

PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

1. The following are the balance sheets of S Ltd. and its holding company H Ltd. as at 31st March, 2006:

<i>Liabilities</i>	<i>S Ltd.</i>	<i>H Ltd.</i>	<i>Assets</i>	<i>S Ltd.</i>	<i>H Ltd.</i>
10% Preference shares of Rs. 100 each	1,60,000	—	Fixed Assets	4,40,000	5,00,000
Equity shares of Rs. 10 each	2,00,000	6,00,000	Investment – 15,000		
General Reserve	80,000	1,00,000	Equity shares in S Ltd.	—	3,30,000
Profit and Loss A/c (1.4.2005)	25,000	50,000	100 6% Debentures in S Ltd.	—	10,000
Profit for the year	65,000	1,20,000	Current Assets	2,87,000	2,60,000
6% Debentures of Rs. 100 each	40,000	50,000			
Debenture interest accrued	2,400	—			
Bills Payable to H Ltd.	25,000	—			
Sundry Creditors	<u>1,29,600</u>	<u>1,80,000</u>			
	<u>7,27,000</u>	<u>11,00,000</u>		<u>7,27,000</u>	<u>11,00,000</u>

Other Information is as under:

- S Ltd. incurred a major expenditure of Rs. 30,000 on repairs of a machinery in the beginning of the current year and wrongly charged the amount to Profit and Loss Account. Rate of depreciation on Fixed Assets is 10%.
- No entries have been made in the books of H Ltd. for debenture interest due from S Ltd. for the year ended 31st March, 2006.
- H Ltd. acquired shares in S Ltd. on 31st March, 2006. For the purpose of acquisition of shares, fixed assets of S Ltd. were revalued at Rs. 5,00,000.
- Contingent liability of H Ltd. Rs. 50,000 is in respect of bills discounted which includes bills of Rs. 10,000 accepted by S Ltd.
- Ignore tax aspects.

You are required to prepare consolidated balance sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 2006.

2. Following are the Balance Sheet of companies as at 31.12.2005:

<i>Liabilities</i>	<i>D Ltd.</i>	<i>V Ltd.</i>	<i>Assets</i>	<i>D Ltd.</i>	<i>V Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>
Equity share capital (Rs. 100)	8,00,000	6,00,000	Goodwill	6,00,000	—
General Reserve	4,00,000	3,00,000	Fixed Assets	5,00,000	8,00,000
Investment Allowance			Investments	2,00,000	4,00,000
Reserve	—	4,00,000	Current Assets	4,00,000	3,00,000
Sundry Creditors	<u>5,00,000</u>	<u>2,00,000</u>			
	<u>17,00,000</u>	<u>15,00,000</u>		<u>17,00,000</u>	<u>15,00,000</u>

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

- (i) Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 1999-2004 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2008 reserve of Rs. 2,00,000 for utilization.
- (ii) Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.
- (iii) The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.
- (iv) Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.
- (v) Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.
- (vi) Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

3. On the basis of the following Balance Sheets of A Ltd. and B Ltd. and the further information given below, determine a reasonable exchange ratio on the basis of break-up value for the absorption of B Ltd. by A Ltd.

Balance Sheets					
Liabilities	A Ltd. Rs.	B Ltd. Rs.	Assets	A Ltd. Rs.	B Ltd. Rs.
Equity Share Capital (shares of Rs. 100 each)	1,00,000	50,000	Land and Building	30,000	10,000
Reserves	5,000	7,500	Plant and Machinery	60,000	40,000
Debentures	40,000	20,000	Furniture	7,500	5,000
Sundry Creditors	35,000	15,000	5% Government Securities	10,000	5,000
Profit and Loss A/c:			Stock	30,000	10,000
Profit for the year	20,000	7,500	Sundry Debtors	50,000	25,000
			Bills Receivable	5,000	2,000
			Bank	7,500	3,000
	<u>2,00,000</u>	<u>1,00,000</u>		<u>2,00,000</u>	<u>1,00,000</u>

Further information:

- (1) Land and Building, Plant and Machinery and Stock are worth as follows:

	A Ltd.	B Ltd.
Land and Building	50,000	20,000
Plant and Machinery	70,000	50,000
Stock	28,000	9,000

- (2) It is agreed that goodwill is to be valued at 3 years' purchase of super profits.
- (3) For the past three years the profits of A Ltd. have shown an increase of Rs. 2,000 annually and the profits of B Ltd. have shown an increase of Rs. 1,000 annually.
- (4) Companies of similar nature are showing a profit earning capacity of 10% on the market value of the shares.

4. Omega Co. Ltd. started its business on 1st April, 2003. On 31st March, 2006, its balance sheet in a summarized form was as follows:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets (cost less depreciation)	30,00,000
10,000, 14% Preference shares of Rs. 100 each, fully paid	10,00,000	Current Assets	40,00,000
3,00,000 Equity shares of Rs. 10 each, fully paid	30,00,000	Preliminary Expenses	50,000
Profit prior to Incorporation	25,000		
Profit & Loss Account	5,50,000		
13% Debentures	5,00,000		
Sundry Creditors	18,00,000		
Provision for Income tax	<u>1,75,000</u>		
	<u>70,50,000</u>		<u>70,50,000</u>

The company is yet to declare its maiden (first) dividend. A revaluation reveals that the fixed assets as on 31st March, 2006 of worth Rs. 32,00,000. Calculate the intrinsic worth of the two classes of shares. Ignore corporate dividend tax.

5. Capital structure of Lot Ltd. as at 31.3.2006 as under:

	(Rs. in lakhs)
Equity share capital	10
10% preference share capital	5
15% debentures	8
Reserves	4

Lot Ltd. earns a profits of Rs. 5 lakhs annually on an average before deduction of interest on debentures and income tax which works out to 40%.

Normal return on equity shares of companies similarly placed is 12% provided:

- Profit after tax covers fixed interest and fixed dividends at least 3 times.
- Capital gearing ratio is .75.
- Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

Lot Ltd. has been regularly paying equity dividend of 10%.

Compute the value per equity share of the company.

6. From the following information in respect of Pretext Ltd., prepare a value added statement for the year 2005:

	(Rs.'000)
Turnover	2,300
Plant and Machinery (net)	1,080
Depreciation on Plant and Machinery	275
Dividends to ordinary shareholders	146
Debtors	195
Creditors	127

Total stock of all materials, WIP and finished goods	
Opening stock	160
Closing stock	200
Raw materials purchased	625
Cash at Bank	98
Printing and Stationery	22
Auditor's remuneration	28
Retained profits (opening balance)	994
Retained profits for the year	288
Rent, Rates and Taxes	165
Other expenses	85
Ordinary share capital issued	1,500
Interest on borrowings	40
Income tax for the year	276
Wage and Salaries	327
Employees State Insurance	35
PF-Contribution	28

Calculate the value added per employee, average earnings per employee and sales per employee on the basis that 95 employees work in Pretext Ltd.

