- Opportunity cost (HRA).

Fund based Accounting

14. From the following details of Loan Fund of Kanpur Institute of Technology for the year 2007-2008, you are required to prepare a statement showing changes in the Loan Fund Balance :

	Rs.
Fund balance as on 1.4.2007	25,00,000
Grants from the Government and Society	12,00,000
Grants from Revenue Fund	50,000
Other transfer from Unrestricted Fund	70,000
Investment income	60,000
Interest on Loan	40,000
Refund to Granters	25,000
Bad Debts written off	15,000
Administration and collection costs	25,000

Indian AS, IFRS and US GAAPs

15. Explain significant differences and similarities between Indian Accounting Standards, IAS/IFRS and USGAAPs on the issues of
 - (i) Contingencies;
 - (ii) Related party transactions.
16. Write short notes on:
 - (i) Asset Management company in the context of mutual fund.
 - (ii) Capital adequacy requirements for merchant bankers.
 - (iii) Embedded derivatives.
 - (iv) Growing scope of human capital reporting.

Theory questions based on Accounting Standards and Guidance Notes

17.
 - (i) Define "Exercise of an Option" and "Daily Settlement Price" with reference to Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options.
 - (ii) How will you calculate diluted earnings for a particular period?
 - (iii) What are the conditions that are to be satisfied for 'Amalgamation in the nature of merger'?
 - (iv) Explain the 'Accounting for Revaluation of fixed assets' with reference to AS 10.
 - (v) What do you mean by 'events occurring after the balance sheet date'? Describe disclosure requirements required for such events.
 - (vi) Write short note on Sale and Lease Back Transactions as per Accounting Standard 19.
18.
 - (i) Explain the method of accounting for investment by a holding company in its subsidiaries.
 - (ii) Discuss with reference to the Accounting Standards, the nature of classification and disclosure requirements in the statement of profit and loss of an entity in the following cases–
 - (a) Losses sustained as a result of enemy action.
 - (b) Disposal of long-term investments of a trading entity.
 - (iii) How refund of revenue grant received from the Government is disclosed in the Financial Statements?
 - (iv) What are the principles for recognition of deferred taxes under AS 22?

19. (i) Describe the disclosure requirements for 'deferred tax assets' and 'deferred tax liabilities' as per AS 22.
- (ii) Explain the concept of related party transactions under AS 18.
- (iii) Distinguish between
 - (a) Integral foreign operation and Non-integral foreign operation.
 - (b) Operating lease and Non-operating lease.
- (iv) Explain the treatment of intra-enterprise transactions while preparing segment reports.

Practical questions based on Accounting Standards

20. (a) U.K. International Ltd. is developing a new production process. During the financial year ending 31st March, 2007, the total expenditure incurred was Rs.50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2006. Expenditure incurred till this date was Rs.22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2008 was Rs.80 lakhs. As at 31st March, 2008, the recoverable amount of know-how embodied in the process is estimated to be Rs.72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

- (i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2007 and carrying value of intangible as on that date.
- (ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2008.

Ignore depreciation.

- (b) A private limited company manufacturing fancy terry towels had valued its closing stock of inventories of finished goods at the realisable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

Comment on the valuation of the stocks by the company.

- (c) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

21. (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) Narmada Ltd. sold goods for Rs.90 lakhs to Ganga Ltd. during financial year ended 31-3-2009. The Managing Director of Narmada Ltd. own 100% of Ganga Ltd. The sales were made to Ganga Ltd. at normal selling prices followed by Narmada Ltd. The Chief accountant of Narmada Ltd contends that these sales need not require a different treatment from the other sales made by the company and hence no disclosure is necessary as per the accounting standard. Is the Chief Accountant correct?
- (c) Milton Ltd. is a full tax free enterprise for the first 10 years of its existence and is in the second year of its operations. Depreciation timing difference resulting in a deferred tax liability in years 1 and 2 is Rs.200 lakhs and 400 lakhs respectively. From the 3rd year onwards, it is expected that the timing difference would reverse each year by Rs.10 lakhs. Assuming tax rate @35%, find out the deferred tax liability at the end of the second year and any charge to the profit and loss account.
- (d) Accountants of Poornima Ltd. show a net profit of Rs.7,20,000 for the third quarter of 2008 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.

22. (a) On 1st December, 2008, Vishwakarma Construction Co. Ltd. undertook a contract to construct a building for Rs. 85 lakhs. On 31st March, 2009 the company found that it had already spent Rs. 64,99,000 on the construction. Prudent estimate of additional cost for completion was Rs. 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 2009 as per provisions of Accounting Standard 7 (Revised)?

- (b) Mini Ltd. took a factory premises on lease on 1.4.07 for Rs.2,00,000 per month. The lease is operating lease. During March, 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.
- (c) X Co. Ltd. supplied the following information. You are required to compute the basic earning per share:

(Accounting year 1.1.2008 – 31.12.2008)

Net Profit	:	Year 2008 : Rs. 20,00,000
	:	Year 2009 : Rs. 30,00,000
No. of shares outstanding prior to Right Issue	:	10,00,000 shares
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares.
		Right Issue price – Rs. 20
		Last date of exercise rights – 31.3.2009.
Fair rate of one Equity share immediately prior to exercise of rights on 31.3.2009	:	Rs. 25

23. (a) 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.
- (b) Venus Ltd. has an asset, which is carried in the Balance Sheet on 31.3.2008 at Rs. 500 lakhs. As at that date the value in use is Rs. 400 lakhs and the net selling price is Rs. 375 lakhs.

From the above data:

- (i) Calculate impairment loss.
 - (ii) Prepare journal entries for adjustment of impairment loss.
 - (iii) Show, how impairment loss will be shown in the Balance Sheet.
- (c) X Ltd. began construction of a new building on 1st January, 2007. It obtained Rs.1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
Rs.5,00,000	11%
Rs.9,00,000	13%

The expenditure that were made on the building project were as follows:

	Rs.
January 2007	2,00,000
April 2007	2,50,000
July 2007	4,50,000
December 2007	1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in AS-16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

- (d) Y Co. Ltd., used certain resources of X Co. Ltd. In return X Co. Ltd. received Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respective from Y Co. Ltd. during the year 2007-08.

You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

24. (a) X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2005. Till March, 2006, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2006.
- (b) A Cosmetic articles producing company provides the following information:

	Cold Cream	Vanishing Cream
January, 2006 – September, 2006 per month	2,00,000	2,00,000
October, 2006 – December, 2006 per month	1,00,000	3,00,000
January, 2007- March, 2007 per month	0	4,00,000

The company has enforced a gradual change in product-line on the basis of an overall plan. The Board of Directors of the company has passed a resolution in March, 2006 to this effect. The company follows calendar year as its accounting year. Should this be treated as a discontinuing operation? Give reasons in support of your answer.

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) ABC Ltd. grants 1,000 employees stock options on 1.4.2004 at Rs.40, when the market price is Rs.160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2006. 600 options are exercised on 30.6.2007. 100 vested options lapse at the end of the exercise period. Pass Journal Entries giving suitable narrations.
- (c) How are capital expenditures not represented by any specific or tangible assets dealt in financial statements?

