

PAPER – 1: FINANCIAL REPORTING

Question No.1 is compulsory.

Answer any Five questions from the remaining Six questions.

Working notes should form part of the respective answers.

Wherever necessary, candidates are permitted to make suitable assumptions which should be disclosed by way of a note.

Question 1

1. (a) Primus Hospitals Ltd. had acquired 40 units of Doppler Scan machines from Holiver USA at a cost of US\$ 165,100 per unit in the beginning of financial year 2008-09. The prevailing rate of exchange was ₹ 50 to 1 US \$. The acquisition was partly funded out of a government grant of ₹ 5 crores. The grant relating to such machines was given with a rider that in the event of a change in management, the entity is bound to return the grant. In April 2011, 51% control in the company was taken over by an overseas investor. The expected productive period of such an asset is normally reckoned as 5 years. The depreciation rate adopted was 20% p.a. on S.L.M. basis. The company had incurred expenditure of US \$ 4000 towards bank charges and ₹ 7500 per unit as sea freight. You are also informed that neither capital reserve nor deferred income account has been maintained by the company. You are required to suggest the accounting treatment as a result of the return of the grant, in the light of the relevant AS.
- (b) The following balances are extracted from the books of Ram Ltd. a real estate company on 31st March, 2011 :

	Dr. (₹ in '000)	Cr. (₹ in '000)
Lease hold premises	42	
Equipment, fixtures and fittings at cost on 1.4.2010	264	
Deprecation on equipments, fixtures and fittings on 1.4.2010		164

The following additional information's are also provided.

1. Depreciation on equipment, fittings and fixtures is provided @ 15% on written down value.
2. On 1st October 2010, the company moved to a new premises. The premise is on a 12 year lease and the lease premium paid amounted to ₹ 42,000. The company used sub-contract labour of ₹ 40,000 and materials at cost of ₹ 38,000 in the refurbishment of the premises. These are to be considered as part of the cost of lease hold premises.

You are required to prepare the 'Notes to accounts' including significant accounting policies forming part of the financial statements, for disclosure of above facts and information provided.

- (c) On 1st April, 2010, a company offered 100 shares to each of its 500 employees at ₹ 50 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under the plan (ESPP) shall be subject to lock-in on transfers for three years from grant date. The market price of shares of the company on the grant dated is ₹ 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 56 per share.

On 30th April, 2010, 400 employees accepted the offer and paid ₹ 30 per share purchased. Nominal value of each share is ₹ 10.

Record the issue of shares in the books of the company under the aforesaid plan.

- (d) From the following details, compute the total value of human resources of skilled and unskilled group of employees according to Lev and Schwartz (1971) model:

	Skilled	Unskilled
(i) Annual average earning of an employee till the retirement age.	60,000	40,000
(ii) Age of retirement	65 years	62 years
(iii) Discount rate	15%	15%
(iv) No. of employees in the group	30	40
(v) Average age	62 years	60 years

(4 × 5 = 20 Marks)

Answer

- (a) Calculation of Revised Book value as on 1st April, 2010

Particulars	(₹)
Acquisition of 40 Doppler Scan machines [US \$ 165,100 x ₹ 50 x 40 machines]	33,02,00,000
Add: Bank charges paid (\$ 4000 x ₹ 50)	2,00,000
Add: Sea Freight on the above machines (₹ 7,500 per unit x 40machines)	<u>3,00,000</u>
Total landed cost as on 1 st April, 2008	33,07,00,000
Less: Government grant	<u>(5,00,00,000)</u>
Value of 40 Doppler Scan machines	28,07,00,000

Less: Depreciation @ 20% for 3 years on SLM basis (i.e ₹ 28,07,00,000 x 20% x 3 years)	<u>(16,84,20,000)</u>
WDV at the beginning of the year 2011-12	11,22,80,000
Add: Refund of Government grant	<u>5,00,00,000</u>
Revised Book value on 1 st April, 2011	<u>16,22,80,000</u>

Note: As per para 16 of AS 6 'Depreciation Accounting', where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual useful life of the asset. In this case, on 1st April, 2011, the remaining useful life is only two years i.e. 2011-12 & 2012-13. Hence the WDV of ₹ 16,22,80,000 is to be written off under SLM @ 50% each year i.e. ₹ 8,11,40,000 per year.

The Government grant of ₹ 5 crores that becomes refundable should be accounted for as an extraordinary item as per AS 12 'Government Grants', with related disclosure of the increased depreciation of ₹ 2.5 crores (i.e. ₹ 8,11,40,000 – ₹ 5,61,40,000) consequent to the return of such grant.

- (b) Since the implicit rate of interest is not mention in the question it is assumed that value of lease premium paid along with the refurbishment cost is the fair value of the leased asset. Accordingly, question has been solved assuming the lease as finance lease.

Notes on Accounts for the year ended 31st March, 2011:

The cost of lease hold premises includes the cost of refurbishment to the extent of ₹ 78,000 (Materials ₹ 38,000 + Labour ₹ 40,000).

Working Notes:

(a)	Fixed Assets :	(₹ in 000)		
	Equipment, fixtures & fittings	264		
	* Lease hold premises (42+40+38)	<u>120</u>		
		<u>384</u>		
(b)	Depreciation			
	Equipment, fixtures & fittings as on 1.4.2010	164		
	For the year 2010-11	<u>15</u>	179	
	* Cost of leasehold premises written off [(42+40+38) x 1/12 x ½]		<u>5</u>	
			<u>184</u>	

Significant Accounting Policies

1. Depreciation has been charged on equipment, fixtures & fittings on the basis of written down value method year after year. Equipment fixtures & fittings are shown at cost in the balance sheet & depreciation accumulated, thereon is shown on the liability side of the balance sheet.
2. According to AS-19 leases, the lease has been classified as finance lease assuming that lessor has transferred substantially all the risks and rewards incident to ownership to Ram Ltd. At the inception of lease, asset under finance lease is capitalized in the books of the lessee with the corresponding liability wherein lease payments are recognized as an expense in the profit and loss account on a systematic basis (i.e straight line) over the lease term. The person (lessor/lessee) presenting the leased asset in his balance sheet should also consider the additional requirements of AS 6 and AS 10.

- (c) Fair value of an ESPP = ₹ 56 – ₹ 50 = ₹ 6

Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares

Fair value of ESPP which will be recognized as expenses in the year 2010-11 = 40,000 shares x ₹ 6 = ₹ 2,40,000

Vesting period = 1 month

Expenses recognized in 2010-11 = ₹ 2,40,000

Date	Particulars	₹	₹
30.04.2010	Bank (40,000 shares x ₹ 50) Dr.	20,00,000	
	Employees compensation expense A/c Dr.	2,40,000	
	To Share Capital (40,000 shares x ₹ 10)		4,00,000
	To Securities Premium (40,000 shares x ₹ 46)		18,40,000
	(Being shares issued under ESPP @ ₹ 50)		

- (d) Value of Employees as per Lev and Schwartz method:

Value of Skilled Employees:

$$V = \sum_{t=t}^t \frac{I(t)}{(1+r)^{t-t}}$$

Where,

V = the human capital value of a person t years old.