7. From the following details of Loan Fund of Panipat Institute of Technology for the year 2005-2006, you are required to prepare a statement showing changes in the Loan Fund Balance :

	Rs.
Fund balance as on 1.4.2005	12,50,000
Grants from the Government and Society	6,00,000
Grants from Revenue Fund	25,000
Other transfer from Unrestricted Fund	35,000
Investment income	30,000
Interest on Loan	20,000
Refund to Granters	12,500
Bad Debts written off	7,500
Administration and collection costs	12,500

8. Alpha Co. provides you with the following information:

Equity	Rs. 100 lakhs
8% Secured Loans	Rs. 20 lakhs
10% Unsecured Loans	Rs. 30 lakhs
Profit after tax	Rs. 15,83,000
Rate of Tax	40%
Normal Bank Rate	12%

You are required to calculate EVA for Alpha Co.

9. (i) 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?

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

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

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

10. Mr. A buys the following equity stock options from the seller, Mr. B. From the following information, pass necessary journal entries for final settlement in the books of the A:

<i>Date of purchase</i>	<i>Type of Options</i>	<i>Expiry date</i>	<i>Market lot</i>	<i>Premium per unit</i>	<i>Strike price (Rs.)</i>
29th June, 2005	XYZ Co. Ltd.—Call	20th August, 2005	100	15	230
30th, June, 2005	ABC Co. Ltd.—Put	30th August, 2005	200	20	275

11. Usha Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it.

	<i>(Rs. in lakhs)</i>	
	<i>Cost</i>	<i>Market price</i>
Equity Shares:		
Scrip A	40.00	40.80
Scrip B	21.00	16.00
Scrip C	40.00	24.00
Scrip D	40.00	80.00
Scrip E	<u>60.00</u>	<u>70.00</u>
	<u>201.00</u>	<u>230.80</u>
Mutual Funds		
MF ₁	26.00	16.00
MF ₂	20.00	14.00
MF ₃	<u>4.00</u>	<u>6.00</u>
	<u>50.00</u>	<u>36.00</u>

Government Securities

GV ₁	40.00	44.00
GV ₂	<u>50.00</u>	<u>48.00</u>
	<u>90.00</u>	<u>92.00</u>

- (i) Can the company adjust depreciation of a particular item of investment within a category?
 - (ii) What should be the value of investments?
 - (iii) Is it possible to offset depreciation in investment of mutual funds against appreciation of value of investments in Equity Shares and Government Securities?
12. From the following in respect of Jalan Limited, calculate the total value of human capital by Lev and Schwartz Model.

Distribution of Employees of Jalan Limited

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

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

Annuity Factor @ 10%

For 5 years = 3.7908

For 10 years = 6.1446

For 15 years = 7.6061

For 20 years = 8.5136

For 25 years = 9.0770

13. (a) What disclosures are required to be made by a Non-banking finance company in its balance sheet.
- (b) What type of books of accounts are generally maintained by a stock broker?
- (c) Why R. Likert's model of human resource revaluation is now totally rejected?
14. (a) What procedure is followed for valuation on group basis of Human Resources explained by Jaggi and Lau?
- (b) Define the term 'Subordinated debt' in the context of NBFC.
15. (a) What is meant by 'Merchant Broker'? What capital adequacy requirements are required to be followed by a Merchant Banker?
- (b) Write a short note on accounting issues involved in Environmental Accounting.
16. How is the difference between forward rate and exchange rate recognised on the date of transaction in a forward contract ?
17. Define the term 'Beta' in the context of Economic Value Added
18. Enumerate the major heads identified for corporate social reporting purposes.
19. What are, the special features of accounting for Educational Institutions?

20. Differentiate between AS and IAS on the following issues:
 - (i) Revenue Recognition
 - (ii) Government grants
 - (iii) Borrowing costs
21. Theory questions based on Accounting Standards
 - (i) Disclosure requirements as regards to the investor, where the associate has contingent liabilities.
 - (ii) Recognition of an intangible asset.
 - (iii) Objective of AS 27.
 - (iv) Disclosure under AS 1 required for a company in liquidation?
 - (v) Classify the following as "Timing Difference" and "Permanent Difference".
 - (i) Interest on loans payable to Scheduled Banks not paid during current year but accounted as an expenditure in the books.
 - (ii) Difference in Depreciation rates as per Income Tax and as per Books.
 - (iii) Unabsorbed losses.
 - (iv) Revaluation Reserve.
 - (vi) Can internally generated brands, publishing titles and other similar items be recognized as intangible assets?
 - (vii) Discuss with reference to AS 13, the nature of classification and disclosure requirements in the Statement of profit and loss account of an entity in case of disposal of long-term investment of a trading entity.
 - (viii) When can an enterprise commence to capitalize the borrowing costs? What are the conditions to be satisfied for commencement of capitalization?
 - (ix) What are the basic criteria for classification of leases into Operating Lease and Finance Lease.
 - (x) What do you understand by "Recognition"? Is there any change in the manner of recognition and measurement of items while reporting an interim statement?
 - (xi) What are the disclosure requirements for contingent liabilities as per AS 29? Explain in brief.
 - (xii) Distinguish between Integral Foreign Operation (IFO) and Non-Integral Foreign Operation (NFO).
 - (xiii) If Potential Equity Shares were not considered in the previous year because they were anti-dilutive, can these be considered in the current period if they are dilutive? If yes, is the prior period EPS required to be restated?
 - (xiv) How are intra enterprise transactions treated when preparing Segment Reports?
 - (xv) What is the basis for recognition of revenue by way of Interest, Royalties and Dividends?

Questions based on practical application of Accounting Standards and Guidance Notes:
22. Classify the following under operating, financing and investing activity as per AS 3 (Revised)
 - (i) Interest and dividends received by financial institutions .
 - (ii) Redemption of preference share capital.
 - (iii) Receipt from trade debtors.
 - (iv) Payment for acquisition of long term assets.
 - (v) Payment to employees.

- (vi) Dividend paid to shareholders.
- (vii) Acquisition of equity or debt securities.
23. Rahul Ltd. experienced Rs. 50,000 decline in the market value of its inventory in the first quarter of its financial year. Rahul Ltd. had expected this decline to reverse in the third quarter, and in fact, the third quarter recovery exceeded the previous decline by Rs. 10,000. Rahul Ltd.'s inventory did not experience any other declines in market value during the financial year. What amount of loss and/or gain should Rahul Ltd. report in its interim financial statements for the first and third quarters?
24. Should appropriation to mandatory reserves be excluded from net profit attributable to equity shareholders?
- Kashyap Ltd. is engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered into with its debentureholders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the Reserve constitutes at least half the value of such debentures. As such, appropriations are not available for distribution to the equity shareholders. Kashyap Ltd. has excluded this from the numerator in the computation of basis EPS. Is this treatment correct?
25. A company has purchased plant and machinery in the year 2001-2002 for Rs. 45 lakhs. A balance of Rs. 5 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2004-2005. The company treated it as income and credited to profit and loss account during 2004-2005.
- Whether accounting treatment of the company is correct. If not, state with reasons.
26. X and Y entered into an agreement on 20.12.2005 which provided for the sale of an asset (book value Rs. 2,50,000) for Rs. 3,70,000 to Y. The sale deed was to be registered and other formalities completed on 15.1.2006. Y has paid an advance money of Rs. 50,000 to X on 20.12.2005. Both X and Y prepare final accounts on December 31 every year and present in April next. How the transaction be shown in the books of X and for the year 2005?
27. 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.
28. During 2004, an enterprise incurred costs to develop and produce a routine, low risk computer software product, as follows:

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

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

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

<i>For the year ended on</i>	<i>Estimated cash flow (Rs. in lakhs)</i>
31.3.2005	50
31.3.2006	30
31.3.2007	30
31.3.2008	20
31.3.2009	20

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

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

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

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

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

30. X Ltd. has invested to the extent of 25% in Y & Co., during the end of the financial year, for the purpose of reporting, X Ltd., the investor company values its investment in the associate. It finds that its share of losses of the associate exceeds the amount at which the investment is carried. Further in the current year, the associate reports loss. Should X Ltd. recognise the loss for the current year?
31. X Limited sold to Y Limited goods having a sales value of Rs. 25 lakhs during the financial year ended 31.03.2004. Mr. A, the Managing Director and Chief Executive of X Limited owns nearly 100 percent of the capital of Y Limited. The sales were made to Y Limited at the normal selling price of X Limited. The Chief Accountant of X Limited does not consider that these sales should be treated differently from any other sale made by the company despite being made to a controlled company, because the sales were made at normal and, that too, at arms' length prices. Discuss the above issue from the view point of AS 18.

32. A plant was depreciated under two different methods as under:

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

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

33. Advise the company on the following item while from the view point of finalisation of accounts:

While executing a new project, the company had to pay Rs. 50 lakhs to the State Government as part of the cost of roads built by the State Government in the vicinity of the project for the purpose of carrying machinery and materials to the project site. The road so built is the property of the State Government.

34. SCL Ltd. sells agriculture products to dealers. One of the condition of sale is that interest is payable at the rate of 2% p.m., for delayed payments. Percentage of interest recovery is only 10% on such overdue outstanding due to various reasons. During the year 2005-2006 the company wants to recognise the entire interest receivable. Do you agree?
35. In May, 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

36. Distinguish between "Timing differences" and "Permanent differences" referred to in AS 22 on Accounting for Taxes, giving 2 examples of each.

SUGGESTED ANSWERS/HINTS

1. As shares are acquired on the date of the balance sheet, total reserve and surplus of S Ltd., is pre-acquisition and, thus capital profit.

Calculation of Capital Profits of S Ltd.

	Rs.	Rs.
Profit and Loss Account		
Profit for equity shareholders on 1.4.2005		25,000
Profit for the year 2005–2006	65,000	
Add: Wrong recording of repair of machinery	<u>30,000</u>	
	95,000	
Less: Depreciation on 30,000 @ 10%	<u>3,000</u>	
Correct profit	92,000	
Less: Preference dividend	<u>16,000</u>	
Profit for the year 2005–2006 for equity shareholders		76,000

Add: General Reserve		80,000	
Add: Profit on Revaluation of fixed assets:			
Value on 31.3.2006	4,40,000		
Add: Effect of wrong recording of repair (30,000 – 3,000)	<u>27,000</u>		
Correct value on the date of revaluation	4,67,000		
Less: Revalued figure	<u>5,00,000</u>	<u>33,000</u>	
			<u>2,14,000</u>

Share of H Ltd. = $2,14,000 \times 75\%$ = Rs. 1,60,500

Share of Majority = $2,14,000 \times 25\%$ = Rs. 53,500

Calculation of cost of control

Investment in S Ltd.		3,30,000	
Less: Cost of shares:			
Share capital	1,50,000		
Capital profit	<u>1,60,500</u>	<u>3,10,500</u>	
Goodwill			<u>19,500</u>

Calculation of Minority Interest

Minority Interest = Share in equity share capital + Share in 10% preference share capital + share in profits for equity + share in dividend for preference shareholders

= $50,000 + 1,60,000 + 53,500 + 16,000$ = Rs. 2,79,500.

Consolidated Balance Sheet as at March 31, 2006

Liabilities		Amount		Assets		Amount	
	Rs.		Rs.		Rs.		Rs.
Equity Share Capital (H Ltd.)		6,00,000		Goodwill			19,500
Minority Interest		2,79,500		Fixed Assets			
General Reserve		1,00,000		H Ltd.	5,00,000		
Profit and Loss A/c				S Ltd. (revalued at)	<u>5,00,000</u>	10,00,000	
H Ltd. on 1.4.2005	50,000			Investment in			
				Debentures	10,000		
Profit during 2005 – 2006	<u>1,20,000</u>			Less: Common debt	<u>10,000</u>		Nil
	1,70,000						
Add: Accrued Debenture Interest	<u>600</u>	1,70,600		Current Assets:			
6% Debentures H Ltd.	50,000			H Ltd.	2,60,000		
S Ltd.	<u>40,000</u>			S Ltd.	<u>2,87,000</u>		
	90,000				5,47,000		
Less: Common Debt	<u>10,000</u>	80,000		Add: Accrued debenture			
Debenture interest accrued	2,400			Interest of H Ltd.	<u>600</u>		
Less: Common debt	<u>600</u>	1,800			5,47,600		
				Less: Common Debt			
Bills payable of H Ltd.	25,000			B/P (25,000 – 10,000)	<u>15,000</u>		
Less: Common debt	<u>15,000</u>	10,000			5,32,600		
Sundry Creditors H Ltd.	1,80,000			Less: Common debt of			
S Ltd.	<u>1,29,600</u>	3,09,600		accrued debenture			
				interest	<u>600</u>		<u>5,32,000</u>
							<u>15,51,500</u>

Note: Contingent liability for bills discounted Rs. 40,000.

2.

Journal Entries in the Books of D Ltd.

		<i>Dr.</i>	<i>Cr.</i>
		<i>Amount</i>	<i>Amount</i>
		<i>Rs.</i>	<i>Rs.</i>
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd.
as on 31st December, 2005

<i>Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
	<i>Rs.</i>		<i>Rs.</i>
<i>Equity Share Capital:</i>		Fixed Assets	
17,036 shares of Rs. 100 each		(5,00,000 + 8,50,000)	13,50,000
(out of which 9036 shares are		Goodwill	
issued in favour of vendor for		(6,00,000 + 1,00,000 + 16,000)	
consideration other than cash)	17,03,600	Investments	7,16,000
General Reserve	4,00,000	(2,00,000 + 1,92,500)	3,92,500
Securities Premium	3,38,850	Current Assets	
Investment Allowance Reserve	2,00,000	(7,00,000 – 50 – 16,000)	6,83,950
Sundry Creditors	7,00,000	Amalgamation Adjustment Account	<u>2,00,000</u>
	<u>33,42,450</u>		<u>33,42,450</u>

Working Notes:

1. Calculation of net asset value of shares

	<i>D Ltd.</i>	<i>V Ltd.</i>
	<i>Rs.</i>	<i>Rs.</i>
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	<u>4,00,000</u>	<u>3,00,000</u>
	16,00,000	15,80,000
 Less: Sundry Creditors	 <u>5,00,000</u>	 <u>2,00,000</u>
Net assets	<u>11,00,000</u>	<u>13,80,000</u>
Number of shares	8,000	6,000
Value per equity share	137.50	230
<i>*Investments of V Ltd. are calculated as follows:</i>		<i>Rs.</i>
Shares in D Ltd. (1,000 × 137.50)		1,37,500
Market value of remaining investments (given)		<u>1,92,500</u>
		<u>3,30,000</u>