SUGGESTED ANSWERS/HINTS

1. Consolidated Balance Sheet of Arun Ltd. and its subsidiaries
as on 31.12.2008

Liabilities	Rs.	Assets	Rs.
Share Capital (Shares of Rs. 100 each)	6,00,000	Goodwill (W. N. 5)	1,81,000
Minority Interest (W. N. 4)	2,33,729	Fixed Assets	7,08,000
Reserves (W. N. 8)	83,021	Current Assets	5,14,000
Profit & Loss A/c (W. N. 8)	2,54,250	Cash in Transit (W. N. 7)	8,000
Sundry Creditors	<u>2,40,000</u>		
	<u>14,11,000</u>		<u>14,11,000</u>

Working Notes:

1. Shareholding Pattern

In Brown Ltd.:	Number of Shares	%age of Holding
Arun Ltd.	3,000	75%
Minority Interest	1,000	25%

In Crown Ltd.:

Arun Ltd.	400	16.667%
Brown Ltd.	1,400	58.333%
Minority Interest	600	25%

2. Analysis of apportionment of profit in Crown Ltd.

(a) Calculation of Unrealized Profit in Equipment

Crown Ltd sold equipment to Brown Ltd. at a profit of Rs. 8,000 and this would be apportioned to

	Rs.
Arun Ltd.	1,333
Brown Ltd.	4,667
Minority Interest	<u>2,000</u>
	<u>8,000</u>

Brown Ltd sold the equipment to Arun Ltd. at a profit of Rs. 4,000. This would be apportioned to:

	Rs.
Arun Ltd.	3,000
Minority Interest	<u>1,000</u>
	<u>4,000</u>

The above amounts are to be deducted from the respective share of profits.

(b) Reserves

	Rs.	
Closing balance	30,000	
Opening balance	<u>20,000</u>	Capital Profit
Current year Appropriation	<u>10,000</u>	
Apportionment of Profit from 1.1.2008 to 30.6.2008	<u>5,000</u>	Capital Profit
Apportionment of Profit from 1.7.2008 to 31.12.2008	<u>5,000</u>	Revenue Reserve

(c) Profit and Loss Account

Closing balance	1,00,000	
Opening balance	<u>12,000</u>	Capital Profit
Current year profits before interim dividend	<u>1,12,000</u>	
Apportionment of Profit from 1.1.2008 to 30.6.2008	56,000	
Less: Interim Dividend	<u>24,000</u>	
	32,000	Capital Profit
From 1.7.2008 to 31.12.2008	<u>56,000</u>	Revenue Profit

(d) Apportionment of profits of Crown Ltd.

	Pre-Acquisition	Post Acquisition	
	Capital Profit	Revenue Reserve	Revenue Profit
	Rs.	Rs.	Rs.
Reserves	25,000	5,000	--
Profit & Loss Account	<u>44,000</u>	<u>--</u>	<u>56,000</u>
	<u>69,000</u>	<u>5,000</u>	<u>56,000</u>
Arun Ltd [16.667%]	11,500	833	9,333
Brown Ltd. [58.333%]	40,250	2,917	32,667
Minority Interest [25%]	17,250	1,250	14,000

3. Analysis of Profit of Brown Ltd

(a) Reserves

	Rs.	
Closing balance	40,000	
Opening balance	<u>40,000</u>	(Capital Profit)
Current year Appropriation	<u>Nil</u>	

(b) Profit and Loss Account

	Rs.
Closing balance	1,20,000
Opening balance (Dr.)	<u>20,000</u>
Current year Appropriation after interim dividend	1,40,000
Interim Dividend	<u>40,000</u>
Profit before Interim Dividend	1,80,000
Less: Dividend from Crown Ltd.	<u>14,000</u>
	<u>1,66,000</u>
Apportionment of Profit from 1.1.2008 to 30.6.2008	83,000
Less: Interim Dividend	<u>40,000</u>
Capital profit	<u>43,000</u>
Apportionment of Profit from 1.7.2008 to 31.12.2008 (Revenue profit)	<u>83,000</u>

(c) Apportionment of Profit of Brown Ltd.

	Pre- Acquisition	Post-Acquisition	
	Capital Profit	Revenue Reserve	Revenue Profit
	Rs.	Rs.	Rs.
Reserves	40,000	--	--
Profit & Loss Account			
(Opening balance (-) 20,000+43,000)	23,000		83,000
Less: Unrealised Profit of Equipment from Crown Ltd.			(4,667)
Share of Post-Acquisition Profit of Crown Ltd.	<u>--</u>	<u>2,917</u>	<u>32,667</u>
	<u>63,000</u>	<u>2,917</u>	<u>1,11,000</u>
Arun Ltd. 75%	47,250	2,188	83,250
Minority Interest 25%	15,750	729	27,750

4. Minority Interest

	Brown Ltd. Rs.	Crown Ltd. Rs.
Share Capital	1,00,000	60,000
Capital Profit	15,750	17,250
Revenue: Reserves	729	1,250
Profit & Loss Account	27,750	14,000
Unrealised Profit on Equipment	<u>(1,000)</u>	<u>(2,000)</u>
	<u>1,43,229</u>	<u>90,500</u>

Total Minority Interest: Rs.1,43,229+ Rs.90,500 = Rs.2,33,729

5. Cost of Control

	Arun Ltd. in Brown Ltd. Rs.	Arun Ltd. in Crown Ltd. Rs.	Brown Ltd in Crown Ltd. Rs.
Amount Invested	3,60,000	60,000	2,08,000
Less: Pre-acquisition dividend*	<u>30,000</u>	<u>4,000</u>	<u>14,000</u>
Adjusted Cost of Investment (A)	<u>3,30,000</u>	<u>56,000</u>	<u>1,94,000</u>
Share capital	3,00,000	40,000	1,40,000
Capital Profit	<u>47,250</u>	<u>11,500</u>	<u>40,250</u>
(B)	<u>3,47,250</u>	<u>51,500</u>	<u>1,80,250</u>
Capital Reserve/Goodwill (A)-(B)	(17,250)	4,500	13,750
Net Goodwill	Rs.1,000		
Goodwill on Consolidation Rs. (80,000+ 60,000+40,000+1,000) = Rs.1,81,000			

6. Dividend declared

	Brown Ltd. Rs.	Crown Ltd. Rs.
Dividend declared	<u>40,000</u>	<u>24,000</u>
Share of: Arun Ltd.	30,000	4,000
Brown Ltd.		14,000
Minority	10,000	6,000

7. Inter-Company Transactions

(a) Owings

	Dr. Arun Ltd. Rs.	Cr. Brown Ltd. Rs.	Cr. Crown Ltd. Rs.
Balance in books	80,000	40,000	32,000
Less: Inter- co. owings	<u>72,000</u>	<u>40,000</u>	<u>32,000</u>
Cash-in-transit	<u>8,000</u>	<u>NIL</u>	<u>NIL</u>

(b) Fixed Assets

	Rs.
Total Fixed Assets	7,20,000
Less: Unrealised Profit on sale of equipment	<u>12,000</u>
Amount to be taken to consolidated Balance Sheet	<u>7,08,000</u>

* The entire amount of interim dividend of 10 % has been treated as pre-acquisition dividend.