$I(t)$ = the person's annual earnings up to retirement.

r = a discount rate specific to the person.

t = retirement age.

$$\begin{aligned}
&= \frac{60,000}{(1+0.15)^{65-62}} + \frac{60,000}{(1+0.15)^{65-63}} + \frac{60,000}{(1+0.15)^{65-64}} \\
&= \frac{60,000}{(1+0.15)^3} = \frac{60,000}{(1+0.15)^2} + \frac{60,000}{(1+0.15)^1} \\
&= ₹ 39,450.97 + ₹ 45,368.62 + ₹ 52,173.91 = ₹ 136,993.50
\end{aligned}$$

Total value of skilled employees is

$$₹ 1,36,993.50 \times 30 \text{ employees} = ₹ 41,09,805$$

Value of unskilled employees:

$$\begin{aligned}
&= \frac{40,000}{(1+0.15)^{62-60}} + \frac{40,000}{(1+0.15)^{62-61}} \\
&= \frac{40,000}{(1+0.15)^2} + \frac{40,000}{(1+0.15)^1} \\
&= ₹ 30,245.74 + ₹ 34,782.60 = ₹ 65,028.34
\end{aligned}$$

$$\text{Total value of unskilled employees} = ₹ 65,028.34 \times 40 \text{ employees} = ₹ 26,01,133.60$$

\ Total value of human resources (skilled and Unskilled)

$$= ₹ 41,09,805 + ₹ 26,01,133.60 = ₹ 67,10,938.60$$

Question 2

Kim and Kin floated a new company KimKin Ltd on 1st April 2010 with a capital of ₹ 5 lakhs represented by 50,000 ordinary shares of ₹ 10 each, subscribed equally by both groups.

KimKin Ltd. made the following acquisitions on the same date:

- (1) 3000 shares of ₹ 10 each in Klean Ltd. at ₹ 35,000
- (2) 10,000 shares of ₹ 10 each in Klinik Ltd. for ₹ 72,000
- (3) 8,000 equity shares of ₹ 10 each in Klear Ltd. for ₹ 92,000 and 200 8% Cumulative Preference shares @ ₹ 140 per share.

The following are the summarized Balance sheets of the three companies as on 31.03.2011

LIABILITIES

	Klean Ltd.(₹)	Klinik Ltd. (₹)	Klear Ltd. (₹)
Equity Share Capital	40,000	1,20,000	1,00,000
8% Cumulative Preference share Capital (₹ 100 shares)			25,000
Reserves (31.03.2010)	3,000		7,500

Profit & Loss Account	6,000		15,000
Sundry Creditors	<u>2,900</u>	<u>8,000</u>	<u>7,500</u>
Total	<u>51,900</u>	<u>1,28,000</u>	<u>1,55,000</u>

ASSETS

	(₹)	(₹)	(₹)
Goodwill (self generated)	4,000		15,000
Freehold Land	8,000	52,000	50,000
Plant & machinery	16,000	19,000	37,000
Inventories	8,900	25,000	26,000
Sundry Debtors	4,000	12,000	15,500
Bank	11,000	2,000	11,500
Profit & Loss A/c		<u>18,000</u>	
Total	<u>51,900</u>	<u>1,28,000</u>	<u>1,55,000</u>

You are supplied with the following information and requested to compile the Consolidated Balance Sheet as on 31st March 2011 of the entire Group.

1. The freehold land of Klear Ltd. carries a fair value of ₹ 65,000 as on 1-04-2010.
2. The plant & machinery of Klinik Ltd. to be depreciated by ₹ 3,000.
3. Inventories of Klean Ltd are undervalued by ₹ 2,000.
4. On Balance Sheet date, Kimkin Ltd. owed Klean Ltd. ₹ 10,500 and is owed ₹ 8,200 by Klinik Ltd. Klear Ltd. is owed ₹ 1,300 by Klean Ltd. and ₹ 2,000 by Klinik Ltd.
5. The balances in Profit and Loss account on date of acquisition were : Klean Ltd. ₹ 2,000 (Cr) ; Klinik Ltd. ₹ 12,000 (Dr.) and Klear Ltd. ₹ 4,000 (Cr.)

The credit balances of Klean Ltd. & Klear Ltd. were wholly distributed as dividends in June 2010.

6. During 2010-11 Klean Ltd. & Klear Ltd. declared and paid interim dividends of 8% and 10% respectively.
7. Klear Ltd. has discharged dividend obligations towards its Preference Shareholders up-to March 2009.

(16 Marks)

Answer

Consolidated Balance Sheet of Kimkin Ltd. & its subsidiaries as on 31-03-2011

Liabilities	₹	Assets	₹
Share Capital		Fixed Assets	
Authorised, Issued, Subscribed & Paid up 50,000 Ordinary shares of ₹ 10 each	5,00,000	Goodwill (4,000+15,000)	19,000
Minority Interest	62,390	Freehold lands(W.N. 5)	1,25,000
Reserves & Surplus		Plant & Machinery(W.N 5)	69,000
Capital Reserve	17,630	Current Assets	
Profit & Loss Account(W.N. 6)	20,580	Inventories(W.N 5)	61,900
		Debtors	28,200
Current Liabilities		Bank Balances(W.N. 5)	3,14,900
Creditors	<u>19,600</u>	Cash in transit(W.N 7)	<u>2,200</u>
	<u>6,20,200</u>		<u>6,20,200</u>

Working Notes:

1.	Analysis of profits	₹	₹
	Klean Ltd.	Capital	Revenue
	Reserves as on 1 st April, 2010	3,000	
	Profit and Loss account as on 1 st April, 2010 net of dividend	0	
	Current year profits after interim dividend of ₹ 3,200		6,000
	Appreciation in inventory value		<u>2,000</u>
		3,000	8,000
	Less : Minority interest (1/4)	<u>(750)</u>	<u>(2,000)</u>
	Share of Kimkin Ltd. (3/4)	<u>2,250</u>	<u>6,000</u>
	Klinic Ltd.	Capital	Revenue
	Loss on date of acquisition	(12,000)	
	Current year loss after additional depreciation of ₹ 3,000 = (18,000 + 3,000 - 12,000)		<u>(9,000)</u>
		(12,000)	(9,000)
	Less: Minority interest (1/6)	<u>(2,000)</u>	<u>(1,500)</u>
	Share of Kimkin Ltd. (5/6)	<u>(10,000)</u>	<u>(7,500)</u>