2. Calculation of Purchase Consideration

	<i>Rs.</i>
Net assets of V Ltd.	<u>13,80,000</u>
Value of Shares of D Ltd.	<u>137.50</u>
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	<u>1,000</u>
Additional shares to be issued	<u>9,036.36</u>
 Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	<u>50</u>
	<u>12,42,500</u>

3. Calculation of capital employed

	<i>A Ltd.</i>	<i>B Ltd.</i>
Land and Building	50,000	20,000
Plant and Machinery	70,000	50,000
Furniture	7,500	5,000
Stock	28,000	9,000
Sundry Debtors	50,000	25,000
Bills Receivable	5,000	2,000
Bank	<u>7,500</u>	<u>3,000</u>
	2,18,000	1,14,000
 Less: Debentures	 40,000	 20,000

Sundry Creditors	<u>35,000</u>	<u>15,000</u>
	<u>75,000</u>	<u>35,000</u>
Capital Employed	1,43,000	79,000
Less: Half of the current year's profits	<u>10,000</u>	<u>3,750</u>
Average Capital Employed	<u>1,33,000</u>	<u>75,250</u>
Normal Profit (10% of Capital Employed)	<u>13,300</u>	<u>7,525</u>
Super profit:		
Average Profit P Ltd. (20,000 + 18,000 + 16,000/3)	18,000	
Q Ltd. (7,500 + 6,500 + 5,500/3)		6,500
Less: Interest on Investments	<u>500</u>	<u>250</u>
Future Maintainable Profit	17,500	6,250
Less: Normal Profit	<u>13,300</u>	<u>7,525</u>
Super Profit	<u>4,200</u>	<u>-1,275</u>
Value of Goodwill (Rs. 4,200 × 3)	<u>12,600</u>	<u>Nil</u>
Total Assets (as above)	2,18,000	1,14,000
Add: 5% Government Securities	<u>10,000</u>	<u>5,000</u>
	2,28,000	1,19,000
Add: Goodwill	<u>12,600</u>	<u>Nil</u>
	2,40,600	1,19,000
Less: Debentures & Sundry Creditors	<u>75,000</u>	<u>35,000</u>
Funds for Equity Shareholders	1,65,600	84,000
No. of shares	1,000	500
Value per share	165.6	168.0
Exchange Ratio should be 1 : 1.(approximately)		

Note: 5% Government Securities have been considered as non-trading investment, therefore, not taken for the computation of capital employed.

4.	Rs.	Rs.
Net assets of the company		
Fixed Assets		32,00,000
Current Assets		<u>40,00,000</u>
		72,00,000
Less: 13% Debentures	5,00,000	
Sundry Creditors	18,00,000	
Provision for Income Tax	<u>1,75,000</u>	<u>24,75,000</u>
		<u>47,25,000</u>
Alternatively, net assets may be calculated as follows:-		
Preference Share Capital		10,00,000
Equity Share Capital		30,00,000
Profit Prior to Incorporation		25,000
Profit & Loss Account		5,50,000
Appreciation in the value of Fixed Assets		<u>2,00,000</u>

	47,75,000
Less: Preliminary Expenses	<u>50,000</u>
	<u>47,25,000</u>
Preference Shares:	
Preference Share Capital	10,00,000
Add: Dividend @ 14% for 3 years	<u>4,20,000</u>
	<u>14,20,000</u>

$$\begin{aligned}\text{Value of one preference share} &= \text{Rs. } \frac{14,20,000}{10,000} \\ &= \text{Rs. 142}\end{aligned}$$

Equity Shares:

Net assets remaining, after satisfying preference shareholders' claim =
Rs. 47,25,000 – Rs. 14,20,000 = Rs. 33,05,000.

$$\begin{aligned}\text{Value of one equity share} &= \text{Rs. } \frac{33,05,000}{3,00,000} \\ &= \text{Rs. 11.02}\end{aligned}$$

5. (i) Profit for calculation of interest and fixed dividend coverage:	Rs.
Average profit of the Company (before interest and taxation)	5,00,000
Less: Debenture interest (15% on Rs. 8,00,000)	<u>1,20,000</u>
	3,80,000
Less: Tax @ 40%	<u>1,52,000</u>
Profit after interest and taxation	2,28,000
Add back: Debenture interest	<u>1,20,000</u>
Profit before interest but after tax	<u>3,48,000</u>
(ii) Calculation of interest and fixed dividend coverage:	Rs.
Fixed interest and fixed dividend:	
Debenture interest	1,20,000
Preference dividend	<u>50,000</u>
	<u>1,70,000</u>

$$\text{Fixed interest and fixed dividend coverage} = \frac{3,48,000}{1,70,000} = 2.05 \text{ times}$$

Interest and fixed dividend coverage 2.05 times is less than the prescribed three times.

(iii) Capital gearing ratio:

$$\begin{aligned}\text{Equity share capital + reserves} &= \text{Rs. 10,00,000} + \text{Rs. 4,00,000} \\ &= \text{Rs. 14,00,000} \\ \text{Preference share capital + debentures} &= \text{Rs. 5,00,000} + \text{Rs. 8,00,000} \\ &= \text{Rs. 13,00,000}\end{aligned}$$

$$\text{Capital Gearing Ratio} = \frac{13,00,000}{14,00,000} = 0.93 \text{ (approximately)}$$

Ratio 0.93 is more than the prescribed ratio of 0.75.

(iv) Yield on equity shares:

	Rs.
Average profit after interest and tax	2,28,000
Less: Preference Dividend	50,000
Equity Dividend (10% on Rs. 10,00,000)	<u>1,00,000</u>
Undistributed profit	<u>78,000</u>
50% of distributed profit (50% of Rs. 1,00,000)	50,000
5% of undistributed profit (5% of Rs. 78,000)	<u>3,900</u>
	<u>53,900</u>

$$\text{Yield on equity shares} = \frac{53,900}{10,00,000} \times 100 = 5.39\%$$

(v) Expected yield of equity shares:

	%
Normal return	12.00
Add: For low coverage of fixed interest and fixed dividends (2.05 < 3)	0.50*
Add: For high capital gearing ratio (0.93 > 0.75)	<u>0.50**</u>
	<u>13.00</u>

(vi) Value per equity share:

$$= \frac{5.39}{13.00} \times \text{Rs. } 100^{***} = \text{Rs. } 41.46$$

Notes: * When interest and fixed dividend coverage is low, riskiness of equity investors is high. So they should claim additional risk premium over and above the normal rate of return. Here, the additional risk premium is assumed to be 0.50%. Students may make any other reasonable assumption.

** Similarly, higher the ratio of fixed interest and dividend bearing capital to equity share capital plus reserves, higher is the risk and so higher should be risk premium. Here also the additional risk premium has been taken as 0.50%. The students may make any other reasonable assumption.