8. Reserves and Profit and Loss Account balances in the Consolidated Balance Sheet

	Reserves Rs.	Profit and Loss A/c Rs.
Balance in Books	80,000	2,00,000
Add: Shares of Post Acquisition Profits:		
From Brown Ltd.	2,188	83,250
From Crown Ltd	833	9,333
Less: Pre-Acquisition dividend:		
From Brown Ltd.		(30,000)
From Crown Ltd		(4,000)
Less: Unrealised Profit on Equipment:		
From Brown Ltd.		(3,000)
From Crown Ltd.		<u>(1,333)</u>
	<u>83,021</u>	<u>2,54,250</u>

2. (a) Journal of Travels & Tours Ltd.

Particulars		(Rs. in crores)	
		Dr.	Cr.
		Rs.	Rs.
Current liabilities account	Dr.	200	
Loan fund (secured) account	Dr.	100	
Provision for depreciation account	Dr.	200	
Loss on reconstruction account (Balancing figure)	Dr.	400	
To Fixed assets account			600
To Current assets account			300
(Being the assets and liabilities of International division taken out of the books on transfer of the division to IT Ltd.; the consideration being allotment to the members of the company of one equity share of Rs. 10 each of that company at par for every share held in the company vide scheme of reorganisation)*			

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

Journal of IT Ltd.

		(Rs. in crores)	
		Dr.	Cr.
		Rs.	Rs.
Fixed assets account (600 – 200)	Dr.	400	
Current assets account	Dr.	300	
To Current liabilities account			200
To Loan funds (secured) account			100
To Equity share capital account			50
To Capital reserve account			350
(Being the assets and liabilities of International division of Travels & Tours Ltd. taken over by IT Ltd. and allotment of 5 crore equity shares of Rs. 10 each at par as fully paid up to the members of Travels & Tours Ltd.)			

Travels & Tours Ltd. Balance Sheet as on 1st January, 2009

		(Rs. in crores)	
		After reconstruction	Before reconstruction
I. SOURCES OF FUNDS			
(1) Shareholders' Funds			
(a) Capital	50	50	
(b) Reserves and Surplus (Schedule A)	<u>250</u>	<u>650</u>	
		300	700
(2) Loans Funds			
Secured Loans		<u>—</u>	<u>100</u>
Total		<u>300</u>	<u>800</u>
II. APPLICATION OF FUNDS			
(1) Fixed Assets			
(a) Gross Block	600	1,200	
(b) Less: Depreciation	<u>500</u>	<u>700</u>	
(c) Net block		100	500
(2) Investments		—	—
(3) Current Assets	400	700	
Less: Current liabilities	<u>200</u>	<u>400</u>	
Net current assets		<u>200</u>	<u>300</u>
Total		<u>300</u>	<u>800</u>

Schedule to Balance Sheet

		(Rs. in crores)
	After reconstruction	Before reconstruction
A. Reserves and surplus	650	650
Less: Loss on reconstruction	<u>400</u>	<u>—</u>
	<u>250</u>	<u>650</u>

Note to Accounts: Consequent to reconstruction of the company and transfer of international division of Travels & Tours Ltd. to newly incorporated Company IT Ltd., the members of the company have been allotted 5 crore equity shares of Rs. 10 each at par of 'IT Ltd.'

IT Ltd. Balance Sheet as on January 1, 2009

		(Rs. in crores)
I. SOURCES OF FUNDS		
(1) Shareholder's Funds		
(a) Capital (Schedule A)	50	
(b) Reserves and Surplus	<u>350</u>	400
(2) Loans Funds		
Secured Loans		<u>100</u>
	Total	<u>500</u>
II. APPLICATION OF FUNDS		
(1) Fixed Assets		400
(2) Investments		—
(3) Current Assets	300	
Less: Current Liabilities	<u>200</u>	
Net current assets		<u>100</u>
	Total	<u>500</u>

Schedule to Balance Sheet

	(Rs. in crores)
A. Share Capital:	
Issued and paid up capital:	
5 crore equity shares of Rs. 10 each fully paid up	50
(All the above equity shares have been issued for consideration other than cash to the members of Travels and Tours Ltd. on takeover of International division.)	

(b) Net Asset Value of an equity share

	Pre-Demerger	Post-Demerger
Travels & Tours Ltd.	<u>Rs. 700 crores</u> 5 crore shares = Rs. 140	<u>Rs. 300 crores</u> 5 crore shares = Rs. 60
IT Ltd.	—	<u>Rs. 400 crores</u> 5 crore shares = Rs. 80

- (c) Demerger into two companies has no impact on 'net asset value' of shareholding. Pre-demerger, it was Rs. 140 per share. After demerger, it is Rs. 60 + Rs. 80 = Rs. 140 per original share.

It is only the yield valuation that is expected to change because of separate focussing on two distinct businesses whereby profitability is likely to improve on account of de-merger.

3. (i) Computation of Purchase Consideration

	Rs.
(a) Preference Shareholders	
Current income of preference shareholders of P Ltd.	40,000
Add: 10% increase thereof	<u>4,000</u>
	<u>44,000</u>
Preference shares to be issued	
$= 44,000 \times \frac{100}{8} =$	5,50,000
(b) Equity Shareholders	
(1) Issue of Equity Shares	
P/E ratio in R Ltd.	
	Rs.
Profit before tax	10,64,000
Less: Tax	<u>4,00,000</u>
	6,64,000
Less: Preference dividend	<u>64,000</u>
Profit available for equity shareholders	<u>6,00,000</u>

$$\text{Earnings per share (EPS)} = \frac{6,00,000}{2,40,000} = \text{Rs. } 2.50$$

$$\text{Price earnings ratio (P/E)} = \frac{40}{2.50} = \text{Rs. } 16$$

EPS of P Ltd:

	Rs.
Profit before tax	4,80,000
Less: Tax	<u>2,00,000</u>
Profit after tax	2,80,000
Less: Preference dividend	<u>40,000</u>
Profit available for equity shareholders	<u>2,40,000</u>

$$\text{EPS} = \frac{2,40,000}{1,20,000} = \text{Rs. } 2$$

Valuation of equity shares of P Ltd:

$$= 1,20,000 \text{ shares} \times (\text{Rs. } 2 \times 16 \times 0.75 \text{ i.e. Rs. } 24)$$

$$= \text{Rs. } 28,80,000$$

Number of equity shares to be issued:

$$= \frac{28,80,000}{40} = 72,000$$

	Rs.
Equity Share Capital	7,20,000
Share (Securities) Premium	<u>21,60,000</u>
	<u>28,80,000</u>

(2) Issue of Preference Shares

Current equity dividend	Rs. 1,92,000
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Less: Expected equity dividend from R Ltd.

$$(\text{Rs. } 7,20,000 \times 2,88,000/24,00,000)$$

	<u>86,400</u>
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Loss in income	<u>1,05,600</u>
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$$8\% \text{ Preference Shares to be issued} = \frac{1,05,600}{0.08} = \text{Rs. } 13,20,000$$

Total Purchase Consideration:	Rs.
-------------------------------	-----

Preference shares to be issued	5,50,000	
	<u>13,20,000</u>	18,70,000

Equity shares to be issued (at premium)		<u>28,80,000</u>
		<u>47,50,000</u>

(ii)

R Ltd.