	Klear Ltd.	Capital	Revenue
	Reserves as on 1st April, 2010	7,500	
	Profit & Loss as on 1 st April, 2010 net of dividend	0	
	Current year profits after interim dividend of ₹ 10,000		15,000
	Appreciation in freehold property value s on 01.04.2010	15,000	
	Arrears of Preference Dividend of Minority's Preference Shares(as per para 27 of AS 21)	<u>(400)</u>	<u>(400)</u>
		22,100	14,600
	Less: Minority Interest (1/5)	<u>(4,420)</u>	<u>(2,920)</u>
	Share of Kimkin Ltd. (4/5)	<u>17,680</u>	<u>11,680</u>
2.	Cost of control/capital reserve		₹
	Cost of Investment in Klean Ltd.	35,000	
	Less: Pre-acquisition Dividend = $\frac{3}{4} \times 2,000$	<u>(1,500)</u>	33,500
	Cost of Investment in Klinik Ltd.		72,000
	Cost of Equity Investment in Klear Ltd.	92,000	
	Less: Pre-acquisition Dividend = $\frac{4}{5} \times 4,000$	<u>(3,200)</u>	88,800
	Cost of Investment in Cum-Preference shares in Klear Ltd.		<u>28,000</u>
			2,22,300
	Less: Paid up Value of Equity Shares in Klean Ltd.	30,000	
	Paid up Value of Equity Shares in Klinik Ltd.	1,00,000	
	Paid up Value of Equity Shares in Klear Ltd.	80,000	
	Paid up Value of Preference Shares in Klear Ltd	<u>20,000</u>	<u>(2,30,000)</u>
			(7,700)
	Less: Capital Profits in Klean Ltd	2,250	
	Capital Profits in Klinik Ltd.	(10,000)	
	Capital Profits in Klear Ltd	<u>17,680</u>	<u>(9,930)</u>
	Capital Reserve		<u>17,630</u>

3. Minority Interest

	Klean Ltd	Klinik Ltd.	Klear Ltd.
	₹	₹	₹
Equity Share Capital	10,000	20,000	20,000

Preference Share Capital			5,000
Arrears of Preference Dividend			800
Capital Profits	750	(2,000)	4,420
Revenue Profits	<u>2,000</u>	<u>(1,500)</u>	<u>2,920</u>
	<u>12,750</u>	<u>16,500</u>	<u>33,140</u>

4. Bank Account of Kimkin Ltd.

	₹		₹
To Share Capital	5,00,000	By investments in Klean Ltd.	35,000
To Investment in Klean Ltd. (Pre-acquisition Dividend)	1,500	By Investments in Klinik Ltd.	72,000
To Investment in Klear Ltd. (Pre-acquisition Dividend)	3,200	By Investments in Klear Ltd. (92,000 + 28,000)	1,20,000
To Dividend Received		By Klinik Ltd (Owings)	8,200
Klean Ltd.	2,400	By Balance c/d	2,90,400
Klear Ltd.	8,000		
To Klean Ltd. (Owings)	<u>10,500</u>		
	<u>5,25,600</u>		<u>5,25,600</u>

5. Statement showing consolidated balances

	Land	Plant	Inventory	Debtors	Bank	Creditors
	₹	₹	₹	₹	₹	₹
Kimkin Ltd.				8,200	2,90,400	10,500
Klean Ltd.	8,000	16,000	10,900	4,000	11,000	2,900
Klinik Ltd.	52,000	16,000	25,000	12,000	2,000	8,000
Klear Ltd.	<u>65,000</u>	<u>37,000</u>	<u>26,000</u>	<u>15,500</u>	<u>11,500</u>	<u>7,500</u>
	1,25,000	69,000	61,900	39,700	3,14,900	28,900
Less: Mutual Owings	—	—	—	<u>11,500*</u>	—	<u>(9,300)*</u>
Consolidated Balances	<u>1,25,000</u>	<u>69,000</u>	<u>61,900</u>	<u>28,200</u>	<u>3,14,900</u>	<u>19,600</u>

* According to the additional information given in the question, balance of debtors A/c of Klean Ltd. should be ₹ 10,500 or more. However, balance sheet of Klean Ltd. Showed sundry debtors of ₹ 4,000 only which is very low in comparison to ₹ 10,500. Therefore it is presumed that the entry of ₹ 10,500 has been omitted in the books of Klean Ltd. Hence, no elimination of mutual owing in respect of ₹ 10,500 has been made while preparing the consolidated balance sheet.

6. Consolidated Revenue Profits

	₹
Klean Ltd.	6,000
Klinic Ltd.	(7,500)
Klear Ltd.	<u>11,680</u>
	10,180
Add : Interim Dividend received(2,400 + 8,000)	<u>10,400</u>
Consolidated Profit and Loss A/c	<u>20,580</u>

7. Cash-in-transit

Amount due from Klinic Ltd. (₹ 8,200 ₹ 2,000)	₹ 10,200
Less: Balance of Creditors of Klinic Ltd.	
as on 31.3.2011 (as per separate balance sheet)	<u>₹ 8,000</u>
Cash in transit	<u>₹ 2,200</u>

Note:-

- (1) As per the Companies Act 1956, Preference shareholders have preferential right for the receipt of dividend before equity dividend. However as per the information given in question, preference dividend is in arrears for last 2 years and equity dividend (interim) is paid during the year 2010-11. In this regard it may be noted the workings have been done solely on the basis of the information as given in the question.
- (2) Note:- Since, as per para 35 of AS 26 'Intangible Assets' internally (self) generated goodwill should not be recognized as an asset in the balance sheet. Therefore, goodwill shown in the Balance Sheet may be read as goodwill (purchased).

Question 3

As part of its expansion strategy White Ltd. has decided to amalgamate its business with that of Black Ltd. and new company Black & White Ltd. being incorporated on the 1st September 2010 having an authorized equity capital of 2 crore shares of ₹ 10 each. M/s Black & White Ltd. shall in turn acquire the entire ownership of White Ltd. and Black Ltd. in consideration for issuing its equity at 25% premium on 1st October, 2010. It is also agreed that the consideration shall be based on the product of the profits available to equity shareholders of each entity, times its PE multiple. The preference Shareholders & Debenture holders are to be satisfied by the issue of similar instruments in Black & White Ltd. on 1-10-2010 in lieu of their existing holdings. Accordingly the relevant information is supplied to you as under:

	White Ltd.	Black Ltd.
Paid up Equity shares of ₹ 10 class (Nos)	3 Lakh	1.2 Lakh
8% Preference Shares ₹ 10 paid (Nos)		1 Lakh

5% Redeemable Debentures 2015 of ₹ 10 each (Nos)		0.8 Lakh
Profits before Interest & Taxation (₹)	6,00,000	4,40,000
Price to Earnings Multiple	15	10

To augment the Cash retention level of Black & White Ltd. it is decided that on 1st October, 2010 Black & White Ltd. shall collect full share application money for the issue 20,00,000 equity shares @40% premium under Private Placement. The allotment of the shares will be made on 31-12-2010 and such shares shall qualify for dividend from 2011 only.