*** Paid up value of a share has been taken as Rs. 100.

6. Statement showing value added of Pretext Ltd. for 2005

	(Rs. '000)
Turnover	2,300
Less: Cost of bought-in materials and services	
(625 + 160 – 200 + 22 + 28 + 165 + 85)	<u>885</u>
Value added	<u>1,415</u>
Applied as:	
Wages and salaries	327
E.S.I.	35
P.F. Contribution	<u>28</u>
	390

Cost of Capital		
Dividend	146	
Interest	<u>40</u>	186
Income tax		276
Provision for maintenance		
Expansion:		
Depreciation	275	
Retained profits	<u>288</u>	<u>563</u>
		<u>1,415</u>

Value-added ratios

Value added per employees = $14,15,000/95 = \text{Rs. } 14,895$

Average earning per employee = $3,90,000/95 = \text{Rs. } 4,105$

Sales per employee = $23,00,000/95 = \text{Rs. } 24,211$.

7. Panipat Institute of Technology Statement of changes – Loan funds

		Rs.
Balance as on 1st April, 2005		12,50,000
<i>Additions during the year 2005-2006:</i>		
Grants from government and society	6,00,000	
Investment income	30,000	
Interest on loan	20,000	
Grants from revenue fund	25,000	
Other transfer from unrestricted funds	<u>35,000</u>	7,10,000
<i>Deductions during the year 2005-06:</i>		
Refund to granters	12,500	
Bad debts written off	7,500	
Administration and collection costs	<u>12,500</u>	<u>32,500</u>
Balance as on 31st March, 2006		<u>19,27,500</u>

8. We know that:

Cost of capital = $\{[\text{Interest} \times (1 - \text{Effective Tax Rate})] / \text{Debt}\} \times 100$

$\therefore$ Cost of secured loan = $\{[1.60 \text{ lakhs} \times (1 - 0.40)] / 20 \text{ lakhs}\} \times 100$
= 4.8%

Cost of unsecured loan = $\{[3 \text{ lakhs} \times (1 - 0.40)] / 30 \text{ lakhs}\} \times 100$
= 6%

Cost of equity = 12% (given)

Weighted Average Cost

Funds		Cost after tax	Weights**	Weighted cost
Equity	100 lakhs	12%	0.667	8.0%

**100/150; 20/150; 30/150

Secured loan	20 lakhs	4.8%	0.133	0.6%
Unsecured loan	<u>30 lakhs</u>	6%	0.200	<u>1.2%</u>
	<u>150 lakhs</u>			<u>9.8%</u>

Weighted Average cost of capital = Capital Employed* × Weighted Average Cost

= 150 lakhs × 9.8%

= 14.7 lakhs

∴ Economic Value Added = Rs. 15,83,000 – Rs. 14,70,000 = Rs. 1,13,000

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

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.

(ii) Statement Showing Computation of Tier-I Capital

		(Rs. in lakhs)
Paid up Equity Capital		100
Free Reserve		<u>500</u>
	(A)	600
Deduct deferred expenditure	(B)	<u>200</u>
	(C)	<u>400</u>
Investments		
In shares of subsidiaries and Group Companies		100
In Debenture of subsidiaries and Group Companies		<u>100</u>
		<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>

10. In the books of buyer/holder

Entries for final Settlement of equity stock Option

Call Option

		Dr.	Cr.
		Rs.	Rs.
(a) Equity Shares of XYZ Co. Ltd. Account	Dr.	23,000	
To Bank Account			23,000
(Being the call option exercised and shares acquired)			
(b) Profit and Loss Account	Dr.	1,500	
To Equity Stock Option Premium Account			1,500
(Being the premium on option written off on exercise of option)			

*Opening balances are not given for calculation of average capital employed.

Put Option

(a)	Bank Account	Dr.	55,000	
	To Equity Shares of ABC Ltd. Account			55,000
	(Being put option exercised and shares delivered)			
(b)	Profit and Loss Account	Dr.	4,000	
	To Equity Stock Option Premium Account			4,000
	(Being the premium on option written off on exercise of option)			

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

Rs.

(ii)	Equity Shares	201.00
	Mutual Funds	36.00
	Government Securities	90.00

- (iii) No.

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

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

Working Notes:

Particulars	No.	Annual Salary	Total Salary	PV Factor	Present Value
Unskilled Employees					
Age Group 30 – 39 Years					
For next 10 years	100	18,000	18,00,000	6.1446	1,10,60,280
For year 11 – 20	100	30,000	30,00,000	2.3690	71,07,000
For year 21 – 25	100	36,000	36,00,000	0.5634	<u>20,28,240</u>
					<u>2,01,95,520</u>
Age Group 40 – 49 Years					
For next 10 years	50	30,000	15,00,000	6.1446	92,16,900
For year 11 – 15	50	36,000	18,00,000	1.4615	<u>26,30,700</u>
					<u>1,18,47,600</u>
Age Group 50 – 55 Years					
For next 5 years	30	36,000	10,80,000	3.7908	<u>40,94,064</u>

Semiskilled Employees

Age Group 30 – 39 Years

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

Age Group 40 – 49 Years

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

Age Group 50 – 55 Years

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

Age Group 30 – 39 Years

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

Age Group 40 – 49 Years

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

Age Group 50 – 55 Years

For next 5 years	10	1,80,000	18,00,000	3.7908	<u>68,23,440</u>
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13. (a) Disclosure in the balance sheet required to be made by a non-banking finance company:
- (1) Every NBFC shall, separately disclose in its balance sheet the required provisions without netting them from the income or against the value of assets.
 - (2) The provisions shall be distinctly indicated under separate heads of accounts as under:
 - (i) provisions for bad and doubtful debts; and
 - (ii) provisions for depreciation in investments.
 - (3) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the NBFC.
 - (4) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads 'general provisions and loss reserves' may be written back without making adjustment against them.
- (b) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:
- (a) Register of transactions (Sauda book)/Daily transaction list;
 - (b) Clients ledger;
 - (c) General ledger;
 - (d) Journals;

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

In addition to the above statutory requirements, stock brokers are also required to maintain scripwise clientwise list in respect of scripts of specified group, client upla statement, duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of 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.

- (c) R Likert's, Model of human resource valuation is now totally rejected for the following reasons:-
 - (i) It considers capitalisation of historical costs which are actually sunk costs and irrelevant for decision-making.
 - (ii) It failed to provide a reasonable value to human assets.
 - (iii) It capitalises only training and development costs incurred on employees and ignores the future expected cost to be incurred for their maintenance.
 - (iv) It distorts the value of highly skilled human resources.
- 14. (a) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:
 - (i) Ascertain the number of employees in each rank.
 - (ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.
 - (iii) Ascertain the economic value of an employee in a specified rank during each time period.
 - (iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process, they ignored the

exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

- (b) "Subordinated debt" means a fully paid-up capital instrument, which is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of the NBFC. The book value of such instrument shall be subjected to discounting as provided hereunder:

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

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

15. (a) Merchant banking in India started with management of public issues and loan syndication and has been gradually covering activities like project counselling portfolio management, investment counselling and mergers and amalgamation of the corporate firms. A 'merchant banker' has been defined under the Securities and Exchange Board of India (Merchant Banker) Rules, 1992 as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management." Merchant bankers are the specialized agency which manage the capital issues. They are also called the managers to the issue.

Every merchant banker shall keep and maintain the following books of account, records and documents as per Regulation 14:

- (a) a copy of balance sheet as at the end of the each accounting period;
- (b) a copy of profit and loss account for that period;
- (c) a copy of the auditor's report on the accounts for that period;
- (d) a statement of financial position.