Balance Sheet as at 31st March, 2009
(after absorption)

	Schedule No.		Rs.
I. SOURCES OF FUNDS			
(1) Shareholders' funds:			
(a) Capital	A	57,90,000	
(b) Reserves and Surplus	B	<u>51,60,000</u>	1,09,50,000
(2) Loan funds			--
Total			<u>1,09,50,000</u>
II. APPLICATION OF FUNDS			
(1) Fixed assets:			
Net block	C		91,10,000
(2) Investments			—
(3) Net Current assets	D		<u>18,40,000</u>
Total			<u>1,09,50,000</u>
Schedules to Balance Sheet			

	Rs.
A. Share Capital:	
3,12,000 Equity Shares of Rs. 10 each (of the above shares, 72,000 equity shares are allotted as fully paid up for consideration other than cash)	31,20,000
2,67,000 8% Preference Shares of Rs. 10 each (of the above, 1,87,000 are allotted as fully paid up for consideration other than cash)	<u>26,70,000</u>
	<u>57,90,000</u>
B. Reserves and Surplus:	
As per last Balance Sheet	30,00,000
Share (Securities) Premium	<u>21,60,000</u>
	<u>51,60,000</u>
C. Fixed Assets:	
As per last Balance Sheet	55,00,000
Taken over on absorption of P Ltd.	<u>28,00,000</u>
	83,00,000
Goodwill	<u>8,10,000</u>
	<u>91,10,000</u>
D. Net Current Assets:	
As per last Balance Sheet	7,00,000
Taken over on absorption of P Ltd.	<u>11,40,000</u>
	<u>18,40,000</u>

Working Note:

Calculation of Goodwill on Absorption

		Rs.
Purchase consideration		47,50,000
Fixed assets taken over	28,00,000	
Current assets taken over	<u>21,00,000</u>	
	49,00,000	
Less: Current liabilities	<u>9,60,000</u>	
Net assets taken over		<u>39,40,000</u>
Goodwill		<u>8,10,000</u>

4.

1. Calculation of Capital employed (CE)

	As on 31.3.08	Rs. in lakhs As on 31.3.09
Replacement Cost of Fixed Assets	1100.00	1250.00
Trade Investment (50%)	125.00	125.00
Current cost of stock		
$130 + 130 \times \frac{120}{100}$	286.00	
$150 + 150 \times \frac{120}{100}$		330.00
Debtors	170.00	111.40
Cash-at-Bank	<u>46.00</u>	<u>45.00</u>
Total (A)	<u>1727.00</u>	<u>1861.40</u>
Less: Outside Liabilities		
18% term loan	180.00	165.00
Sundry creditors	35.00	48.60
Provision for tax	<u>11.00</u>	<u>13.00</u>
Total (B)	<u>226.00</u>	<u>226.60</u>
Capital employed (A-B)	<u>1501.00</u>	<u>1634.80</u>

$$\begin{aligned} \text{Average Capital employed at current value} &= \frac{\text{CE as on 31.3.2008} + \text{CE as on 31.3.2009}}{2} \\ &= \frac{1501 + 1634.80}{2} = 1567.90 \text{ Lakhs}^* \end{aligned}$$

* Average capital employed can also be calculated in the following manner:

Closing capital employed as on 31.3.2009	Rs. 1,634.80 lakhs
Less: $\frac{1}{2}$ of actual post tax profit for 2008-2009	<u>Rs. 90.00 lakhs</u>
Average capital employed	<u>Rs. 1,544.80 lakhs</u>

2.	Future Maintainable Profit	Rs. in Lakhs	
	Increase in General Reserve	25	
	Increase in Profit and Loss Account	30	
	Proposed Dividends	<u>125</u>	
	Profit After Tax	<u>180</u>	
	Pre-Tax Profit = $\frac{180}{1 - 0.5}$		360
	Less: Fictitious Assets written off (10 – 8)	2.00	
	Non-Trading investment income (10% of Rs.125)	12.50	
	Subsidy	60.00	
	Exchange Loss on creditors [0.6 lakhs × (39-33)]	3.60	
	Additional Depreciation on increase in value of Fixed Assets (current year) $\left(1250 - 650 = 600 \times \frac{5}{100}\right)$ i.e.,	<u>30.00</u>	<u>108.10</u>
			251.90
	Add: Exchange Gain on Debtors [0.35 lakhs × (39-35)]	1.40	
	Research and development expenses written off	125.00	
	Stock Adjustment (30-26)	<u>4.00</u>	<u>130.40</u>
			382.30
	Add: Expected increase of 10%		<u>38.23</u>
	Future Maintainable Profit before Tax		420.53
	Less: Tax @ 40% (40% of Rs.420.53)		<u>168.21</u>
	Future Maintainable Profit		<u>252.32</u>
3.	Valuation of Goodwill	Rs. in lakhs	
(i)	According to Capitalisation of Future Maintainable Profit Method		
	Capitalised value of Future Maintainable Profit		
	= $\frac{252.32}{15} \times 100$		1,682.13
	Less: Average capital employed		<u>1567.90</u>
	Value of Goodwill		<u>114.23</u>

Or

(ii) According to Capitalisation of Super Profit Method	Rs. In lakhs
Future Maintainable Profit	252.32
Less: Normal Profit @ 15% on average capital employed (1567.90 × 15%)	<u>235.19</u>
Super Profit	<u>17.13</u>
Capitalised value of super profit $\frac{17.13}{15} \times 100$ i.e. Goodwill	114.2

Goodwill exists, hence director's fear is not valid.

Leverage Effect on Goodwill	Rs. in lakhs
Future Maintainable Profit on equity fund	252.32
Future Maintainable Profit on Long-term Trading Capital employed	
Future Maintainable Profit After Tax	252.32
Add: Interest on Long-term Loan (Term Loan)	
(After considering Tax) $165 \times 18\% = 29.7 \times \frac{50}{100}$	<u>14.85</u>
	267.17
Average capital employed (Equity approach)	1567.90
Add: 18% Term Loan $(180+165)/2$	<u>172.50</u>
Average capital employed (Long-term Fund approach)	<u>1740.40</u>

Value of Goodwill

(A) Equity Approach

Capitalised value of Future Maintainable Profit = $\frac{252.32}{15} \times 100 =$	1682.13
Less: Average capital employed	<u>1567.90</u>
Value of Goodwill	<u>114.23</u>

(B) Long-Term Fund Approach

Capitalised value of Future Maintainable Profit = $\frac{267.17}{12} \times 100 =$	2226.42
Less: Average capital employed	<u>1740.40</u>
Value of Goodwill	<u>486.02</u>

Comments on Leverage effect of Goodwill:

Adverse Leverage effect on goodwill is 371.79 lakhs (i.e., Rs.486.02-114.23). In other words, Leverage Ratio of Popular Ltd. is low as compared to industry for which its goodwill value has been reduced when calculated with reference to equity fund as compared to the value arrived at with reference to long term fund.