Black & White Ltd. also shall avail a 12.50% TOD of 15 lakhs to meet its preliminary expenses and cost of working which amount to ₹12 lakhs and ₹ 2 lakhs respectively. The TOD will be availed on 1st November 2010 and closed on 31st December. 2010. Preliminary expenditure is tax deductible @ 20% each year.

Due to an accounting omission the opening inventory of Black Ltd. of 5 lakh (actual value) & the closing stock of White Ltd. of 2.20 lakh was understated & overstated by 5% and 10% respectively.

The dividend schedule proposed is that all companies would pay interim dividend for equity, for the period from 1st October, 2010 to 31st December, 2010. The rates of dividend being White Ltd. @5% Black Ltd. @2% and Black & White Ltd. @3.5% . The preference shareholders & debenture holders dues for the post take over period are discharged on 31.12.2010.

It is proposed that in the period October-December 2010, Black & White Ltd. would carry out trade in futures that would generate an absolute post tax return of 18% by using the funds generated from the Private Placement. The trades would be squared off on 31.12.2010. Proceeds from such transactions are not liable to withholding taxes.

You are required to prepare a projected Profit & Loss A/c for the period ended 31st December 2010 and a Balance Sheet on that date for Black & White Ltd.

The corporation tax rate for the company is 40%.

(16 Marks)

Answer

Projected Profit & Loss Account of Black & White for the period ended 31-12-2010

	₹		₹
To Working capital expenses	2,00,000	By Profits from Futures Trading	84,00,000
To TOD Interest	31,250	By Dividends received	1,74,000
To Debenture interest	10,000		

To Provision for tax @ 40% on pre tax profit - ₹ 81,58,750*	32,63,500		
To Profit after tax	<u>50,69,250</u>		
	<u>85,74,000</u>		<u>85,74,000</u>
To Dividends (Equity & Preference)	2,06,760**	By Profit for the year after tax	50,69,250
To Profit transferred to Balance Sheet	<u>48,62,490</u>		
	<u>50,69,250</u>		<u>50,69,250</u>

Projected Balance Sheet of Black & White Ltd. as at 31-12-2010

Liabilities	₹	Assets	₹
<i>Authorised share capital</i>		<i>Investments in Subsidiaries</i>	
2 crore Equity shares of ₹ 10 each	<u>20,00,00,000</u>	In Equity shares at cost	66,70,000
Issued, subscribed & paid up 25,33,600 Shares of ₹ 10 each (of the above 5,33,600 shares issued for consideration other than cash)	2,53,36,000	In preference shares at cost	10,00,000
Preference Shares		5% Red. Deb 2015 of ₹ 10	8,00,000
1 lakh 8% Preference Shares ₹ 10 paid	10,00,000	Current Assets, Loans & Advances	
Reserves & Surplus		Bank Balance	3,49,25,990
Securities Premium Account (93,34,000 – 12,00,000)	81,34,000		
Profit & Loss Account	48,62,490		
Secured loan			
5% Red. Debentures 2015 of ₹ 10 each	8,00,000		
Current Liabilities & Provisions			
Provision for taxation	<u>32,63,500</u>		
	<u>4,33,95,990</u>		<u>4,33,95,990</u>

Note 1:- Dividend received is exempted income and is not subject to tax in the hands of recipient. It is assumed that rate of dividend given in the question is net of tax.

Note 2:- Dividend distributed by Black and White Ltd. is subject to Dividend distribution tax if not net of tax.

Note 3:- As per the Companies Act, 1956, the balance of securities premium account can be used for writing off the preliminary expenses. As the company is having sufficient balance in the securities premium account, the amount of preliminary expenses is adjusted from the balance of securities premium account. However, whenever there is conflict in the treatment of a particular item as per Law/Statute & Accounting Standards then the Law/Statute will prevail. Accordingly, the above question has been solved by setting off the preliminary expenses from securities premium A/c. In this case it will be treated as permanent difference. Hence no DTA/DTL will be created.

Note 4: Alternatively Students may follow the treatment prescribed by AS 26 and expense out the preliminary expenses in the year it is incurred. In that case Deferred tax liability will be created due to the temporary difference arising on account of the difference in the treatment of preliminary expense in the books of accounts and as per the Income tax Act, 1961.

Working Notes:

1. Calculation of Rectified Profits

	White Ltd.(₹)	Black Ltd. (₹)
Value of Inventory as given	2,20,000(Overstated)	5,00,000(Actual)
Adjustment therein due to incorrect valuation will be reduced from profits	$2,20,000 \times 10/110 = 20,000$	$5,00,000 \times 5/100 = 25,000$

2. Computation of Shares to be issued as purchase

	White Ltd. ₹	Black Ltd. ₹
Profit before interest & tax	6,00,000	4,40,000
Less: Reduction in profit due to incorrect inventory valuation	(20,000)	(25,000)
Less: Debenture interest	—	<u>(40,000)</u>
Profit before tax	5,80,000	3,75,000
Less: Tax @ 40%	<u>(2,32,000)</u>	<u>(1,50,000)</u>
Profit after tax (PAT)	3,48,000	2,25,000
Less: Preference dividend	—	<u>(80,000)</u>

Profit available to equity shareholders [A]	<u>3,48,000</u>	<u>1,45,000</u>
Price Earnings Multiple [B]	15	10
Total Purchase Consideration to be given (A x B)	<u>52,20,000</u>	<u>14,50,000</u>
Equity Share Capital (Purchase Consideration x 100/125)	41,76,000	11,60,000
Securities Premium (25% of the above)	10,44,000	2,90,000