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.

<i>Category</i>	<i>Minimum Amount</i> <i>Rs.</i>
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

(b) Major accounting issues involved in environmental accounting can be explained as follows:

- (i) *Distinction between environmental expenditure and normal business expenditure:* Many new machines may incorporate state-of-the-art environmental technology and accordingly, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. It is necessary to frame guidelines indicating whether the reporting entity should properly allocate the capital and revenue expenditures between environmental expenditure and normal business expenditure.
- (ii) *Capitalisation of environmental expenditures vis-a-vis expensing them during the current accounting period:* Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is recoured to and/or persuaded to follow environmental accounting, the adverse impact on EPS is a major concern. Accordingly many Western Corporations prefer to capitalise environment costs instead of immediate expensing and adopt an amortisation policy extending upto 10 years. Although this accounting practice has no theoretical support and rather contradicts the well established accounting concept of "prudence", it is considered as a practical solution to off-load burden of accumulated environmental costs without abruptly disturbing the cash flows attributable to the lenders, Government and finally to the shareholders. However, recognition of environmental costs should not necessarily be restricted to the expenses accrued in view of the applicable environmental laws. It should be guided by ethical consideration.
- (iii) *Recognition of environment related contingent liabilities:* Environmental contingent liabilities are a matter of increasing concern throughout the world. Recognising a liability of hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably.

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

16. Para 13 of AS 11 Revised – "Accounting for the Effects of changes in Foreign Exchange Rate" states that an enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward contract , to establish the amount of the reporting currency required or available at the settlement date of a transaction. The difference between the forward rate and the exchange rate on the date of the transaction should be recognized as income or expense over the life of the contract except in respect of liabilities incurred for acquiring fixed assets in which case such difference should be adjusted in the carrying amount of the respective fixed assets.
17. Beta is a relative measure of volatility that is determined by comparing the return on a share to the return on the stock market. In simple terms, greater the volatility, more risky the share and higher the Beta. If a company is affected by the macroeconomic factors in the same way as the market is, then the company will have a Beta of one and will be expected to have returns equal to the market. A company having a Beta of 1.2 implies that it stock market increases by 10% the company's share price will increase by 12 % (i.e., $10\% \times 1.2$) and if the stock market decreases by 10% the company's share price will decrease by 12%. Beta is a statistical measure of volatility and is calculated as the Covariance of daily return on stock market indices and the return on daily share prices of a particular company divided by the Variance of the return on daily Stock Market indices. While considering market index a broad based index like S & P 500 should be considered.

For the companies, which are not listed in stock exchanges, beta of the similar industry may be considered after transforming it to un-gearred beta and then re-gearing it according to the debt equity ratio of the company. The formula for un-gearing and gearing beta is shown below:

Un-gearred Beta = Industry Beta / [1+ (1- Tax Rate)(Industry Debt Equity Ratio)]

Gearred Beta = Un-gearred Beta x [1 + (1- Tax Rate)(Debt Equity Ratio)]

18. Considering the major socio-economic problems of the country, eight major heads may be identified for Social Reporting purposes:

- I. Employment Opportunities.
- II. Foreign Exchange Transactions
- III. Energy Conservation.
- IV. Research and Development.
- V. Contribution to Government Exchequer.
- VI. Social Projects
- VII. Environmental Control.
- VIII. Consumerism.

- I. Creation of employment opportunities during the year may be classified into opportunities in India and opportunities abroad. In India employment may be created either by expansion/diversification in backward or other areas. However, employment protection by absorption of sick units may also be treated as employment opportunities. Moreover, the corporate enterprise may create new openings abroad by adopting foreign projects. In all such cases, quantitative information needs to be disclosed giving break-up of SC/ST persons, physically handicapped persons, women and other workers appointed during the year. Tax advantage or subsidy received for establishing industrial units in backward areas or absorption of sick units should be disclosed properly. If the corporate enterprise follows human resource accounting system, it may show human assets created during the year and costs incurred for such purpose.
- II. In view of the scanty foreign exchange reserve, it is desirable to disclose foreign exchange transactions in details. Foreign exchange inflows occur by exports or earnings from foreign projects. Also saving in foreign exchange is equivalent to foreign exchange inflows. An enterprise can save foreign exchange by import substitution and replacement of foreign technology/technician. Foreign exchange outflows are caused by purchase of raw materials/spares, plant and machinery capital repayment, payment of dividend and interest. It is desirable to report inflows and outflows for each currency separately and a summary statement in Indian currency. Any tax advantage/export subsidy received for foreign exchange earnings should be disclosed as an item of social cost.
- III. Energy purchased/generated and energy consumed per unit of standard product are to be reported along with consumption norm of the industry. Energy Audit Reports prepared by BICP may be followed for industry norms wherever applicable. Positive/negative variation in energy consumption should be reported along with reasons therefor.
- IV. Recurring/non-recurring cost incurred for research and development is to be reported along with results. If possible, effect of research and development activities may be quantified in terms of cost saved/profit added. Any tax advantage/subsidy received is to be reported as social cost incurred along with the generation of social benefits from research and development.
- V. Contribution to Government exchequer by way of sales tax, income tax, excise, custom and other duties needs to be reported as an item of social benefits.
- VI. Contribution to social projects may be further classified into direct involvement of corporate enterprise and donations to different organisations. Social projects like construction of road,

establishment of school, college, research institute, hospital, stadium, etc. may be earmarked along with the categories of beneficiaries and cost involved.

In case of donation to any organisation, the nature of the organisation may be stated along with the tax advantage received by way of such donations.

(Contribution of the corporate enterprise for development of sports and games, cultural matters and self-employment programmes may be reported as creation of social benefit).

- VII. Negative social effect caused by the corporate enterprise may be quantified stating use of irreplaceable resources and nature of pollution caused. Action taken and cost involved for pollution control should be reported as an item of social benefit.
 - VIII. Failures in terms of complaints received against improper quality, poor service etc. may be reported under social costs. Action taken and cost involved for undertaking quality control and customers' service should be reported under social benefits.
19. **Special Features of Accounting for Educational Institutions:** An educational institution is generally not run for profit. Its administrators, as custodians of public funds, are accountable of their proper expenditure for educational purpose. The marked difference between commercial accounting and that for educational institutions is that the former places emphasis on proper ascertainment of profits, while the latter is more generally concerned with exercising control over expenditure so as to conform to the stipulated norms and to the academic objectives of the institution to which it relates.

In the case of institutions like colleges and universities, separate ledgers are maintained for each fund. Funds may be broadly classified into two categories - Revenue Funds and Specific Funds. Revenue Funds may be further classified as Unrestricted Fund and Restricted Fund. Specific Funds are Endowment Funds, Annuity and Life Income Funds, Development Funds etc. Separate balance sheet is prepared for each fund and a statement of activity (popularly known, as Income and Expenditure Account) is prepared for only revenue funds- both restricted and unrestricted. Finally, each individual balance sheet is consolidated to get a general balance sheet of the institution as a whole.

Revenue Funds- Restricted and Unrestricted: Revenue funds essentially record normal revenue transactions. However, the use of revenue fund may be restricted or unrestricted. In the case of restricted funds, income is recognised to the extent of expenditure incurred. The accounting basis of the unrestricted fund is the accrual method as used for commercial entities.