Working Notes:

(1)	Stock adjustment		Rs. in lakhs
	(i)	Excess current cost of closing stock over its Historical cost (330 – 300)	30.00
	(ii)	Excess current cost of opening stock over its Historical cost (286-260)	<u>26.00</u>
	(iii)	Difference [(i– ii)]	<u>4.00</u>
(2)	Debtors' adjustment		
	(i)	Value of foreign exchange debtors at the closing exchange rate (\$35,000×39)	13.65
	(ii)	Value of foreign exchange debtors at the original exchange rate (\$35,000×35)	<u>12.25</u>
	(iii)	Difference [(i) – (ii)]	<u>1.40</u>
(3)	Creditors' adjustment		
	(i)	Value of foreign exchange creditors at the closing exchange rate (\$60,000×39)	23.40
	(ii)	Value of foreign exchange creditors at the original exchange rate(\$60,000×33)	<u>19.80</u>
	(iii)	Difference [(i) – (ii)]	<u>3.60</u>
5.	(i)	Intrinsic value on the basis of book values	Rs. in lakhs
		Goodwill	420
		Other Fixed Assets	11,166
		Current Assets	2,910
		Loans and Advances	<u>933</u>
			15,429
		Less: Secured loans	4,500
		Current liabilities	1,242
		Provisions	<u>960</u>
			6,702
			8,727
		Add: Notional call on 90 lakhs equity shares @ Rs. 2 per share	<u>180</u>
			<u>8,907</u>

Equivalent number of equity shares of Rs. 10 each.

	Rs. in lakhs
Fully paid shares of Rs. 10 each	180
Partly-paid shares after notional call	90
Fully paid shares of Rs. 5 each, $\left[\frac{\text{Rs.150 lakhs}}{\text{Rs.10}} \times \text{Rs. 5} \right]$	<u>75</u>
	<u>345</u>

$$\text{Value per equivalent share of Rs. 10 each} = \text{Rs. } \frac{8,907 \text{ lakhs}}{345 \text{ lakhs}} = \text{Rs. 25.82}$$

Hence, intrinsic values of each equity share are as follows:

Value of fully paid share of Rs. 10 = Rs. 25.82 per equity share.

Value of share of Rs. 10, Rs. 8 paid-up = Rs. 25.82 – Rs. 2 = Rs. 23.82 per equity share.

$$\text{Value of fully paid share of Rs. 5} = \frac{\text{Rs. 25.82}}{2} = \text{Rs. 12.91 per equity share.}$$

(ii) Valuation on dividend yield basis:

$$\text{Value of fully paid share of Rs. 10} = \frac{20}{15} \times \text{Rs. 10} = \text{Rs. 13.33}$$

$$\text{Value of share of Rs. 10, Rs. 8 paid-up} = \frac{20}{15} \times \text{Rs. 8} = \text{Rs. 10.67}$$

$$\text{Value of fully paid share of Rs. 5} = \frac{20}{15} \times 5 = \text{Rs. 6.67}$$

(iii) Valuation on the basis of EPS:

Profit after tax = Rs. 1,371 lakhs

Total share capital = Rs. (1,800 + 720 + 750) lakhs = Rs. 3,270 lakhs

$$\text{Earning per rupee of share capital} = \text{Rs. } \frac{1,371 \text{ lakhs}}{3,270 \text{ lakhs}} = \text{Re. 0.419}$$

Earning per fully paid share of Rs. 10 = Re. 0.419 × 10 = Rs. 4.19

Earning per share of Rs. 10 each, Rs. 8 paid-up = Re. 0.419 × 8 = Rs. 3.35

Earning per share of Rs. 5, fully paid-up = Re. 0.419 × 5 = Rs. 2.10

Value of fully paid share of Rs. 10 = Rs. $\frac{4.19}{2} \times 10 = \text{Rs. } 20.95$

Value of share of Rs. 10, Rs. 8 paid-up = Rs. $\frac{3.35}{2} \times 10 = \text{Rs. } 16.75$

Value of fully paid share of Rs. 5 = Rs. $\frac{2.10}{2} \times 10 = \text{Rs. } 10.50$

6.

Kalyani Ltd.

Value Added Statement

for the year ended 31st March, 2009

	Rs. in lakhs	Rs. in lakhs	%
Sales		206.42	
Less: Cost of bought in material and services:			
Production and operational expenses	150.57		
Administration expenses	3.92		
Interest on working capital loans	<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:			
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 Debentures	1.80		
Interest on Fixed Loans	3.90		
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		
Retained 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)	(Rs. in lakhs)
Profit before tax		30.24
Add back:		
Depreciation	5.69	
Salaries, Wages, Bonus and other benefits	12.80	
Directors' Remuneration	2.20	
Cess and Local Taxes	3.20	
Interest on Debentures	1.80	
Interest on Fixed Loans	<u>3.90</u>	<u>29.59</u>
Total Value Added		<u>59.83</u>

7. Economic Value Added (EVA) for short, is primarily a benchmark to measure earnings efficiency. Though the term "Economic Profit" was very much there since the inception of "Economics", Stern Stewart & Co., of USA has got a registered Trade Mark for this by the name "EVA", an acronym for Economic Value Added.

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. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

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, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholder wealth is to integrate the EVA framework in four key areas; to measure business performance; to guide managerial decision making; to align managerial incentives with shareholders' interests; and to improve the financial and business literacy throughout the organisation.

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it

must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically $EVA = OPBT - Tax - (TCE \times COC)$

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

8. (a) The content of Corporate Social Report is essentially based on the social objectives. Brummet identified five areas wherein social objectives can be traced out, namely, Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

In view of the social objectives, the importance of earning objective is not understated, rather attainment of social objectives is dependent on earning objective. A sick business entity becomes liability to the society and sustains social costs instead of generating social benefits.

Human Resource Contribution is the indicator of the impact of organisational activities (viz. pay and allowances, perks and incentives, recruitment, training and development, placement, promotion and transfer, welfare measure, etc.) on people of the organisation. Public Contribution is the indicator of general philanthropy in the cultural and social welfare programmes and contribution to national exchequer by way of tax and duties.

Industrial activity is supposed to consume irreplaceable resources and produces solid wastes. By this process it pollutes air and water, causes noise and spoils the environment. These are termed as negative social effects. The corporate social objective is the abatement of such negative effect. It is covered by environmental contribution.

Lastly, the Product or Service Contribution covers the qualitative aspects of the organisation's product or service. It includes quality guarantee, redressal of customers' grievances, honest exposure in advertisement etc.

Although Brummet covered wide range of objectives, still these are not essentially exhaustive. Social objectives are determined by socio-economic conditions of a country. It is difficult to set universal list of social objectives to be pursued by the corporate sector. For example, in India, regional imbalance, unemployment, reservation for weaker sections of the population, scarcity of foreign exchange, energy deficit, population pressure and illiteracy are some of the widely accepted socio-economic problems. And obviously the general expectation is that the corporate sector will positively contribute to such socio-economic problems. Since the socio-economic problems of a country change over time or the priority attached to a problem shifts.