3. Bank Account

Date	Particulars		₹	Date	Particulars	₹
1.10.2010	To Share Application Money (20,00,000 x ₹ 14)		2,80,00,000	1.10.2010	By Futures Trading A/c	2,80,00,000
1.11.2010	To 12.5% TOD		15,00,000	1.11.2010	By Preliminary Expenses	12,00,000
31.12.2010	To Future Trading A/c [(2,80,00,000 x (18/100) x (100/60) + 2,80,00,000)		3,64,00,000	31.12.2010	By Working Capital expenses	2,00,000
31.12.2010	To Dividend received			31.12.2010	By Dividends Paid [(41,76,000 + 11,60,000) x 3.5/100]	1,86,760
	White Ltd (3,00,000 x 10 x 5%)	1,50,000		31.12.2010	By TOD Interest (15,00,000 x 12.5/100 x 2/12)	31,250
	Black Ltd. (1,20,000 x 10 x 2 %)	<u>24,000</u>	1,74,000	31.12.2010	By Debenture Interest (80,000 x ₹ 10 x 5/100 x 3/12)	10,000
				31.12.2010	By Preference Dividend (1,00,000 x ₹ 10 x 8/100 x 3/12)	20,000
				31.12.2010	By 12.5% TOD	15,00,000
				31.12.2010	By Balance c/d	<u>3,49,25,990</u>
			<u>6,60,74,000</u>			<u>6,60,74,000</u>

Question 4

- (a) Prepare a value added statement for the year ended on 31.03-2011 and reconciliation of total value added with profit before taxation, from the profit and loss account of Paradise Ltd. for the year ended on 31-03-2011.

Income:	(₹ in Lakhs)
Sales	254.00
Other income	<u>....6.00</u>

Total	<u>260.00</u>
Expenditure:	
Operating cost	222.00
Excise duty	11.20
Interest on bank overdraft	1.00
Interest on 9% debentures	<u>15.00</u>
	<u>249.20</u>
Profit before depreciation	10.80
Depreciation	<u>4.10</u>
Profit before tax	6.70
Provision for tax	<u>2.40</u>
Profit after tax	4.30
Proposed dividend	<u>0.30</u>
Retained profit	<u>4.00</u>

The following additional information are given:

- (i) Sales represents net sales after adjusting discounts, returns and sales tax.
 - (ii) Operating cost includes ₹ 82.00 lakhs as wages, salaries and other benefits to employees.
 - (iii) Bank overdraft is temporary.
- (b) Eagle Ltd. had acquired 51% in Sparrow Ltd. for ₹ 75.80 lakhs on April 1st, 2010. On date of the acquisition Sparrow's Assets stood at ₹ 196 lakhs and liabilities at ₹ 16 lakhs. The Net asset position of Sparrow Ltd. as on 31st March, 2011 & 30th September 2011 were ₹ 280 lakhs & ₹ 395 lakhs respectively, the increase resulting from profits earned during the period.

On 1st Oct, 2011, 25.5% holdings were sold for ₹ 125 lakhs. You are required to explain the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship. The profit arising on part sale of investment, carrying value of the portion unsold & goodwill/capital reserve that arises on change in nature of the investment may also be worked out by you.

(8 + 8 = 16 Marks)

Answer

(a) Value Added Statement of M/s. Paradise Ltd.

		₹ in lakhs
Sales		254.00
Less: Cost of bought in material and services:		
Operating cost(₹ 222.00 lakhs – ₹ 82 lakhs)	140.00	
Excise duty	11.20	
Interest on bank overdraft	<u>1.00</u>	<u>(152.20)</u>
Value added by trading activities		101.80
Add: Other income		<u>6.00</u>
Total Value Added		<u>107.80</u>

Application of value added

		₹ in lakhs	%
To pay Employees:			
Wages, salaries and other benefits		82.00	76.07
To pay Government : Corporate tax		2.40	2.23
To pay Providers of Capital :			
Interest on 9% debentures	15.00		
Dividends	<u>0.30</u>	15.30	14.19
To provide for Maintenance and expansion of the Company			
Depreciation	4.10		
Retained profit	<u>4.00</u>	<u>8.10</u>	<u>7.51</u>
		<u>107.80</u>	<u>100</u>

Reconciliation between Total Value Added and Profit before Taxation:

	₹ in lakhs
Profit before tax	6.70
Add back:	
Depreciation	4.10
Wages, salaries and other benefits	82.00
Interest on Debentures	<u>15.00</u>
Total Value Added	<u>107.80</u>

- (b) Sparrow Ltd. became a subsidiary of Eagle Ltd. on 1st April 2010 when 51% thereof was acquired. The holding –subsidiary relationship continued till 30th September 2011 and from 1st Oct, 2011 the relationship between the two companies will change to Associate. As per para 24 of AS 21, "Consolidated Financial Statements", the carrying value of the investment at the date it ceases to be subsidiary is regarded as cost thereafter. Accordingly, if the nature of the investee changes to that of an associates, the carrying amount of the investment in CFS of the investor, as on date it ceases to be a subsidiary, would be considered as cost of investment in the associate. Goodwill or capital reserve arising on account of the change in the nature of the investment will be computed as on the date of such change. Accordingly, when a part of the investment takes the form of an investment in an associates, the results of operations of the subsidiary will be included in the consolidated statement of P/L for the period from the beginning of the period until it ceased to be a subsidiary.

Ascertainment of gain or loss on the disposal of the part of the investment in Sparrow Ltd.

		₹
Proceeds received on sale of 25.5% holdings in Sparrow Ltd.		125,00,000
Net Assets of Sparrow Ltd. on the date of disposal	3,95,00,000	
Less: Minority's interest on the date of disposal	<u>(1,93,55,000)</u>	
Share of Eagle Ltd. in Net Assets	2,01,45,000	
Less: Capital reserve on acquisition (Refer W.N.)	<u>(16,00,000)</u>	
Total value of investment in consolidated financial statements of Eagle Ltd.	<u>1,85,45,000</u>	
Less: Carrying Value of investment disposed off (1,85,45,000 x 25.5/51)		<u>92,72,500</u>
Profit on sale of 25.5% of investment		<u>32,27,500</u>
Carrying Value of unsold portion of the investment retained in the consolidated financial statements		
Total value of investment in consolidated financial statements of Eagle Ltd.	1,85,45,000	
Less: Carrying value of investment disposed off	<u>92,72,500</u>	
Carrying Value of the investment retained in consolidated financial statements including capital reserve.		<u>92,72,500</u>
This amount of ₹ 92,72,500 would be used to apply the equity method of accounting as specified in AS 23		

Goodwill / Capital Reserve arising on the Carrying Value of unsold portion of the investment		
Carrying value of 25.5% holdings in Sparrow Ltd. as on 1 st October 2011		92,72,500
Less: Share in value of equity of Sparrow Ltd., as at date of investment when Subsidiary relationship is transformed to an Associate (3,95,00,000 x 25.5%)		<u>(1,00,72,500)</u>
Capital reserve arising on such investment under Equity method as per AS 23		<u>(8,00,000)</u>

Working Note:

Calculation of Goodwill

Net Assets on Acquisition date (₹ 1,96,00,000 – ₹ 16,00,000)	1,80,00,000
51% thereof [A]	91,80,000
Less: Cost of investment [B]	<u>(75,80,000)</u>
Capital reserve on acquisition [A-B]=C	<u>16,00,000</u>