There may be transfers out of revenue funds to specific funds and vice-versa. Some transfers are mandatory and some are non-mandatory.

Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds.

Specific Funds: Specific funds are earmarked for well defined purposes. Contributions and transfers are directly credited to respective fund balances. Expendable resources are transferred to revenue funds except for capital outlay and debt retirement which are accounted for in development or asset fund and loan fund respectively. For the specific funds no statement of income is prepared. However a statement is prepared showing the movements in fund balances. The features of certain important specific funds are discussed below.

- (a) **Endowment Funds:** Incomes from these funds usually are transferred to another fund where it may be expended. Interest revenue out of such fund is accrued at the end of accounting year. The fund is usually invested in some securities and such investment is valued at cost price. If the income out of such investment is available for unrestricted purposes it is recognised in the unrestricted fund. On the other hand if the income is to be used for some specific purpose it is transferred to that specific fund. The only time, the investment income is recognised in the endowment fund is when the terms of agreement specify that the income must be added to the endowment principal.

- (b) *Loan Funds*: Loan funds account for resources that may be loaned to faculty or staff. No revenue or expense accounts are used in the loan fund. All transactions affecting fund balance are recorded directly to fund balance. Interest on loan is credited to the fund balance on accrual basis. Investment income is also accrued. Administration and collection costs relating to granting and recovery of loans are directly charged to this fund. Any bad debt or provision for doubtful loans are also charged to this fund.
- (c) *Annuity and Life Income Funds*: These funds account for resources that are given to a not for profit organisation provided that the organisation agrees to make periodic payments to a designated recipient. In the case of annuity funds, the amount of periodic payment is fixed whereas payments vary with the amount of income earned in the case of life income funds.
- (d) *Development Funds*: These funds are utilised for developmental purposes like acquisition of building and equipments, major repairs to fixed assets etc. Separate fund may be maintained for each developmental activity. Alternatively a combined development fund may be maintained to account for all acquisitions and/or construction of fixed assets. Any expenditure incurred for the purpose of construction or acquisition of building, laboratory etc. are met out of this fund and the asset is recognised in the general balance sheet. Consequently that portion of the fund which has been utilised for the acquisition or construction of the asset should be transferred to unrestricted fund. Depreciation on these fixed assets should be shown as part of operating expenses of unrestricted revenue fund.

To sum up the following statements are to be prepared to get a consolidated picture the organisation as a whole:

- (a) Income and Expenditure Account for revenue funds.
- (b) Statement showing changes in fund balances.
- (c) Balance Sheet of individual funds.
- (d) General Balance Sheet.

20. (i)	Position under IAS / IFRS	Position under Indian AS
Revenue recognition	Revenue from sale of goods cannot be recognized if entity retains continuing managerial ownership or effective control over the sold goods. In case of revenue from rendering of services, IAS 18 allows only percentage of completion method. Under IAS 18, payments received in advance for goods yet to be manufactured cannot be recognized as revenue until such goods are delivered to the buyer.	Under AS 9, such stipulation is not there. AS 9 allows both completed service contract method and percentage of completion method. AS 9 permits recognition when the goods are manufactured, identified and ready for delivery in such cases.
(ii)	Government Grants	No concept of extra-ordinary item. Government grant for financial support/compensation for losses is disclosed as extra-ordinary item in profit and loss account as per AS 12.
(iii)	Borrowing costs	IAS 23 requires borrowing costs to be recognized as expense as benchmark treatment. Capitalisation is also permitted as an alternative. AS 16 requires capitalization of borrowing costs.

21. (i) Paragraph 21 of Accounting Standard 23 on Accounting for Investments in Associates says that where the associate has a contingent liability, the investor has to disclose the following in the consolidated financial statements in accordance with AS 4:-
 - Its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and
 - those contingencies that arise because the investor is severally liable for the liabilities of the associate.
- (ii) As per AS 26 on Intangible assets, an intangible asset should be recognised if, and only if:
 - it meets the definition criteria;
 - it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
 - the cost of the asset can be measured reliably.
- (iii) The objective of AS 27 on Financial Reporting of Interests in Joint Ventures is to set out principles and procedures for accounting for interests in joint ventures and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors.
- (iv) For a company under liquidation, the fundamental accounting assumption of “going concern” is apparently not valid. The assets and liabilities would stand appropriately adjusted to reflect the realizable value, by way of carrying amounts. This information will be required to be disclosed by the company under AS 1 on Disclosure of Accounting Policies.
- (v) Classification of the items into timing and permanent differences is as under :-
 - (i) Interest paid to bank is a timing difference.
 - (ii) Difference in depreciation rates is a timing difference.
 - (iii) Unabsorbed losses is a timing difference.
 - (iv) Revaluation Reserve is a permanent difference.
- (vi) Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognized as intangible assets.
 Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets.
- (vii) As per AS 13, in case of disposal of a long-term investment, the difference between the carrying amount and net disposal proceeds should be charged / credited to profit and loss account.
 Also, AS 5 requires that all items of income and expense, which are recognized in a period, should be included in the determination of net profit or loss for the period. It also requires separate disclosure of the nature and amount of such items of income and expense within profit or loss from ordinary activities, which by their size, nature or incidence require disclosure to explain the enterprise's performance for the period.
 Since the company is a trading entity (i.e. in commodities), disposal of long-term investments falls in the category of special items (as per AS 5). Hence, its nature and amount should be disclosed separately. This disclosure will also comply with AS –13.
- (viii) Capitalisation of borrowing costs as part of the cost of a qualifying asset should commence only when all the following conditions are satisfied:
 1. The expenditure is being incurred for the Acquisition, construction or production of a qualifying asset;
 2. Borrowing costs are being incurred; and

3. Activities that are necessary to prepare the asset for its intended use or sale, (including any technical or administrative work prior to the commencement of physical construction but excluding such activities during which no production or development takes place) are in progress.

- (ix) 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.

- (x) Recognition is the "process of incorporating in the Balance Sheet or Statement of Profit and Loss, an item that meets the definition of an element and satisfies the criteria for recognition".

The definition of Assets, liabilities, income and expenses are fundamental to recognition, both at annual and interim financial reporting dates.

The measurement procedures to be followed should be designed to ensue that the resulting information is reliable and that all relevant material financial information is appropriately disclosed. The preparation of interim financial reports generally requires a greater use of estimation methods than annual financial reports.

An enterprise should apply the same accounting policies in its interim financial statements as are applied in its Annual Financial Statements, except for accounting policy changes made after the date of the most recent Annual Financial Statements that are to be reflected in the next Annual Financial Statements.

The frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. Hence, measurements for interim reporting purposes should be made on a year-to-date basis.

- (xi) Unless the possibility of any outflow in settlement is remote, the following should be disclosed for each class of Contingent liability as on the balance sheet date

- (a) Brief description of the nature of Contingent liability; and

- (b) Where practicable:

- An estimate of its financial effect, measured under paragraphs 35-45 of AS 29;
- An indication of the uncertainties relating to any outflow; and
- The possibility of any reimbursement.

Note: Where any of the information required by para 68 is not disclosed because it is not practicable to do so, the fact should be stated.