(b) Social Balance Sheet of Steel India Ltd.
as at 31.03.2008

(Rs. in lakhs)

Liabilities:

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

Assets:

Social Capital Investment:

(a) Buildings		
(i) Residential	17.00	
(ii) Hospital	1.00	
(iii) School	1.40	
(iv) Welfare	<u>0.80</u>	20.20
(b) Equipments		
(i) Residential	2.80	
(ii) Hospital	1.00	
(iii) School	<u>1.00</u>	4.80
(c) Water, Electricity and Gas supply systems		1.00
Human assets (as valued by the specialist)		<u>828.00</u>
Total		<u>854.00</u>

9. 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;
 - (iv) To investigate suo moto in the interest of securities business or investors' interest into the affairs of merchant bankers.
10. 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 valan 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.

$$\begin{aligned}
 11. \text{ NAV of MF} &= \frac{\text{Total Market Value of all MF holdings} - \text{All MF liabilities}}{\text{No. of MF units}} \\
 &= \frac{\text{Rs. 1,50,00,00,000}}{5,00,00,000} \\
 &= \text{Rs. 30}
 \end{aligned}$$

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.

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 Debentures of subsidiaries and Group Companies	<u>100</u>
	<u>200</u>
10% (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. (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:
- Ascertain the number of employees in each rank.
 - 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) **Opportunity Cost:** It is one of the Economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.

14.

Kanpur Institute of Technology

Statement of Changes – Loan funds

		Rs.
Balance as on 1st April, 2007		25,00,000
Additions during the year 2007-2008:		
Grants from government and society	12,00,000	
Investment income	60,000	
Interest on loan	40,000	
Grants from revenue fund	50,000	
Other transfer from unrestricted funds	<u>70,000</u>	14,20,000
Deductions during the year 2007-08:		
Refund to granters	25,000	
Bad debts written off	15,000	
Administration and collection costs	<u>25,000</u>	<u>(65,000)</u>
Balance as on 31st March, 2008		<u>38,55,000</u>

15. (i)

Contingencies	Indian Accounting Standards	IFRS / IAS	US GAAPs
	Contingent liabilities are disclosed unless the probability of outflows is remote. Contingent gains are neither recognized nor disclosed.	Unrecognised possible losses and probable gains are disclosed.	Similar to IFRS.

(ii)

Related-party transactions	Indian Accounting Standards	IFRS / IAS	US GAAPs
	Determined by level of direct or indirect control, joint control and significant influence of one party over another or common control by another entity. However, the determination may be based on legal form rather than substance. Hence, the scope of parties covered under the definition of related party could be less than under IFRS or US GAAP. Exemption from disclosure for certain SMEs having turnover or borrowings below certain limit. No exemption for separate financial statements of subsidiaries.	Determined by level of direct or indirect control, joint control and significant influence of one party over another or common control by another entity. Name of the parent entity is disclosed and, if different, the ultimate controlling party, regardless of whether transactions occur. For related-party transactions, nature of relationship (seven categories), amount of transactions, outstanding balances, terms and types of transactions are disclosed. Some exemptions available for separate financial statements of subsidiaries.	Similar to IFRS. Exemptions from disclosures are narrower than under IFRS.

16. (i) "Asset management company" means a company formed and registered under the Companies Act, 1956 and approved as such by the Securities and Exchange Board of India to manage the funds of a mutual fund.

- (ii) 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

- (iii) 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.

- (iv) Of late there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (which can be measured in monetary terms) to a more comprehensive approach of reporting under which human resources are also

considered as measurable assets. Having followed the methods of accounting of fixed assets, one can take into account the employee-related costs like cost of recruitment, training and orientation of employees, for the purpose of capitalization and then the appropriate portion thereof can be amortised each year over the estimated years of effect of such costs.

The relevance of human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organization. Comparison of the specific values of human capital based on the organisation's scales of wages and salaries with the general industry standards, can be a good source of information to the management. There is no standard human capital reporting format as employment reporting is relatively a new form of reporting. Usually, the report inter alia contains data pertaining to employee numbers, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and disabled employee numbers.

Human capital reporting provides scope for planning and decision-making in relation to proper manpower planning. Also, such reporting can bring out the effect of various rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes, laws and the like.

17. (i) **Exercise of an Option:** Exercise of an Option means enforcing the right by the Option Buyer/Holder available under the option contract of buying or selling the underlying asset at the Strike Price.

Daily Settlement Price: Daily Settlement Price is the closing price of the equity index/stock futures contract for the day or such other price as may be decided by the Clearing House from time to time.

- (ii) For the purpose of calculating diluted earnings per share, the amount of net profit or loss for the period attributable to equity shareholders, as calculated in accordance with paragraph 11, should be adjusted by the following, after taking into account any attributable change in tax expense for the period:
- (a) any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders as calculated in accordance with paragraph 11;
 - (b) interest recognized in the period for the dilutive potential equity shares; and
 - (c) any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.
- (iii) For 'amalgamation in the nature of merger', all the following conditions should be satisfied:

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
 - (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
 - (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
 - (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
 - (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.
- (iv) An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve, it is sometimes charged against that earlier increase. It sometimes happens that an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to profit and loss statement in which case the increase is credited to profit and loss statement to the extent that it offsets the previously recorded decrease.
- (v) 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 and in the case of any other entity by the corresponding approving authority.
- (i) Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate. However, assets and liabilities should not be adjusted for but disclosure should be made in the

report of the approving authority of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

- (ii) Disclosure regarding events occurring after the balance sheet date :
 - (a) The nature of the event;
 - (b) An estimate of the financial effect, or a statement that such an estimate cannot be made.

- (vi) As per AS 19 on 'Leases', a sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the asset back to the vendor. The lease payments and the sale price are usually interdependent, as they are negotiated as a package. The accounting treatment of a sale and lease back transaction depends upon the type of lease involved.

If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sale proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

If sale and leaseback transaction results in a operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

- 18. (i) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies shows investment in subsidiary just like any other investment and is generally classified as trade investments. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares

by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) are carried normally at cost.

- (ii) (a) Losses sustained as a result of enemy action constitute an extraordinary item since it is an event which is clearly distinct from the ordinary activities of the enterprise and is not expected to recur frequently or regularly. As per AS 5, the nature and amount of each extraordinary item should be separately disclosed in a manner that its impact on current profit or loss can be perceived.
- (b) AS 13 on "Accounting for Investments" requires that on disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to profit and loss account. AS 5 (Revised) requires separate disclosure of items of income/expense from ordinary activities if their size, nature or incidence makes their disclosure relevant to explain entity's performance. The disposal of long-term investments, may fall in this category requiring separate disclosure particularly in view of the fact that "disposal of long-term investments" is visualized as one of the circumstances in AS 5 itself.
- (iii) The amount refundable in respect of a grant related to revenue should be 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 should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be 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 should be provided prospectively over the residual useful life of the asset.
- (iv) Taxable income is calculated in accordance with tax laws. In some circumstances the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. This results in a difference between the taxable and the accounting income. Such differences are classified into Permanent and Timing differences. The tax effect of the timing differences is known as Deferred Tax and is included as tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.