Question 5

The following is the Balance Sheet of Bat Ltd. as on 31st March 2010:

Liabilities	Rs.	Assets	Rs.
3,00,000 Equity Shares of ₹ 10 each fully paid	30,00,000	Goodwill	3,00,000
12.5% Redeemable preference shares of ₹ 100 each fully paid	20,00,000	Building	20,00,000
General Reserve	15,00,000	Plant & Machinery	22,00,000
Profit & Loss A/c	3,00,000	Furniture	10,00,000
Secured Loan	10,00,000	Investments	16,00,000
Creditors	30,00,000	Stock	12,00,000
		Debtors	20,00,000
		Bank Balance	4,00,000
		Preliminary Expenses	1,00,000*
	108,00,000		108,00,000

* As per para 56 of AS 26 "Intangible Assets", preliminary expenses should not appear in the Balance Sheet

Additional Information:

- (i) Fixed assets are worth 20% more than book value. Stock is overvalued by Rs.1,00,000. Debtors are to be reduced by ₹ 40,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.
- (ii) Trade investments were purchased on 1.4.2009. 50% of non-trade investments were purchased on 1.4.2008 and the rest on 1.4.2009. Non-trade investments yielded 15% return on cost.
- (iii) In 2008-2009, Furniture with a book value of ₹ 1,00,000 was sold for ₹ 50,000. This loss should be treated as non-recurring or extraordinary item for the purpose of calculating adjusted average profit.
- (iv) In 2007-2008, new machinery costing ₹ 2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.
- (v) Return on capital employed is 20% in similar business.
- (vi) goodwill is to be valued at two years purchase of super profits based on simple average profits of last four years.

Profit of last four years are as under:

Year	Amount (₹)
2006-2007	13,00,000
2007-2008	14,00,000
2008-2009	16,00,000
2009-2010	18,00,000

- (vii) It is assumed that preference dividend has been paid till date.
- (viii) Depreciation on the overall increased value of assets (worth 20% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Find out the intrinsic value of the equity share. Ignore income tax and dividend tax. (16 Marks)

Answer**Calculation of Intrinsic Value of Equity Shares of Bat Ltd.**

Net Assets available for Equity Shareholders.

		₹	₹
Goodwill (W.N. 1)			4,14,484
Sundry fixed assets			64,14,960

Trade and non-trade investments (1,44,000+14,40,000)			15,84,000
Debtors			19,60,000
Stock			11,00,000
Bank balance			4,00,000
Total Assets			<u>1,18,73,444</u>
Less: Outside liabilities			
Secured loan	10,00,000		
Creditors	30,00,000	40,00,000	
Preference share capital		20,00,000	(60,00,000)
Net assets available for equity shareholders			<u>58,73,444</u>

Value of a equity shares = $\frac{\text{Net Assets Available to Equity Shareholders}}{\text{Number of Equity Shares}}$

$$= \frac{\text{₹ } 58,73,444}{3,00,000} = \text{₹ } 19.59 \text{ (approx)}$$

Working Notes:

1. Calculation of Goodwill

(i) Capital Employed

	₹	₹
Fixed assets:		
Building	20,00,000	
Plant and machinery (₹ 22,00,000 + ₹ 1,45,800)	23,45,800	
Furniture	<u>10,00,000</u>	
	53,45,800	
Add: 20% Appreciation	<u>10,69,160</u>	
	64,14,960	
Trade investments (₹ 16,00,000 x 10% x 90%)	1,44,000	
Debtors (₹ 20,00,000 – ₹ 40,000)	19,60,000	
Stock (₹ 12,00,000 – ₹ 1,00,000)	11,00,000	
Bank Balance	<u>4,00,000</u>	1,00,18,960
Less: Outside liabilities:		
Secured Loan	10,00,000	
Creditors	<u>30,00,000</u>	(40,00,000)
Capital employed		<u>60,18,960</u>

(ii) Future Maintainable Profit

Calculation of Average Adjusted Profit

	2006- 2007 ₹	2007- 2008 ₹	2008- 2009 ₹	2009-2010 ₹
Profit	13,00,000	14,00,000	16,00,000	18,00,000
Add: Capital Expenditure of Machinery charged to revenue	-	2,00,000	-	-
Loss on sale of furniture	<u> </u>	<u> </u>	<u>50,000</u>	<u> </u>
	<u>13,00,000</u>	<u>16,00,000</u>	<u>16,50,000</u>	<u>18,00,000</u>
Less: Depreciation on machinery	-	(20,000)	(18,000)	(16,200)
Income from non-trade investments (W.N.2)			(1,08,000)	(2,16,000)
Reduction in the value of stock	-	-	-	(1,00,000)
Bad debts	-	-	-	(40,000)
Adjusted Profit	13,00,000	15,80,000	15,24,000	14,27,800

Total adjusted profit for four years				58,31,800
Average profit (₹ -58,31,800/4)				14,57,950
Less: Depreciation at 10% on Additional Value of Machinery (22,00,000 + 1,45,800) x 20% x 10%				
Average Adjusted Profit				<u>(46,916)</u>
				<u>14,11,034</u>

(iii) Normal Profit 20% on Capital Employed,

i.e. 20% on ₹ 60,18,960 = ₹ 12,03,792

(iv) Super Profit = Average Adjusted profit–Normal profit

= ₹ 14,11,034 – ₹ 12,03,792 = ₹ 2,07,242

(v) Goodwill

= 2 years' purchase of super profit

= ₹ 2,07,242 x 2 = ₹ 4,14,484

2. Trade investments = ₹ 16,00,000 x 10% x 90% = ₹ 1,44,000

Non-trade investment = ₹ 16,00,000 - ₹ 1,60,000 = ₹ 14,40,000

Non-trade investment purchased on 1.4.2008 = 50% of ₹ 14,40,000, = ₹ 7,20,000

Non-trade investment purchased on 1.4.2009 = ₹ 14,40,000 – ₹ 7,20,000 = ₹ 7,20,000

Income from non-trade investment:

In the year 2008-2009 : 7,20,000 × 15% = ₹ 1,08,000

In the year 2009-2010 : 7,20,000 × 15% = ₹ 1,08,000

7,20,000 × 15% = ₹ 1,08,000

₹ 2,16,000

Question 6

- (a) Life Industries Ltd (LIL) furnishes the following information from which you are required to calculate the prevailing Economic Value Added of the company and also explain the reason for the difference, if any, between the EVA as calculated by you and the M V A (Market Value Added) of LIL amounting to Rs.14005 crores.