The nature of items should be sufficiently similar, in order to be considered as a single class. For example, warranties for different products can be considered as a single class. However, normal warranties and warranties in respect of amounts that are subject to legal proceedings cannot be considered as a single class.

Where a provision and Contingent liability arise from the same set of circumstances, the enterprise should make the disclosures required in para 66 – 68 in a way that shows the link between the provision and the contingent liability.

In extremely rare cases, disclosure of some or all of the information required by para 66-70 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

(xii) Particulars	Integral Foreign Operation (IFO)	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.

- (xiii) 1. AS-20 Principle: As per Para 41, "Potential Equity Shares are anti-dilutive when their conversion to equity shares would increase EPS from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive Potential Equity shares are ignored in calculating Diluted EPS".
2. Analysis: The above assessment of dilutive/anti-dilutive effect should be performed in each reporting period and accordingly, the same Potential Equity Shares may in the subsequent year become dilutive in nature and would need to be considered in calculating Dilutive EPS.
3. Conclusion: Potential Equity Shares that were not considered in previous year because they were anti-dilutive, can be considered in the current period if they are dilutive. If Potential Equity Shares that were not considered in previous year because

they were anti-dilutive are considered in the current period, prior period EPS does not require to be restated.

- (xiv) 1. Prior Determination of item: Segment Revenue, Segment Expense, Segment Assets and Segment Liabilities are determined before intra-enterprise balances.
2. Elimination: Intra-enterprise transactions are eliminated as part of the process of preparation of enterprise Financial Statements.
3. No-elimination: When intra-enterprise balances and transactions are within a single segment, they are NOT eliminated.

(xv) *Interest*: On time proportion basis considering the amount outstanding and rate of interest.

Royalties: On accrual basis in accordance with the terms of relevant agreement.

Dividends: When the owner's right to receive payment is established.

22. Operating activity – (i), (iii), (v)

Financing activity – (ii), (vi)

Investing activity – (iv), (vii)

23. As per AS 25, the principles of other Accounting Standards (in the present case AS 2) have to be applied for Interim Financial Reporting also.

Hence, the loss of Rs. 50,000 has to be recognised in the first quarter and the reversal recognized (not exceeding cost) i.e. upto Rs. 50,000 only in third quarter.

24. Para 11 of AS 20 states that “for the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to Equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period”.

With an emphasis on the phrase “attributable to equity shareholders”, it may be construed that amounts appropriated to Mandatory Reserves as described in this case, though not available for distribution as dividend, are still attributable to equity shareholders.

Therefore, the appropriation made to mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. The treatment made by the company is not correct.

25. As per Para 9.1 of AS 10 the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors. Considering Para 9.1 the treatment done by the company is not correct. Rs. 5 lakhs should be deducted from the cost of fixed assets.

26. Books of X: Agreement to sell has been entered on 20.12.2005 and he has received an advance of Rs. 50,000 on the same date. But the actual sale has taken place only on 15.1.2006 (next year). Though, the sale has taken place before approval of accounts, yet the profit of Rs. 1,20,000 (i.e. Rs. 3,70,000 – Rs. 2,50,000) need not be recognised in the financial statements for the year 2005. The amount received as advance shall be shown as a liability in the balance sheet and there should be an disclosure in Notes to Accounts about the agreement to sell. The profit should be recognized only in the year 2006, when it is actually realized.

Books of Y: He has paid an advance of Rs. 50,000 and it should be shown in the balance sheet. There should be a disclosure in the Notes to Accounts for the year 2005, that agreement for purchase of an asset at a price of Rs. 3,70,000 has been entered and an advance of Rs. 50,000 has been paid.

27. (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>

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.

28. As per para 44 of AS-26, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility/asset recognition criteria has been established for the product. Technological feasibility/asset recognition criteria has been established upon completion of detailed programme design or working model. In this case, Rs. 45,000 would be recorded as an expense (Rs. 25,000 for completion of detailed program design and Rs. 20,000 for coding and testing to establish technological feasibility/asset recognition criteria). Cost incurred from the point of technological feasibility/asset recognition criteria until the time when products costs are incurred are capitalized as software cost (Rs. 42,000 + Rs. 12,000 + Rs.13,000) Rs. 67,000.

29. (a) Present value of future cash flow

Year ended	Future Cash Flow	Discount @ 10% Rate	Discounted cash flow
31.3.2005	50	0.909	45.45
31.3.2006	30	0.826	24.78
31.3.2007	30	0.751	22.53
31.3.2008	20	0.683	13.66
31.3.2009	20	0.620	<u>12.40</u>
			118.82

Present value of residual price on 31.3.2009 = 5×0.620 3.10

Present value of estimated cash flow by use of an asset and residual value, which is called "value in use". 121.92

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

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

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29,

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

we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

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

30. Para 18 of AS-23 on "Accounting for Investments in Associates in CFS" speaks about the recognition of losses. As per the aforesaid para, if the carrying amount of the investment exceeds or equals the investor's share of losses, the investor stops recognizing further losses and carries the investment at 'NIL' value. Therefore X Ltd. need not recognise its share of loss for the current year and shall carry the investment at 'NIL' value for the purpose of CFS. However, in the case of "separate financial statement", permanent diminution in value, if any, should be adjusted from the carrying amount.
31. Para 3 of AS 18 on Related Party Disclosures describes related party relationships as follows:
- enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprises (this includes holding companies, subsidiaries and fellow subsidiaries);
 - associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;
 - individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;
 - key management personnel and relatives of such personnel; and
 - enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

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

- the name of the transacting related party;
- a description of the relationship between the parties;
- a description of the nature of transactions;
- volume of the transactions either as an amount or as an appropriate proportion;
- any other elements of the related party transactions necessary for an understanding of the financial statements;
- the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provision for doubtful debts due from such parties at that date; and
- amounts written off or written back in the period in respect of debts due from or to related parties.

32. As per para 21 of AS 6 on Depreciation Accounting, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In the given case, there is a surplus of Rs. 26.30 lakhs on account of change in the method of depreciation, which will be credited to Profit and Loss Account. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed

33. In this case, the capital expenditure incurred by the company would not be represented by any actual assets, since the roads would remain the property of the relevant State authorities even though a part of their cost has been defrayed by the company in order to facilitate its business.

Having regard to the nature of the expenditure and the purpose for which it is incurred, it is suggested in para 10 of Guidance Note on Treatment of Expenditure During Construction Period that 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" or "Deferred Revenue Expenditure" subject to two conditions. In the first place, the description of the specific item 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.

34. As per para 9.2 of AS 9 on Revenue Recognition, where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g. for escalation of price, export incentives, interest etc, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

Thus, SCL Ltd. cannot recognise the interest amount unless the company actually receives it. 10% rate of recovery on overdue outstandings is also an estimate and is not certain. Hence, the company is advised to recognise interest receivable only on receipt basis.

35. AS 16 clearly state that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2005) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.

36. Timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Examples:

- Unabsorbed depreciation and, carry forward of losses which can be set-off against future taxable income.
- Statutory dues deferred for payment under Section 43B of the Income-Tax Act.

"Permanent Differences" are the differences between taxable income and accounting income for a period that originate in one period but do not reverse subsequently.

Examples:

- Agricultural income.
- Donations/contributions disallowed for tax purposes.