Prudence would dictate that deferred tax liabilities are provided for without exception, even in situations where an enterprise is incurring losses. Deferred tax assets should be recognized and carried forward only to the extent that there is

reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realized. Reasonable certainty can be demonstrated by providing robust and realistic estimates of profits for the future. A company with a track record of losses with no immediate visibility of a turnaround should not recognise a deferred tax asset as a matter of prudence. In the case of an unabsorbed depreciation and carry forward losses under the tax laws, the recognition principles are more stricter, i.e. deferred tax asset should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available.

In that situation there has to be convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. This is a matter of judgement and the conclusion would depend on facts and circumstances of each case.

19. (i) The disclosure requirements under AS 22 are as under:

- (a) Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

A deferred tax asset is more liquid as compared to fixed assets and investments and less liquid as compared to current assets. Thus, in case of a company, it should be presented after the head 'Investments'. Similarly, a deferred tax liability should be presented after the head 'Unsecured Loans'. (ASI 7 issued by Council of ICAI).

- (b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.
- (c) The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

(ii) According to AS 18, "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."

A related party transaction involves a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Following are the examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- ◆ Purchases or sales of goods (finished or unfinished);
- ◆ Purchases or sales of fixed assets;
- ◆ Rendering or receiving of services;
- ◆ Agency arrangements;
- ◆ Leasing or hire purchase arrangements;
- ◆ Transfer of research and development;
- ◆ Licence agreements;
- ◆ Finance (including loans and equity contributions in cash or in kind);
- ◆ Guarantees and collateral etc.
- ◆ Management contracts including for deputation of employees.

(iii) (a)

	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 flows from operations	Cash flows from operations of 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.	Change in the exchange 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.
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.

- (b) 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.

- (iv) Treatment of intra segment transactions while preparing segment reports can be explained as follows:

- (i) Prior Determination of item: Segment Revenue, Segment Expense, Segment Assets and Segment Liabilities are determined before intra-enterprise balances.
- (ii) Elimination: Intra-enterprise transactions are eliminated as part of the process of preparation of enterprise Financial Statements.
- (iii) No-elimination: When intra-enterprise balances and transactions are within a single segment, they are NOT eliminated.

20. (a) As per AS 26 'Intangible Assets'

- (i) For the year ending 31.03.2007

- (1) Carrying value of intangible as on 31.03.2007:

At the end of financial year 31st March 2007, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of Rs. 28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2006).

- (2) Expenditure to be charged to Profit and Loss account:

Rs. 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2007. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

- (ii) For the year ending 31.03.2008

- (1) Expenditure to be charged to Profit and Loss account:

	(Rs. in lakhs)
Carrying Amount as on 31.03.2007	28
Expenditure during 2007 – 2008	<u>80</u>
Total book cost	108
Recoverable Amount	<u>72</u>
Impairment loss	<u>36</u>

Rs. 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2008.

- (2) Carrying value of intangible as on 31.03.2008:

	(Rs. in lakhs)
Total Book Cost	108
Less: Impairment loss	<u>36</u>
Carrying amount as on 31.03.2008	<u>72</u>

- (b) Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realizable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realizable value and not at net realisable value. Further, export incentives are recorded only

in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

- (c) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.
21. (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) As per paragraph 13 of AS 18 'Related Party Disclosures', Enterprises over which a key management personnel is able to exercise significant influence are related

parties. This includes enterprises owned by directors or major shareholders of the reporting enterprise that have a member of key management in common with the reporting enterprise.

In the given case, Narmada Ltd. and Ganga Ltd are related parties and hence disclosure of transaction between them is required irrespective of whether the transaction was done at normal selling price.

Hence the contention of Chief Accountant of Narmada Ltd is wrong.

- (c) In the case of tax free companies, no deferred tax liability is recognized, in respect of timing differences that originate and reverse in the tax holiday period. Deferred tax liability or asset is created in respect of timing differences that originate in a tax holiday period but are expected to reverse after the tax holiday period. For this purpose, adjustments are done in accordance with the FIFO method.

Of Rs.200 lakhs, Rs.80 lakhs will reverse in the tax holiday period. Therefore, Deferred Tax Liability will be created on Rs.120 lakhs @ 35% (i.e.) Rs.42 lakhs.

In the second year, the entire Rs.400 lakhs will reverse only after the tax holiday period.

Therefore, deferred tax charge in the Profit and Loss Account will be $\text{Rs.}400 \times 35\% = 140$ lakhs and deferred tax liability in the Balance Sheet will be $(42+140) = \text{Rs.}182$ lakhs.

- (d) 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).

22. (a)

	Rs.
Cost incurred till 31 st March, 2009	64,99,000
Prudent estimate of additional cost for completion	<u>32,01,000</u>
Total cost of construction	97,00,000
Less: Contract price	<u>85,00,000</u>
Total foreseeable loss	<u>12,00,000</u>

According to para 35 of AS 7 (Revised 2002), the amount of Rs. 12,00,000 is required to be recognized as an expense.

$$\text{Contract work in progress} = \frac{\text{Rs. } 64,99,000 \times 100}{97,00,000} = 67\%$$

Proportion of total contract value recognized as turnover as per para 21 of AS 7 (Revised) on Construction Contracts.

$$= 67\% \text{ of Rs. } 85,00,000 = \text{Rs. } 56,95,000.$$

- (b) In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets' and ASI 30 'Applicability of AS 29 to Onerous Contracts', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous* as the economic benefit of lease contract for next 33 months up to 31.12.2010 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of Rs. 66,00,000 (i.e. 2,00,000 p.m. for next 33 months).

Therefore, provision on account of Rs. 66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right.

- (c) Computation of Basic Earnings Per Share

(as per paragraphs 10 and 26 of AS 20 on Earnings Per Share)

	Year 2008	Year 2009
	Rs.	Rs.
EPS for the year 2008 as originally reported		
= $\frac{\text{Net profit of the year attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$		
= (Rs. 20,00,000 / 10,00,000 shares)	2.00	
EPS for the year 2008 restated for rights issue		
= [Rs. 20,00,000 / (10,00,000 shares × 1.04**)]	1.92	
	(approx.)	
EPS for the year 2009 including effects of rights issue		

* For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it.

** Refer working note 2.

$$\frac{\text{Rs. 30,00,000}}{(10,00,000 \text{ shares} \times 1.04 \times 3/12) + (12,50,000 \text{ shares} \times 9/12)}$$

$$\frac{\text{Rs. 30,00,000}}{11,97,500 \text{ shares}}$$

2.51
(approx.)

Working Notes:

1. Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights} + \text{Total amount received from exercise}}{\text{Number of shares outstanding prior to exercise} + \text{Number of shares issued in the exercise}}$$

$$= \frac{(\text{Rs. } 25 \times 10,00,000 \text{ shares}) + (\text{Rs. } 20 \times 2,50,000 \text{ shares})}{10,00,000 \text{ shares} + 2,50,000 \text{ shares}}$$

$$= \frac{\text{Rs. } 3,00,00,000}{12,50,000 \text{ shares}} = \text{Rs. } 24$$

2. Computation of adjustment factor

$$= \frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}}$$

$$= \frac{\text{Rs. } 25}{\text{Rs. } 24 \text{ (Refer Working Note 1)}} = 1.04 \text{ (approx.)}$$

23. (a) (i) Present value of residual value = Rs. 40,000 × 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>

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

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.