Common shares of ₹ 1,000 face value	1,58,200 units
12% Debentures ₹ 10 face value	50,00,000 units
Current tax rate	30%
Financial Leverage	1.1 times
Securities Premium Account (Rupees in lakhs)	155
Free Reserves (Rupees in lakhs)	154
Capital Reserve (Rupees in lakhs)	109

It is a prevailing practice for companies in the industry to which LIL belongs to pay at least a dividend of 15% p.a. to its common shareholders.

- (b) Sparrow Holdings is a SEBI Registered Mutual Fund which made its maiden N F O (New Fund Offer) on 10th April, 2010 Rs.10 face value per unit. Subscription was received for 90 lakhs units. An underwriting arrangement was also entered into with Affinity Capital Markets Ltd., that agreed to underwrite the entire NFO of 100 lakh units on a commission of 1.5%.

Out of the monies received ₹ 892.50 lakhs was invested in various capital market instruments. The marketing expenses for the N.F.O amounted to ₹ 11.25 lakhs. During the financial year ended March 2011 the Fund sold securities having cost of Rs.127.25 lakh (FV ₹ 54.36 lakhs) for Rs.141.25 lakhs. The fund in turn purchased securities for ₹ 130 lakhs. The management expenses of the fund are regulated by SEBI stipulations which state that the same shall not exceed 0.25% of the average funds invested during the year. The actual amount spent towards management expenses was ₹ 2.47 lakhs of which ₹ 47,000 was in arrear. The dividends earned on the investments held amounted to ₹ 2.51 lakhs of which a sum of ₹ 25,000 is yet to be collected. The fund distributed 80% of realized earnings. The closing market value of the portfolio was ₹ 1120.23 lakhs

You are required to determine the closing per unit NAV of the fund. (8 + 8 = 16 Marks)

Answer

(a) Computation of Economic Value Added

	₹ in lakhs
Profit after tax	420
Add: Interest net of tax = $60 \times \frac{1 - .30}{1.10}$	<u>42</u>
Return to providers of funds	462
Less: Cost of Capital	<u>(342)</u>
Economic Value Added	<u>120</u>

MVA of ₹ 14005 crore:

The MVA of ₹ 14005 crore is the difference between the current Market Value of LIL and the capital contributed by the fund providers. While EVA measures current earning efficiency of the company, MVA takes into consideration the EVA from not only the assets in place but also from the future projects/activities of the company. The difference between MVA over EVA thus represents the value attributed to the future potential of the company & may change from time to time based on market sentiments. In short the MVA is the net present value of all future EVA's.

Working Notes:

1. Calculation of Net Profit after interest and tax

Interest on Debentures = 50,00,000 units x 10 x 12% = ₹ 60,00,000

Therefore, Financial Leverage = $\frac{\text{Profit before Interest \& taxes (PBIT)}}{\text{PBIT less Interest}}$

$$1.10 = \frac{\text{PBIT}}{\text{PBIT} - ₹ 60,00,000}$$

$$1.10 (\text{PBIT} - ₹ 60,00,000) = \text{PBIT}$$

$$1.10 \text{ PBIT} - ₹ 66,00,000 = \text{PBIT}$$

$$1.10 \text{ PBIT} - \text{PBIT} = ₹ 66,00,000$$

$$0.10 \text{ PBIT} = ₹ 66,00,000$$

$$\text{PBIT} = ₹ 6,60,00,000$$

Profit after interest but before tax = ₹ 6,60,00,000 – ₹ 60,00,000 = ₹ 6,00,00,000

Less: Income Tax @ 30% (₹ 1,80,00,000)

Profit After Interest & Tax ₹ 4,20,00,000

2. Calculation of Weighted Average cost of Capital (WACC)

	₹ in lakhs	Amount (1)	Weight (2)	Cost% (3)	WACC% (4)=2X3
Equity Shareholders's fund					
Common Shares	1,582				
Securities Premium	155				
Free Reserves	154				
Capital Reserves	<u>109</u>				
		2,000	0.80	15	12.00
Debentures holders' fund		500	0.20	8.4 *	1.68
		2,500	1.00		13.68

Cost of Capital = Capital Employed x WACC%

= ₹ 2,500 lakhs x 13.68%

= ₹ 342 lakhs

(b) Calculation of closing per unit of NAV of the fund

	₹ in lakhs
Net Assets of Sparrow holding	
Closing cash balance (W.N.2)	79.99
Closing Market Value of Investments	1,120.23
Accrued Dividends (collectable)	<u>0.25</u>
	1,200.47
Less: Current Liabilities	
Outstanding Management Fee (payable)	(0.47)
Closing Net Assets (A)	<u>1,200.00</u>
Units outstanding (in lakhs) (B)	100.00
NAV per unit (A/B)	12.00

Working Notes:

	Lakh ₹
1. Computation of opening cash balance:	
Proceeds of NFO in full including Underwriters commitment	1000.00
Less: Initial Purchase of Securities	(892.50)

* The cost of the debentures is taken at 12% less 30% tax

		107.50
Less: Underwriting Commission	15.00	
Marketing Expenses	11.25	(26.25)
Opening Cash Balance		81.25

2. Computation of Closing cash balance

Opening bank balance (W.N. 1)		81.25
Add: Proceeds from sale of securities	141.25	
Dividends received on investment	2.26	143.51
		224.76
Less: Cost of Securities purchased	130.00	
Management Expenses (W.N.3)	1.76	
Capital Gains Distributed ` (141.25 - 127.25 x 80%)	11.20	
Dividends Distributed ` (2.26 x 80%)	1.81	(144.77)
		79.99
3. Computation of Management Expenses Chargeable		
Actual Expense Incurred [A]		2.47
Opening Investment Made	892.50	
Closing Funds Invested (892.50 - 127.25 + 130)	<u>895.25</u>	
Total	<u>1,787.75</u>	
Average Funds Invested (1,787.75/2)	<u>893.875</u>	
0.25% of Average Funds Invested [B]		2.23
Lower of A or B		2.23
Less: Amount unpaid		(0.47)
Management expenses paid		1.76

Question 7

Answer any **four** parts of the question;

- (a) Mega Ltd., issued ₹ 100,00,000 worth of 8% Debentures of face value ₹ 100 each on par value basis on 1st January, 2011. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for ordinary shares of Mega Ltd., on 1:1 basis. The interest rate for similar debentures that do not carry conversion entitlement is 12%. You are required to calculate the value of the debt portion of the above compound financial instrument. The present value of the rupee at the end of years 1 to 4 at 8% and 12% are supplied to you as:

	8%	12%
End of year 1	0.926	0.893
End of year 2	0.857	0.797
End of year 3	0.794	0.712
End of year 4	0.735	0.636