- (b) (i) Recoverable amount is higher of value in use Rs. 400 lakhs and net selling price Rs. 375 lakhs.

∴ Recoverable amount = Rs. 400 lakhs

Impairment loss = Carried Amount – Recoverable amount

= Rs. 500 lakhs – Rs. 400 lakhs = Rs. 100 lakhs.

(ii)

Journal Entries

Particulars	Dr. Amount Rs. in lakhs	Cr. Amount Rs. in lakhs
(i) Impairment loss account	Dr. 100	
To Asset		100
(Being the entry for accounting impairment loss)		
(ii) Profit and loss account	Dr. 100	
To Impairment loss		100
(Being the entry to transfer impairment loss to profit and loss account)		

(iii) Balance Sheet of Venus Ltd. as on 31.3.2008

		Rs. in lakhs
	Asset less depreciation	500
	Less: Impairment loss	<u>100</u>
		<u>400</u>
(c) (i) Computation of average accumulated expenses		Rs.
Rs. 2,00,000 x 12 / 12	=	2,00,000
Rs. 2,50,000 x 9 / 12	=	1,87,500
Rs. 4,50,000 x 6 / 12	=	2,25,000
Rs. 1,20,000 x 1 / 12	=	<u>10,000</u>
		<u>6,22,500</u>

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (in Rs.)	Rate of interest	Amount of interest (in Rs.)
5,00,000	11% =	55,000
<u>9,00,000</u>	13% =	<u>1,17,000</u>
<u>14,00,000</u>		<u>1,72,000</u>
Weighted average rate of interest ($\frac{1,72,000}{14,00,000} \times 100$)		= 12.285% (approx)

(iii) Interest on average accumulated expenses

	Rs.
Specific borrowings (Rs. 1,00,000 X 10%)	= 10,000
Non-specific borrowings (Rs. 5,22,500* X 12.285%)	= <u>64,189</u>
Amount of interest to be capitalized	= <u>74,189</u>

(iv) Total expenses to be capitalized for building

	Rs.
Cost of building Rs.(2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)	10,20,000
Add: Amount of interest to be capitalised	<u>74,189</u>
	<u>10,94,189</u>

(v)

Journal Entry

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
31.12.2007	Building account	Dr. 10,94,189	
	To Bank account		10,94,189
	(Being amount of cost of building and borrowing cost thereon capitalized)		

- (d) As per para 13 of AS 9 on Revenue Recognition, revenue arising from the use by others of enterprise resources yielding interest and royalties should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

* (Rs. 6,22,500 – Rs. 1,00,000)

- (i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.
 - (ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement.
24. (a) As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.

In this case, the cost of inventory is Rs.10 lakhs. The net realizable value is $11,00,000 \times 90\% = \text{Rs.}9,90,000$. So, the stock should be valued at Rs.9,90,000.

- (b) In response to the market forces, business enterprises often abandon products or even product lines and reduce the size of their work-force. These actions are not in themselves discontinuing operations unless they satisfy the definition criteria.

In the instant case the company has been gradually reducing operation in the product line of cold creams, simultaneously increasing operation in the product line of vanishing creams. The company was not disposing of any of its components. Phasing out a product line as undertaken by the company does not meet definition criteria in paragraph 3 of AS 24, namely, disposing of substantially in its entirety a component of the enterprise. Therefore, this change over is not a discontinuing operation.

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 ABC Ltd.

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
31.3.2005	Employees compensation expenses account	Dr. 48,000	
	To Employees stock option outstanding account		48,000
	(Being compensation expenses recognized in respect of the employees stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)		

	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2006	Employees compensation expenses account	Dr.	48,000	
	To Employees stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of Rs. 120 each, amortised on straight line basis over $2\frac{1}{2}$ years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at the end of the year)			
31.3.2007	Employees stock option outstanding account (W.N.1)	Dr.	12,000	
	To General Reserve account (W.N.1)			12,000
	(Being excess of employees compensation expenses transferred to general reserve account)			
30.6.2007	Bank A/c (600 x Rs.40)	Dr.	24,000	
	Employee stock option outstanding account (600 x Rs.120)	Dr.	72,000	
	To Equity share capital account (600 x Rs. 10)			6,000
	To Securities premium account (600 x Rs.150)			90,000
	(Being 600 employees stock option exercised at an exercise price of Rs. 40 each)			
01.10.2007	Employee stock option outstanding account	Dr.	12,000	

To General reserve account	12,000
(Being Employees stock option outstanding A/c transferred to General Reserve A/c, on lapse of 100 options at the end of exercise of option period)	

Working Note:

On 31.3.2007, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options, that have actually vested. 700 employees stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

	Rs.
No. of options actually vested (700 x Rs.120)	84,000
Less: Expenses recognized Rs.(48,000 + 48,000)	<u>96,000</u>
Excess expenses transferred to general reserve	<u>12,000</u>

- (c) Sometimes circumstances force a project to incur capital expenditure which is not represented by any specific or tangible assets. For example, a project may have to pay the cost of laying pipelines in order to facilitate the supply of its products or raw materials to or from a sea port but the port trust or other similar authorities may insist that the pipelines belong to them even though the cost thereof is paid by the company. In such a case, the capital expenditure incurred by the project for the stated purpose would not be represented by any actual assets, since the pipeline would remain the property of the relevant port trust or other similar authorities even though the whole or a part of their cost may have been defrayed by the company in order to facilitate its business. In such cases the expenditure so incurred would have to be treated in the books of account as the capital expenditure.

There seems to be no valid objection to disclose the expenditure under the general heading of "Capital Expenditure" subject to two conditions. In the first place the description of the specific items on the balance sheet should be such as to indicate quite clearly that the capital expenditure is not represented by any assets owned by the company. In the second place the capital expenditure should be written off over the approximate period of its utility or over a relatively brief period not exceeding five years whichever is less.

In fact having regard to the nature of expenditure and purpose for which it is incurred, it would be more appropriate and realistic to classify such expenditure in the balance sheet under the heading of "Capital Expenditure" rather than either, write off the expenditure to revenue or classify the expenditure under the heading of "Miscellaneous Expenditure".

Note : AS 1 to AS 29 are applicable for June, 2009 Examination.

List of Institute's Publications relevant for Students

The following List of Institute's Publications is relevant for the forthcoming examination i.e. June, 2009.

Final (Old) Course

Paper 1: Advanced Accounting

- I. Statements and Standards
 1. Framework for the Preparation and Presentation of Financial Statements
 2. Accounting Standards – AS 1 to AS 29.
- II. Guidance Notes on Accounting Aspects
 1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
 2. Guarantees and Counter-Guarantees Given by Companies.
 3. Guidance Note on Treatment of Expenditure during Construction Period.
 4. Guidance Note on Accrual Basis of Accounting.
 5. Guidance Note on Accounting Treatment for Excise Duty.
 6. Guidance Note on Accounting for Depreciation in Companies.
 7. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
 8. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
 9. Guidance Note on Accounting for Securitisation.
 10. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
 11. Guidance Note on Accounting for Corporate Dividend Tax.
 12. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
 13. Guidance Note on Accounting for Employee Share-based Payments.
 14. Guidance Note on Accounting for Fringe Benefits Tax.
 15. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.