- (b) G Ltd., acquired a machine on 1st April, 2005 for ₹ 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2009, the carrying value of the machine was reassessed at ₹ 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2011, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only ₹ 79 lakhs. You are required to calculate the loss on impairment of the machine and show how this loss is to be treated in the books of G Ltd., G Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.
- (c) FEE Ltd., borrows a sum of ₹ 20 crore from COFEE Ltd., repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market is 8% FEE Ltd paid an origination fee of ₹ 2,40 crores to COFEE Ltd., to compensate COFEE Ltd., for the lower rate of interest. Apart from the above, there are no other transactions between the two parties. You are required to show the value at which COFEE Ltd., would recognize the loan and the annual interest thereon.
- (d) On 1st April 2010, a mutual fund scheme had 9 lakh units, face value of ₹ 10 each outstanding. The scheme earned ₹ 81 lakhs in 2010-11 out of which ₹ 45 lakhs was earned in first half year. 1 lakh units were sold on 30th September 2010 at NAV ₹ 60. Show important accounting entries for sale of units and distribution of dividend at the end of 2010-11.
- (e) BEE Ltd., has entered into a contract by which it has the option to sell its identified property, plant and equipment (PPE) to AXE Ltd., for ₹ 100 lakhs after 3 years whereas its current market price is ₹ 150 lakhs. Is the put option of BEE Ltd., a financial instrument? Explain

(4 × 4 = 16 Marks)

Answer

(a) Present value of Debentures redeemable in 2014	71,23,200
[₹ 1,00,00,000 × 1.12 × 0.636]	
Present value of interest on debentures	
[₹ 8,00,000* × 3.038 (sum of 4 years discount factors @12%)]	<u>24,30,400</u>
Value of Debt component of the convertible debentures	<u>95,53,600</u>

* Interest payable on debentures every year = ₹ 1,00,00,000 × 8% = ₹ 8,00,000

(b)

	(₹ in crores)
Carrying amount of the machine as on 1 st April 2005	7.00
Depreciation for 4 years i.e. 2005-06 to 2008-09 [$\frac{7\text{crores}}{7\text{years}} \times 4\text{years}$]	<u>(4.00)</u>
Carrying amount as on 31.03.2009	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	<u>2.10</u>
Carrying amount of the machine as on 1 st April 2009 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2009-10 & 2010-11 [$\frac{5.10\text{crores}}{3\text{years}} \times 2\text{years}$]	<u>(3.40)</u>
Carrying amount as on 31.03.2011	1.70
Less: Recoverable amount	<u>(0.79)</u>
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.2011:	
Balance in revaluation reserve as on 31.03.2009	2.10
Less: Enhanced depreciation met from revaluation reserve	
2009-10 & 2010-11=[(1.70 – 1.00) × 2 years]	<u>(1.40)</u>
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 "Impairment of Assets"	<u>(0.70)</u>
Impairment Loss to be debited to profit and loss account	<u>0.21</u>

- (c) Therefore, the fair value of the loan to Cofee Ltd. Is the present value of the interest it will receive over the next 5 years & the present value of repayment it will at the end of the 5th year.

P.V. of interest discounted @ 8% = [(20,00,00,000 × 5%) × 3.9926] = ₹ 3,99,36,000 (A)

P.V. of principal amount = ₹ 20,00,00,000 × discounted @ 8%

= 20,00,00,000 × 0.6806 = 13,61,20,000 (B)

FV of Loan (A + B) i.e. ₹17,60,46,000 (i.e. approximately 17,60,00,000 which is loan amount net of origination fees.

COFEE Ltd. will recognize the loan at ₹ 17.60 crores only.

COFEE Ltd will recognize the interest using the effective interest rate method as worked out below:

Year	Amortised Cost (Opening Balance)	Interest income @ 8% to be recognised	Total	Payment received	Amortised Cost (Closing Balance)
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	17,60,00,000	1,40,80,000	19,00,80,000	1,00,00,000	18,00,80,000
2	18,00,80,000	1,44,06,400	19,44,86,400	1,00,00,000	18,44,86,400
3	18,44,86,400	1,47,58,912	19,92,45,312	1,00,00,000	18,92,45,312
4	18,92,45,312	1,51,39,625	20,43,84,937	1,00,00,000	19,43,84,937
5	19,43,84,937	1,56,15,063*	21,00,00,000	21,00,00,000	Nil

*Note: The interest in the 5th year, has been adjusted in accordance to the value received on closure.

(d) Allocation of earnings

	Old unit holders (9 lakh units)	New unit holders (1 lakh units)	Total Earning
	₹ in lakhs		
First half year (₹ 5.00/unit)	45.00	Nil	45.00
Second half year (₹ 3.60/unit)	<u>32.40</u>	<u>3.60</u>	<u>36.00</u>
	77.40	3.60	81.00
Add: Equalisation payment recovered (₹ 5 per unit x 10,00,000 units)			<u>5.00</u>
Amount available for distribut			<u>86.00</u>

Note: Equalisation payment = ₹ 45 lakhs/9 lakhs units = ₹ 5 per unit

Distribution of earning per unit

	Old unit holders ₹	New unit holders ₹
Dividend distributed per unit (₹ 86 lakhs /10,00,000 units)	8.60	8.60
Less: Equalisation payment per unit	<u>-</u>	<u>(5.00)</u>
Net distributed income	<u>8.60</u>	<u>3.60</u>

Journal Entries

Date		₹	₹	
30/9/10	Bank A/c Dr.	65		1 lakh units x ₹ 65
	To Unit capital A/c		10	1 lakh units x ₹ 10
	To Reserves A/c		50	1 lakh units x ₹ 50

31/3/11	To Dividend Equalisation A/c (Being amount of dividend equalization recovered from the investors along with the NAV per unit)		5	1 lakh units x ₹ 5
	Dividend Equalisation A/c Dr. To Revenue A/c (Being dividend equalization transferred to revenue for equal distribution to all unitholders)	5	5	
31/3/11	Revenue A/c Dr. To Bank A/c (Being dividend distributed to all unit holders @ ₹ 8.60 per unit)	86	86	

- (e) As per AS 31, Financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. In the given case, for the purpose of the definition of financial instrument, Property, Plant and Equipment do not qualify the definition of financial asset as per the standard.

To assess whether the put option of BEE Ltd., is a financial instrument or not it is necessary to evaluate the past practice of Bee Ltd. If Bee Ltd. has the past practice of settling net, then it becomes a financial instrument.

If Bee Ltd. intends to sell the identified Property, Plant and Equipment and settle by delivery and there is no past practice of settling net, then the contract should not be accounted for as financial instrument under AS 30 "Financial Instruments: Recognition and Measurement" and AS 31 "financial Instrument: Presentation:".